



### BRITISH AMERICAN TOBACCO KENYA LIMITED:

#### 1H19 EARNINGS UPDATE

Dear All,

**British American Tobacco Kenya (BAT Kenya)** released its 1H19 results recording a 25.5% y-o-y rise in PAT to KES 2.5 BN. EPS for the period stood at KES 25.28. Trailing EPS stands at KES 45.99. ROA and ROE rose 305 bps and 558 bps y-o-y to 23.0% and 58.2% respectively. The Board recommended an interim dividend of KES 3.50 payable on 20<sup>th</sup> September 2019 to shareholders on the register at the close of business on 19<sup>th</sup> August 2019.

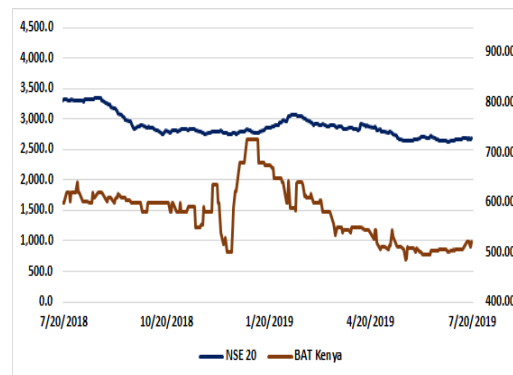
Below please find key highlights:

**Net revenue rose 15.0% y-o-y to KES 11.3 BN:** Gross revenue rose 10.1% y-o-y to KES 19.2 BN. Overall domestic to export revenue mix stood at 48:52 similar to the same period last year on the back of a tough operating domestic environment characterized by increasing business and consumer pressure arising from excise hikes, legal and regulatory uncertainty as well as continued growth of the illicit market which management approximates at 800 MN sticks per annum (corresponding to about KES 2.5 BN of foregone government revenue). Gross domestic revenue declined 9.0% y-o-y whereas market share rose 3.5% y-o-y.

**Excise duty and VAT rose 3.7% y-o-y to KES 7.9 BN.** As a percentage of gross revenue excise duty and VAT declined 252 bps y-o-y to 41.3%. Management expressed concern about the proposed 15.0% excise tax under the 2019 budget statement that is likely to further impact affordability.

**Operating profit rose 23.2% y-o-y to KES 3.7 BN.** This followed an 11.3% y-o-y rise in the cost of operations to KES 7.6 BN. However, management expects full year productivity gains of KES 473.0 MN consistent with their 5 year record that has seen a total of KES 3.0 BN in productivity gains to FY18.

#### BAT KENYA: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE RETURN	ABSOLUTE RETURN	EXCESS RETURN
3 months (%)	(1.0)	5.2
6 months (%)	(23.0)	(16.9)
12 months (%)	(13.3)	5.2

#### KEY METRICS

Current Price (KES)	520.00
52 week Range (KES)	725.00-485.25
YTD Return (%)	(28.3)
Issued Shares (Mn)	100.0
Market Cap (USD Mn)	504.4
Enterprise Value (USD Mn)	542.1
Net Debt/(Cash Position)	3,895.0

Recommendation	BUY
Trailing EPS (KES)	45.99
NAV (KES)	86.9
P/E (x)	11.3
P/FCF (x)	25.1
P/CFO (x)	15.3
P/B (x)	6.0
Div. Yld (%)	0.7

#### Research Analyst

EDWIN CHUI

echui@dyerandblair.com

+254 709 930 129

---

**Profit before tax rose 25.8% y-o-y to KES 3.6 BN** on the back of a 23.2% y-o-y decline in finance costs to KES 126.0 MN. This was in line with the 15.2% y-o-y decline in current liabilities (mainly short term borrowings) to KES 5.9 BN.

**Shareholder funds rose 13.5% y-o-y to KES 8.7 BN** mainly due to a 23.7% y-o-y growth of retained earnings to KES 5.9 BN. As we have argued in other reports, we consider Kenya a second half economy thus good earnings performance in the first half is often a strong indicator of a good full year performance. This on the back of a stable political environment and the aforementioned retained earnings position, gives us confidence that the company may increase the final dividend payout.

