

# British American Tobacco (ROTH MK)

## Regulatory policies in play

### Maintain BUY with unchanged DCF-TP of MYR15.20

We expect FY22 volume growth to remain positive alongside the reopening of the economy post-pandemic. Ramp-up in Government enforcement in key areas will also see more legal volumes return to the industry. However, uncertainties surrounding the potential new regulations may continue to weigh on BAT in the short-term. We keep our earnings estimates, BUY call and DCF-TP of MYR15.20 (WACC: 9.5%, LT growth rate: 2.5%) unchanged with an attractive dividend yield of >7%.

### Volume growth driven by new strategies

Following BAT's 4QFY21 results briefing, management shared that FY21 volumes grew 5% YoY (industry volume growth: +5% YoY) mainly due to (i) new route to market strategies through online and telesales instead of relying solely on exclusive distributors to push their products, and (ii) claw back of legal volumes from tighter trans-shipment regulations from 1 Jan 2021 onwards.

### Increasing enforcement is key

4QFY21 illicit share has reduced by 6% ppts YoY (from 64% in Dec 2020) and we believe it could decrease even more if the Government heightens enforcement further. Stricter trans-shipment regulations have driven up smuggling activities at smaller coastal areas and jetty's to >40% from c.10% previously. Hence, targeted enforcement in these aforementioned areas is vital. The price differential between legal and illicit cigarettes also has to be addressed for further decreases in illicit share, in our view. Note that the minimum price for cigarettes is MYR12/pack versus c.MYR4-MYR8/pack for illicit cigarettes.

### Could the potential smoking ban fuel illicit share?

BAT believes that MOH's intention to implement a generation smoking ban for people born after 2005 could exacerbate Malaysia's already high illicit share (58%) given existing gaps in enforcement. Furthermore, should the ban be extended to vapour products, this may also be counter-intuitive in promoting risk-reducing nicotine products to younger consumers against higher-risk illicit options. A new Tobacco and Smoking Control Act (including the regulatory framework for vapour products) is expected to be tabled in Parliament in Mar 2022.

FYE Dec (MYR m)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	2,315	2,637	2,565	2,680	2,757
EBITDA	360	424	439	452	461
Core net profit	261	295	280	308	315
Core EPS (sen)	91.3	103.2	98.1	107.8	110.4
Core EPS growth (%)	(27.8)	13.1	(5.0)	9.9	2.4
Net DPS (sen)	83.0	98.0	96.4	105.9	108.5
Core P/E (x)	15.4	13.5	12.9	11.8	11.5
P/BV (x)	10.8	10.4	9.3	9.2	9.1
Net dividend yield (%)	5.9	7.0	7.6	8.4	8.6
ROAE (%)	63.5	75.6	72.7	78.9	79.7
ROAA (%)	24.0	23.2	20.1	22.1	22.4
EV/EBITDA (x)	12.5	11.2	9.9	9.7	9.5
Net gearing (%) (incl perps)	129.1	196.9	186.4	189.0	189.3
Consensus net profit	-	-	280	305	318
MKE vs. Consensus (%)	-	-	(0.0)	1.0	(0.8)

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# BUY

Share Price	MYR 12.68
12m Price Target	MYR 15.20 (+28%)
Previous Price Target	MYR 15.20

### Company Description

BAT Malaysia distributes and markets tobacco products. The company's product portfolio includes Dunhill, Kent and Pall Mall.

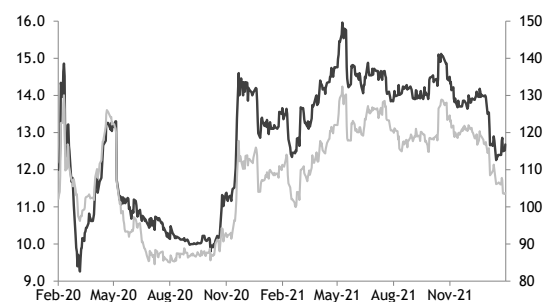
### Statistics

52w high/low (MYR)	15.96/12.26
3m avg turnover (USDm)	0.7
Free float (%)	43.3
Issued shares (m)	286
Market capitalisation	MYR3.6B USD865M

