

British American Tobacco (BAT) 1H18 Earnings Update 'Against the odds'

British American Tobacco (BAT) Kenya registered a **2.0% y/y increase in gross revenue in 1H18**; tough macroeconomic challenges and a largely unstable regulatory environment notwithstanding. **PBT rose 3.0% y/y to KES 2.9B** while **PAT edged up 3.4% y/y to KES 2.0B** compared to KES 2.8B and 1.9B in 1H17 respectively. The board recommended an **interim dividend of KES 3.50** to be paid on 21st September 2018 following the book closure slated for 20th August 2018.

Topline steady; to grow conservatively in the short-term: BAT Kenya's topline grew by 2.0% y/y on the back of a rebounding economic climate and a strategic portfolio of nicotine brands. The steady topline performance is also attributable to BAT gaining market share, though marginally, by 80.0bps h/h in 1H18 supported by a strong performance of its products on both low and high price segments of the market spectrum. Net revenues, however, continue to suffer the aftermath of the 15% excise tax that was introduced in 2015 coupled with incremental inflation on excise-led taxes.

Operating margin takes a 200bps y/y hit: Heightened investment in production innovations, the disproportionate increase in the cost of tax stamps in April 2017, lower product mix and inflationary pressure subdued BAT's operating margin by 200bps y/y to 30.9% in 1H18 though this was partly offset by economies of scale attributable to continued productivity initiatives. We anticipate that sustained improvement in factory efficiency (+320bps in 1H18) should keep the company's EBIT in check consequently improving the operating margin.

Lower finance costs to bolster bottom-line performance: Profit before tax increased by 2.9% y/y to KES 2.9B while profit after tax rose 3.4% y/y to KES 2.0B highlighting the impact of higher revenues and lower financing costs partially offset by a higher cost base.

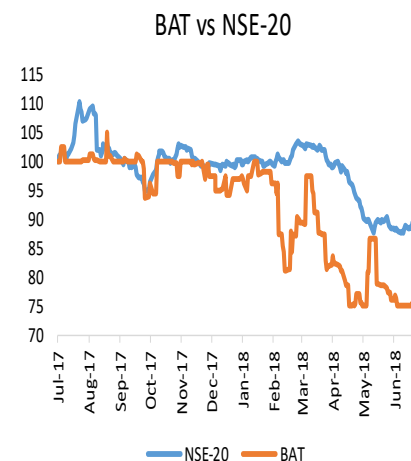
Going forward; Will the promise of sailing on calmer waters steer the ship in the right course? BAT Kenya has endured a tumultuous macroeconomic environment not to mention the sporadic regulatory landscape over the past 3 years. Whilst the NSE-listed company has not come out completely unscathed, management is keen on delivering value to its shareholders through continuous innovation, product development and mitigation of market shocks to increase its market-share in both domestic and export markets. BAT Kenya will focus on exporting cut rug to Zambia as it presents a similar profitability position compared to cigarettes. However, protectionist policies in Uganda and Tanzania as well as elevated political risk in DRC ahead of their December 2018 general elections may dent top-line growth; though ramped up operations at the Nairobi hub may protect the top-line. The counter has seen its share price plummet 21.1% YTD to trade at KES 600.00 at the local bourse on the back weak investor sentiment. The half year results are unlikely to drive demand on the counter which is deemed pricey given the above market average P/E of 23.5x and a low dividend yield of 3.3%.

Bloomberg Ticker	BATK KN
Reuters Ticker	BATK.NR

Share Statistics	
Price	600.00
Issued shares(M)	100.0
Market Cap (USD M)	596.1
Year end	31-Dec
Float (%)	40.0
3-month Avg Trading Vol (USD)	58,151

Price Trend

Source: (NSE)



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Financials

	1H17	FY17	1H18	chg y/y
Income statement	KES M	KES M	KES M	%
Gross revenue	17,142	34,468	17,472	1.9
Exercise duty and value added tax	(8,004)	(15,794)	(7,655)	-4.4
Net revenue	9,138	18,674	9,817	7.4
Total Operating Costs	6,135	(12,921)	6,782	10.5
Operating Profit	3,003	5,753	3,035	1.1
Finance Cost	(210)	(494)	(164)	-21.9
PBT	2,793	4,867	2,871	2.8
Income tax expense	(845)	(1,531)	(857)	1.4
PAT	1,948	3,336	2,014	3.4
EPS (KES)	19.48	33.00	20.14	3.4
DPS (KES)	4.00	26.00	3.50	-12.5

Statement of Financial position	1H17	FY17	1H18	chg y/y
Total equity	6,795	7,840	7,661	12.7
Non-current liabilities	3,371	3,391	3,387	0.5
Non-current assets	9,373	9,140	9,161	-2.3
Current assets	9,988	8,665	8,865	-11.2
Current liabilities	(9,195)	(6,574)	(6,978)	-24.1

Statement of Cash flow	1H17	FY17	1H18	chg y/y
Cash generated from operations	1,723	6,419	903	-47.6
Net interest paid	(208)	(490)	(179)	-13.9
Tax paid	(782)	(1,216)	(745)	-4.7
Net cash generated from operations	733	4,713	(21)	-102.9
Net cash (used in)/ generated from investing activities	(205)	(379)	(266)	29.8
Net cash used in financing activities	(3,950)	(4,300)	(2,250)	-43.0
Net (decrease)/ increase in cash & cash equivalents	(3,422)	34	(2,537)	-25.9
Cash & cash equivalents at end of year	(5,109)	(1,653)	(4,189)	-18.0

Ratios(%)	1H17	FY17	1H18	chg y/y
Operating profit margin (%)	32.9	30.8	30.9	
Net margin (%)	21.3	17.9	20.5	
Payout ratio (%)	20.5	78.8	17.4	
Effective tax rate (%)	30.3	31.5	29.9	
Current ratio	1.1	1.3	1.3	
Return on assets (%)	20.9	19.8	21.5	
Return on Equity (%)	59.0	40.1	55.7	
P/E (x)		23.5		
P/B (x)		10.0		
Dividend yield (%)		3.3		

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