**Going forward:** Management is keen on exports in a bid to reduce the impact of excise taxes, continued efficiency (the factory has been at above 70% efficiency level constantly) and continued advocacy to reduce illicit trade. However, the following key concerns remain:

- **Regulation:** Following the legislation of the Tobacco Control Regulations, the Ministry of Health is yet to give guidance on the calculation of the 2.0% contribution to the Tobacco Control Fund. BAT Kenya has appealed these regulations and the matter is yet to be determined by the courts.
- **Illicit cigarette trades:** Pricing differentials in the region have continued to drive the growth of illicit trades.
- **Export market challenges:** Management highlighted consumer affordability challenges in DRC and Kenya, insecurity and drought in Somalia and non tariff barriers in some markets as the key challenges they expect from export markets.

**On a trailing basis,** BAT is trading at **P/E and P/B** multiples of **11.3x** and **6.8x** respectively against Africa and Middle East averages of 17.5x and 7.7x respectively. We issue a **BUY** recommendation on account of the high dividend value.

## PROFIT AND LOSS SUMMARY (KES MN)

Year End: DECEMBER (KES MN)	1H19	1H18	y-y % chg	2H18	h-h % chg	FY18
Gross Revenue	19,228	17,472	10.1	17,326	11.0	36,496
Excise duty and VAT	(7,939)	(7,655)	3.7	(7,790)	1.9	(15,746)
Net revenue	11,289	9,817	15.0	9,536	18.4	20,750
Cost of operations	(7,551)	(6,782)	11.3	(6,786)	11.3	14,531
Operating profit	3,738	3,035	23.2	2,750	35.9	6,219
Reorganisation costs	-	-	-	(392)	(100.0)	-
Finance costs	(126)	(164)	(23.2)	(284)	(55.6)	(338)
Profit before tax	3,612	2,871	25.8	2,074	74.2	5,881
Income tax expense	(1,084)	(857)	26.5	(686)	58.0	(1,796)
Profit after tax	2,528	2,014	25.5	1,388	82.1	4,085
Fair value and revaluation gains	6	57	-	7	(14.3)	(1)
Comprehensive income	2,534	2,071	22.4	1,395	81.6	4,084
EPS	25.28	20.14	25.5	13.88	82.1	40.85
DPS	3.50	3.50	-	22.50	(84.4)	35.00

(Source: Company, DBIB Research)

## CASHFLOW SUMMARY (KES MN)

Year End: DECEMBER (KES MN)	1H19	FY18	1H18	y-y % ch	h-h % ch
Cash generated from operations	3,397	7,207	903	276.2	(52.9)
Net interest paid	(116)	(352)	(179)	(35.2)	(67.0)
Tax paid	(1,356)	(1,555)	(745)	82.0	(12.8)
Net cash from/(used in) operating activities	1,925	5,300	(21)	(9,266.7)	(63.7)
Net cash from/(used in) investment activities	(360)	(858)	(266)	35.3	(58.0)
Net cash from/(used in) financing activities	(2,169)	(2,600)	(2,250)	(3.6)	(16.6)
Change in cash & equivalents	(604)	1,842	(2,537)	(76.2)	-
Cash at the start	190	(1,652)	(1,652)	(111.5)	(111.5)
Cash at the end	(414)	190	(4,189)	(90.1)	(317.9)

(Source: Company, DBIB Research)

## BALANCE SHEET SUMMARY (KES MN)

Year End: DECEMBER (KES MN)	1H19	FY18	1H18	y-y % ch	h-h % ch
Share capital	1,000	1,000	1,000	-	-
Revaluation & Hedging Reserve	1,833	1,820	1,925	(4.8)	0.7
Retained Earnings	5,860	6,490	4,736	23.7	(9.7)
Shareholders' Funds	8,693	9,310	7,661	13.5	(6.6)
Non Current Liabilities	3,481	3,237	3,387	2.8	7.5
Net Assets	12,174	12,547	11,048	10.2	(3.0)
Non-current assets	9,830	9,123	9,161	7.3	7.7
Current Assets	8,258	9,216	8,865	(6.8)	(10.4)
Current Liabilities	(5,914)	(5,792)	(6,978)	(15.2)	2.1
Working Capital	2,344	3,424	1,887	24.2	(31.5)
Net Assets	12,174	12,547	11,048	10.2	(3.0)