### Major shareholders:

British American Tobacco plc	50.0%
Eastspring Investments (Singapore) Ltd.	1.7%
The Vanguard Group, Inc.	1.7%

### Price Performance



— BAT - (LHS, MYR) — BAT / Kuala Lumpur Composite Index - (RHS, %)

	-1M	-3M	-12M
Absolute (%)	(9)	(12)	(6)
Relative to index (%)	(11)	(15)	(5)

Source: FactSet

**ESG@MAYBANK IBG**  
Tear Sheet Insert

<b>Risk Rating &amp; Score<sup>1</sup></b>	15.6 (Medium)
<b>Score Momentum<sup>2</sup></b>	-1.6
<b>Last Updated</b>	01 Jun 2021
<b>Controversy Score<sup>3</sup></b> (Updated: 27 Apr 2021)	3 - Supply chain, customer and product/service incidents

## Business Model & Industry Issues

- Negative health implications from cigarette smoking are BAT's single biggest ESG issue. Although the tobacco industry is diversifying into alternative products (i.e. tobacco heat products), it still derives the majority of earnings from traditional cigarette sales.
- Since the closure of its manufacturing operations in 2017, BAT converted to an import-based model with only c.1% of goods manufactured out of its Johor Bahru facility. Hence, BAT's environmental impact is low. Energy and water consumption levels are monitored and reduced whenever possible at all its site offices and warehouses.
- Regulators might raise tobacco excise taxes to curb tobacco consumption in the country but this is likely, given weak enforcement, to lead to further increases in illicit market share, which is already at record levels, and further widen the price gap between legal and illicit cigarettes, hence merely shifting consumption to the latter rather than reducing it in totality.
- Overall, BAT's ESG strategy is comparable to its industry peers. ESG compliance will also be strengthened as the tobacco industry gradually diversifies into new-generation products, with less harmful health effects on consumers.

### Material E issues

- BAT is committed to minimising its environmental impact through 2 key indicators - energy and water consumption.
- Its overall energy consumption was reduced by 29% YoY in 2020 largely due to the pandemic as there were lower trade activities, especially in business travel.
- Nevertheless, BAT will continue to reduce electricity consumption at its offices by expanding its usage of hybrid and energy efficient vehicles and telematics systems in its fleet vehicles to reduce fuel consumption.
- Through various initiatives at both its offices and warehouses, BAT also saw a 9% YoY reduction in water consumption in 2020.
- In 2020, BAT's head office received the Leadership in Energy and Environmental Design certification, a globally recognised green building rating system, for its efforts in enhancing indoor air quality, energy and water conservation, and reduced carbon emissions.

### Material S issues

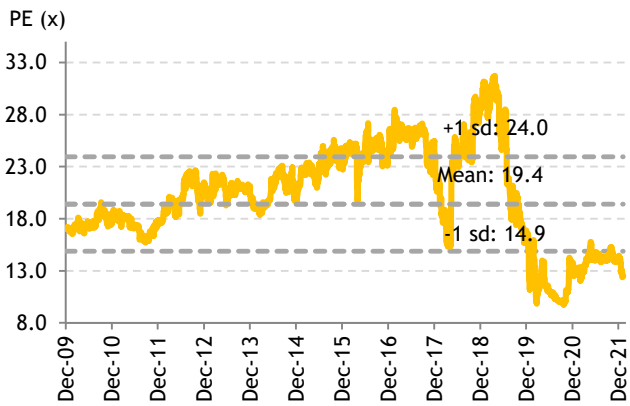
- BAT aims to reduce the health impact of its business through offering a broader range of 'less risky' products and its committed to increase its consumers' consumption of non-combustible products. This began with the launch of its tobacco heated product 'Glo' in 2019.
- In 2020, BAT had 397 employees, with a male:female ratio of 74%:26%.
- BAT's business model is primarily an import-based model with the exception of c.1% of goods manufactured at its Johor Bahru facility. All its raw materials are sourced and managed globally and adhere to the company's suppliers designated code of conduct.
- An array of social engagements, empowerment and fair opportunities to disenfranchised B40 communities are conducted through its CSR arm (BATM SEED), to bridge the economic gap in Malaysia (eg. MyKasih Foundation).

