



BRITISH AMERICAN TOBACCO KENYA LIMITED:

FY19 EARNINGS UPDATE

Dear All,

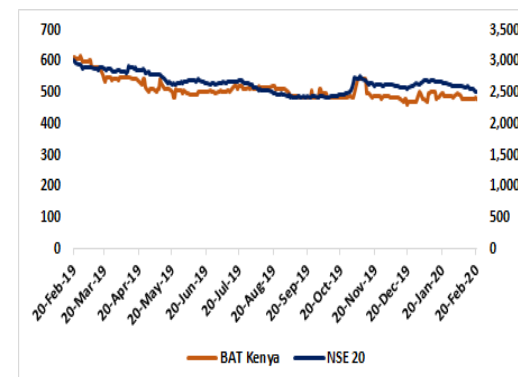
British American Tobacco Kenya (BAT Kenya) released its FY19 results recording a 4.9 % y-o-y decline in PAT to KES 3.9 BN. EPS for the period stood at KES 38.85. ROA dropped 446 bps y-o-y to 17.8% whereas ROE rose 240 bps y-o-y to 40.0%. Total dividend per share stood at KES 33.50, 4.3% lower than that declared in FY18.

Below please find key highlights:

Net revenue rose 15.9% y-o-y to KES 24.0 BN: This was on the back of a 9.1% rise in gross revenue to KES 39.8 BN and a slight increase in excise and VAT charges of 0.3% y-o-y to KES 15.8 BN. Domestic net revenue edged up 22.5% to KES 13.2 BN on the back of excise based increases in cigarette prices. Net revenue from export revenues was up 8.6% y-o-y to KES 10.0 BN. Overall domestic to export revenue mix stood at 55:45 in contrast to the 52:48 recorded in FY18. The company however, reported a drop in the volumes of domestic sales owing to the strain on consumer affordability occasioned by aggressive tax increases. Affordability challenges were as well key set backs in growth of export markets particularly in DRC and Somalia.

Cost of operations edged up 26.0% y-o-y to KES 18.31 BN. The company recorded a significant increase in provisions to cater for the impact of the introduction of the solatium fund 2019. Guidance by government authorities on the basis of computing this levy remains unclear which could see the figure range between KES 200.00 MN to KES 800.00 MN annualized, depending on whether the final verdict is to apply it to net revenue from domestic sales or the company's total gross revenue. Management has taken the prudent approach, providing for 2.0% of total gross revenue retrospectively from 2017. They, however, continue to engage government authorities to ensure that this levy does not affect their competitiveness in the export market space.

BAT KENYA: 52 WEEK PRICE PERFORMANCE



(Source: Company, DBIB Research)

PRICE RETURN	ABSOLUTE RETURN	EXCESS RETURN
3 months (%)	1.9	4.3
6 months (%)	(1.0)	(4.2)
12 months (%)	(16.3)	(5.4)

KEY METRICS

Current Price (KES)	480.00
12 Month Target Price (KES)	641.45
52 week Range (KES)	480.00-613.00
YTD Return (%)	0.4
Issued Shares (Mn)	100.0
Market Cap (USD Mn)	474.1
Enterprise Value (USD Mn)	474.7

Recommendation	BUY
Trailing EPS (KES)	38.85
NAV (KES)	97.2
P/E (x)	12.4
P/CFO (x)	4.6
P/B (x)	4.9
Div. Yld (%)	7.0

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Profit after tax declined by 4.9% y-o-y to KES 3.9 BN despite growth in revenue owing to the effect of increased provisioning for the solatium fund levy on the cost of operations. This saw profit after tax margins drop 144 bps to 9.8%.

Cash generated from operations edged up 44.1% to KES 10.4 BN on the back of better working capital management. Working capital turnover rose 3,354 bps to 44.2x .

Dividends per share dropped 4.3% y-o-y to KES 33.5. Payout ratio increased slightly by 55 bps to 86.2%. The company intends to reinvest its retained earnings into the set up of an oral nicotine factory in Kenya, the first of its kind in Africa. The factory is expected to cost KES 2.5 BN spread out between 5 years. This is in line with the BATK's innovation agenda that has seen them recently venture into reduced harm products.

Going forward: We see the following as the key themes behind BATK's performance in the coming years.

In the domestic market we see

- **Regulation:** Aggressive regulation has and continues to be a key impediment to BATK's growth particularly within its domestic market. Excise duty increases have significantly impacted consumer affordability. Management reports that the decline observed in volumes of sales in Kenya was 3x faster than anticipated. Excise based price increases as well continue to widen the differential between legitimate products and those sold in the illicit market.
- **Innovation:** Late last year, BATK entered the reduced harm products space with the soft introduction of its nicotine pouches dubbed '**lyft**'. Despite the fact that the product was brought to market in the last quarter of the year and was only sold in Nairobi, it contributed KES 112.00 MN to BATK's net revenue. The company is in the process of setting up an oral nicotine plant to service the country and potentially other markets even outside the EAC and COMESA region. BATK is looking forward to nationwide integration this year. We see potential for revenue growth in this area.
- **Illicit trade:** The incidence of illicit trade in FY19 has been reported at 11.3%, 280 bps lower than in FY18 owing to the government's vigilant efforts to counter illicit trade. However, whereas the quantity of locally produced tax evaded products has been on the decline, the vacuum continues to be plugged by illicit cigarettes from neighboring countries, particularly Uganda. This is made even more severe by the widening price differential between products from Kenya and those from Uganda as a result of regulation based price increases.