(Source: Company, DBIB Research)

## OPERATING PERFORMANCE

	1H19	FY18	1H18	y-y bps ch	h-h bps ch
Gross Profit margin (%)	19.4	17.0	17.4	207	240
Excise duty & VAT (%)	41.3	43.1	43.8	(252)	(186)
Pretax margin (%)	18.8	0.2	16.4	235	1,862
PAT margin (%)	13.1	0.1	11.5	162	1,304
Fixed Assets Turnover (x)	3.9	4.0	3.8	10	(9)
Current Assets Turnover (x)	4.7	4.0	3.9	72	70
Current Liabilities Turnover (x)	6.5	(6.3)	5.0	149	1,280
Working capital turnover (x)	16.4	10.7	18.5	(211)	575
Current ratio (x)	(1.4)	(1.6)	1.3	(267)	19

\*Annualized ratios

(Source: DBIB Research)

## FINANCIAL STABILITY & LIQUIDITY

	1H19	FY18	1H18	y-y bps ch	h-h bps ch
Net debt (KES MN)	3,895.0	3,047.0	7,576.0	(3,681)	848
Enterprise value/share (KES)	559.0	669.5	595.8	(37)	(111)
Net debt/equity (%)	44.8	32.7	98.9	(5,408)	1,208
Net debt/EV (%)	7.0	4.6	12.7	(575)	242
EV/EBIT (x)	15.0	22.1	19.6	(468)	(711)
Current ratio (x)	1.4	1.6	1.3	13	(19)
Interest cover (x)	29.7	18.4	18.5	1,116	1,127
FCF/share (KES)	20.7	27.8	(25.4)	4,608	(712)
CFO/share (KES)	34.0	72.1	9.0	2,494	(3,810)
NTA/share (KES)	86.9	93.1	76.6	1,032	(617)
Book value/share (KES)	86.9	93.1	76.6	1,032	(617)
Payout ratio (%)	13.8	85.7	17.4	(353)	(7,183)

(Source: DBIB Research)

## INVESTMENT RETURN

	1H19	FY18	1H18	y-y bps ch	h-h bps ch
RoA	23.0	18.9	19.9	305	413
RoE	58.2	43.9	52.6	558	1,428

\*Annualized ratio

(Source: DBIB Research)

## APPENDIX

### COMPANY INVESTMENT RATINGS

**Buy:** Share price may generate more than 15.0% upside over the next 12 months

**Overweight:** Share price may generate between 5.0% and 15.0% upside over the next 12 months

**Hold:** Share price may fall within the range of <+5.0/ -10.0% over the next 12 months

**Take Profit:** Target price has been attained. Look to accumulate at lower levels. Company fundamentals however remain strong

**Underweight:** Share price may generate between 10.0% and 15.0% downside over the next 12 months

**Sell:** Share price may generate more than 15.0% downside over the next 12 months, significant business and/or financial risks present, industry concerns

**Not Rated:** Counter is not within regular research coverage

### SECTOR INVESTMENT RATINGS

**Overweight:** Industry performance better than that of the whole market

**Equal weight:** Industry performance about the same as that of the whole market

**Underweight:** Industry performance worse than that of the whole market

## DISCLAIMER

*While every care has been taken in preparing this report and it has been prepared from sources believed to be reliable, no representation, warranty, or undertaking (express or implied) is given and no responsibility is accepted by Dyer and Blair Investment Bank Limited, its related companies, subsidiaries, affiliates, its employees and agents, as to the accuracy and completeness of the information contained herein or in respect of any reliance on or use thereof. This report is solely intended for distribution to clients of Dyer and Blair Investment Bank Limited. Any information may be changed after distribution at any time without any notice.*