### Key G metrics and issues

- BAT's board of directors (BOD) comprises of 7 directors - 4 independent non-executive directors (including the chairman), 2 non-independent executive directors and 1 non-independent non-executive director.
- The company's independent director representation is at 57%, above the 50% level required by Bursa listing rules and the Malaysian Code on Corporate Governance.
- The BOD's male:female ratio is 71:29, close to recommended industry practise of at least 30% women directors for large companies.
- The chairman and managing director positions are held by separate individuals.
- The positions of the chairman of the audit committee and the chairman of the board are also held by separate individuals.
- In 2020, the managing directors' remuneration package was MYR1.8m (c.0.7% of the group's FY20 core net profit) while the BOD's total remuneration package equalled to c.3.7% of BAT's FY20 core net profit.
- BAT's does not fully disclose detailed remuneration of each member of senior management on a named basis save for its top 5 senior management members.
- BAT has been audited by KPMG PLT since 2016.
- In line with the Malaysian code of corporate governance, BAT conducted its first fully virtual 59<sup>th</sup> AGM on 15 Jun 2020, which allowed shareholders to participate and vote remotely.
- The group has related-party relations with its holding corporation in regards to purchases of goods, procurement of services, technical and advisory support services and royalty payments (c.12% of BAT's revenue in 2020).  
BAT has not been involved in any controversial corporate transactions/M&A activities or been subject to major regulatory or legal actions in the past. The group has also maintained a consistent dividend policy of >90% over the last decade.

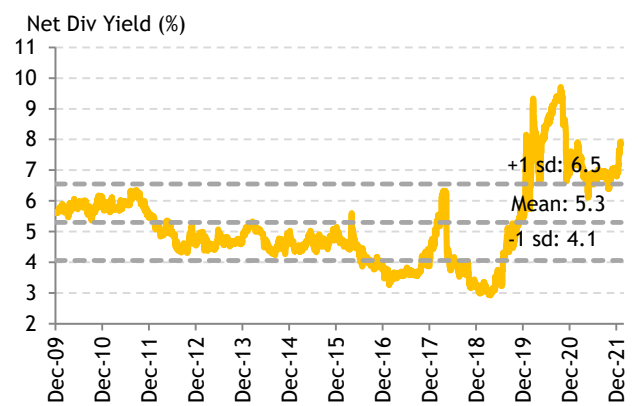
<sup>1</sup>**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. <sup>2</sup>**Score Momentum** - indicates changes to the company's score since the last update - a **negative** integer indicates a company's improving risk score; a **positive** integer indicates a deterioration. <sup>3</sup>**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Fig 1: One-year forward PER



Source: Company

Fig 2: One-year forward dividend yield



Source: Company

### Risk statement

There are several risk factors for our earnings estimates, price target and rating for BAT. Regulatory risk (eg. introduction of plain packaging and display bans at point of sale) could dampen sales volume. Any excise tax shocks will also adversely impact our earnings estimates. Additionally, consistently high illicit incidence will be a barrier to future volume driven earnings recovery.