In the export markets we see :

- **Growth:** We anticipate that BATK's move to begin exporting finished products to Egypt will spur growth in the export market. We believe that it presents great opportunity given that around 22.8% of Egyptians are smokers. We expect that entry into this market will further be supported by the COMESA free trade agreements.
- **Regional Market risks:** BATK noted that consumer affordability challenges in two of its major export destination namely Somalia and DRC weighed down on the growth momentum observed at half year. The value of cigarettes exported as at full year grew 1.0% to KES 8.6 BN while y-o-y cigarette export growth at half year was reported at 11.0%. We see further risk in destination markets arising from the dawn of an election period often characterized by heightened political tensions i.e. Burundi, Ethiopia, Seychelles, South Sudan and Tanzania in 2020; and Uganda and Djibouti in 2021.

On a trailing basis, BAT is trading at **P/E and P/B** multiples of **12.4x** and **4.9x** respectively against a peer median of 26.3x and 7.6x respectively.

We maintain our **BUY** recommendation.

PROFIT AND LOSS SUMMARY (KES MN)

Year End: DECEMBER (KES MN)	FY19	FY18	y-y % ch
Gross revenue	39,827	36,496	9.1
Excise duty & VAT	(15,788)	(15,746)	0.3
Net revenue	24,039	20,750	15.9
Cost of operations	(18,313)	(14,531)	26.0
Operating profit	5,726	6,219	(7.9)
Finance costs	(193)	(338)	(42.9)
Profit before tax	5,533	5,881	(5.9)
Income tax expense	(1,648)	(1,796)	(8.2)
Profit after tax	3,885	4,085	(4.9)
Fair value and revaluation gains	20	(1)	N/A
Comprehensive income	3,905	3,500	11.6
EPS	38.85	40.85	(4.9)
DPS	33.50	35.00	(4.3)

(Source: Company, DBIB Research)

CASHFLOW SUMMARY (KES MN)

Year End: DECEMBER (KES MN)	FY19	FY18	y-y % ch
Cash generated from operations	10,384	7,207	44.1
Net interest paid	(207)	(352)	(41.2)
Tax paid	(2,493)	(1,554)	60.4
Net cash from/(used in) operating activities	7,684	5,301	45.0
Net cash from/(used in) investment activities	(1,564)	(858)	82.3
Net cash from/(used in) financing activities	(4,499)	(2,600)	73.0
Change in cash & equivalents	1,621	1,843	(12.0)
Cash at the start	190	(1,653)	(111.5)
Cash at the end	1,811	190	853.2

(Source: Company, DBIB Research)

BALANCE SHEET SUMMARY (KES MN)

Year End: DECEMBER (KES MN)	FY19	FY18	y-y % ch
Share capital	1,000	1,000	-
Revaluation Reserve	1,756	1,820	(3.5)
Retained Earnings	6,959	6,490	7.2
Shareholders' Funds	9,715	9,310	4.4
Non Current Liabilities	1,871	3,237	(42.2)
Net Assets	11,586	12,547	(7.7)
Non-current assets	10,685	9,123	17.1
Current Assets	11,122	9,216	20.7
Current Liabilities	(10,221)	(5,792)	76.5
Working Capital	901	3,424	(73.7)
Net Assets	11,586	12,547	(7.7)

(Source: Company, DBIB Research)

OPERATING PERFORMANCE

	FY19	FY18	y-y bps ch
Gross Profit margin (%)	14.4	17.0	(266)
Excise duty & VAT (%)	39.6	43.1	(350)
Pretax margin (%)	13.9	16.1	(222)
PAT margin (%)	9.8	11.2	(144)
Fixed Assets Turnover (x)	3.7	4.0	(27)
Current Assets Turnover (x)	3.6	4.0	(38)
Current Liabilities Turnover (x)	3.9	6.3	(240)
Working capital turnover (x)	44.2	10.7	3,354
Current ratio (x)	1.1	1.7	(60)

(Source: DBIB Research)

FINANCIAL STABILITY & LIQUIDITY

	FY19	FY18	y-y bps ch
Net debt (KES MN)	60.0	3,047.0	(9,803)
Enterprise value/share (KES)	480.60	480.03	12
Net debt/equity (%)	19.3	34.8	(1,551)
Net debt/EV (%)	0.1	6.3	(622)
EV/EBIT (x)	8.4	7.7	67
Current ratio (x)	1.1	1.6	(50)
Interest cover (x)	29.7	18.4	1,127
CFO/share (KES)	103.8	72.1	3,177
Book value/share (KES)	97.2	93.1	405
Payout ratio (%)	86.2	85.7	55

(Source: DBIB Research)

INVESTMENT RETURN

	FY19	FY18	y-y bps ch
Return on Assets (RoA)	17.8	22.3	(446)
Return on Equity (RoE)	40.0	37.6	240
Return on Invested Capital (RoIC)	33.5	32.6	97

(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

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