FYE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Key Metrics</b>					
P/E (reported) (x)	13.5	14.0	12.9	11.8	11.5
Core P/E (x)	15.4	13.5	12.9	11.8	11.5
P/BV (x)	10.8	10.4	9.3	9.2	9.1
P/NTA (x)	(103.1)	(137.2)	nm	nm	nm
Net dividend yield (%)	5.9	7.0	7.6	8.4	8.6
FCF yield (%)	4.8	0.7	9.1	8.4	8.9
EV/EBITDA (x)	12.5	11.2	9.9	9.7	9.5
EV/EBIT (x)	13.0	11.5	10.1	9.8	9.6
<b>INCOME STATEMENT (MYR m)</b>					
Revenue	2,315.5	2,637.3	2,564.8	2,679.5	2,756.7
EBITDA	360.2	424.1	439.1	452.0	461.4
Depreciation	(13.8)	(12.9)	(10.5)	(9.0)	(7.9)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	346.5	411.2	428.6	443.1	453.5
Net interest income / (exp)	(17.2)	(16.5)	(24.5)	(23.8)	(24.3)
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	(9.3)	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	329.3	394.7	404.2	419.2	429.3
Income tax	(87.4)	(109.3)	(124.1)	(111.3)	(114.0)
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	241.8	285.5	280.1	307.9	315.3
Core net profit	260.7	294.7	280.1	307.9	315.3
<b>BALANCE SHEET (MYR m)</b>					
Cash & Short Term Investments	29.0	21.8	52.7	32.2	20.8
Accounts receivable	396.5	723.0	703.2	734.6	755.8
Inventory	229.9	177.6	170.2	178.1	183.5
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	57.5	46.4	39.8	34.9	31.2
Intangible assets	411.6	411.6	411.6	411.6	411.6
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	19.4	11.5	11.5	11.5	11.5
<b>Total assets</b>	<b>1,144.0</b>	<b>1,392.0</b>	<b>1,389.0</b>	<b>1,403.0</b>	<b>1,414.3</b>
ST interest bearing debt	510.0	775.0	775.0	775.0	775.0
Accounts payable	205.8	191.8	183.8	192.3	198.1
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	0.0	0.0	0.0	0.0	0.0
Other liabilities	55.0	43.0	43.0	43.0	43.0
<b>Total Liabilities</b>	<b>771.3</b>	<b>1,009.5</b>	<b>1,001.5</b>	<b>1,010.1</b>	<b>1,015.8</b>
Shareholders Equity	372.6	382.5	387.5	392.9	398.5
Minority Interest	0.0	0.0	0.0	0.0	0.0
<b>Total shareholder equity</b>	<b>372.6</b>	<b>382.5</b>	<b>387.5</b>	<b>392.9</b>	<b>398.5</b>
<b>Total liabilities and equity</b>	<b>1,144.0</b>	<b>1,392.0</b>	<b>1,389.0</b>	<b>1,403.0</b>	<b>1,414.3</b>
<b>CASH FLOW (MYR m)</b>					
Pretax profit	329.3	394.7	404.2	419.2	429.3
Depreciation & amortisation	13.8	12.9	10.5	9.0	7.9
Adj net interest (income)/exp	17.2	16.5	24.5	23.8	24.3
Change in working capital	(109.3)	(288.3)	19.3	(30.8)	(20.7)
Cash taxes paid	(67.6)	(106.4)	(124.1)	(111.3)	(114.0)
Other operating cash flow	12.7	0.0	0.0	0.0	0.0
Cash flow from operations	196.1	29.5	334.3	309.9	326.6
Capex	(1.8)	(1.5)	(3.8)	(4.0)	(4.1)
Free cash flow	194.3	28.0	330.4	305.9	322.5
Dividends paid	(254.1)	(279.8)	(275.1)	(302.4)	(309.7)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	89.0	265.0	0.0	0.0	0.0
Other invest/financing cash flow	(20.5)	(25.7)	(24.5)	(23.8)	(24.3)
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
<b>Net cash flow</b>	<b>8.6</b>	<b>(12.5)</b>	<b>30.8</b>	<b>(20.4)</b>	<b>(11.4)</b>

FYE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Key Ratios</b>					
<b>Growth ratios (%)</b>					
Revenue growth	(7.7)	13.9	(2.7)	4.5	2.9
EBITDA growth	(26.8)	17.7	3.5	2.9	2.1
EBIT growth	(27.6)	18.7	4.2	3.4	2.4
Pretax growth	(28.8)	19.9	2.4	3.7	2.4
Reported net profit growth	(30.0)	18.0	(1.9)	9.9	2.4
Core net profit growth	(27.8)	13.1	(5.0)	9.9	2.4
<b>Profitability ratios (%)</b>					
EBITDA margin	15.6	16.1	17.1	16.9	16.7
EBIT margin	15.0	15.6	16.7	16.5	16.5
Pretax profit margin	14.2	15.0	15.8	15.6	15.6
Payout ratio	98.0	98.0	98.2	98.2	98.2
<b>DuPont analysis</b>					
Net profit margin (%)	10.4	10.8	10.9	11.5	11.4
Revenue/Assets (x)	2.0	1.9	1.8	1.9	1.9
Assets/Equity (x)	3.1	3.6	3.6	3.6	3.5
ROAE (%)	63.5	75.6	72.7	78.9	79.7
ROAA (%)	24.0	23.2	20.1	22.1	22.4
<b>Liquidity &amp; Efficiency</b>					
Cash conversion cycle	56.9	77.3	97.4	94.0	94.8
Days receivable outstanding	62.1	76.4	100.1	96.6	97.3
Days inventory outstanding	34.4	37.4	33.3	31.9	32.1
Days payables outstanding	39.7	36.5	36.0	34.4	34.7
Dividend cover (x)	1.0	1.0	1.0	1.0	1.0
Current ratio (x)	0.9	0.9	0.9	1.0	1.0
<b>Leverage &amp; Expense Analysis</b>					
Asset/Liability (x)	1.5	1.4	1.4	1.4	1.4
Net gearing (%) (incl perps)	129.1	196.9	186.4	189.0	189.3
Net gearing (%) (excl. perps)	129.1	196.9	186.4	189.0	189.3
Net interest cover (x)	20.2	25.0	17.5	18.6	18.7
Debt/EBITDA (x)	1.4	1.8	1.8	1.7	1.7
Capex/revenue (%)	0.1	0.1	0.2	0.2	0.2
Net debt/ (net cash)	481.0	753.2	722.3	742.8	754.2

Source: Company; Maybank

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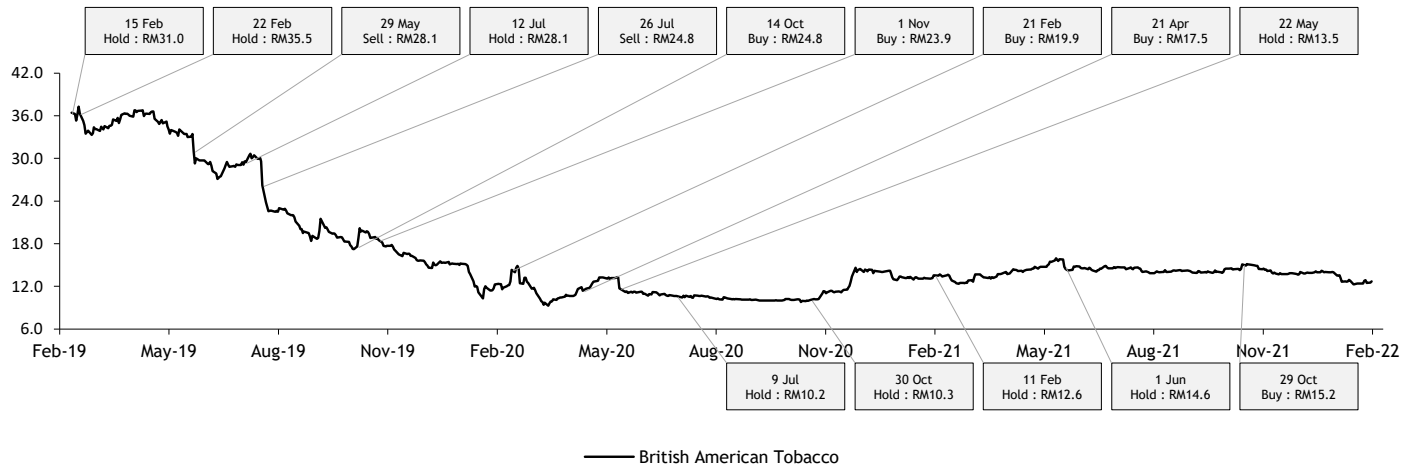
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