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BAT Kenya Half Year 2020 Earnings Update

BAT reported a 6.0% increase in H1-2020 Profit after tax (PAT) to KES 2.68Bn from KES 2.53Bn same period in 2019. Profit before tax increased by 1.5% to KES 3.67Bn from KES 3.61Bn. The bottom-line growth was driven by 10.1% ruction in operating cost, 35.7% decline finance cost while low effective tax rate of 26.9% saw tax expense shrink by 8.9%. The company has seen a 35.1% share value decline in y-t-d basis and a 40.4% y-y decline.

- The cigarette manufacturers saw Gross revenues decline by 13.6% attributed to impact of the COVID-19 pandemic which led to a 16% fall in volumes and consumer downtrading due to affordability. Net revenues declined by 6.7% partly offset by a decrease in Excise Duty and VAT due to decline in domestic sales volumes and the change in VAT rate in April 2020.
- The Covid-19 had a huge consumption habit which saw consumers downtrading with aspirational premium products contribution shrinking from 48.1% to 38.1%. Value for money products increased to 40.5% from 31.4% while low priced products increased to 15.3% from14.2%.
- A study by SBO Research indicated that 33% of consumers bought less or did not buy nicotine products while 49% of consumers reduced cigarettes consumption with a 19% decline in average daily consumption.
- Operating expenses shrunk by 10.1% boosted by KES 220.00Mn from production savings through efficiency, KES 100Mn from Marketing and Distributions due to changes in the business environment and KES 250Mn from reduced overheads. This aided to increase operating margins up by 250bps to 35.6% from 33.1% seen in H1-19.
- Earning per share grew by 6.0% to 26.79 from 25.28. The board voted to maintain an interim dividend of KES 3.50 to be paid on 18th September 2020 with book closure set for 21st August 2020.
- Shareholders' funds shrunk by 4.0% on decline of retained earnings. Total assets dipped by 3.5% caused by retreating current assets. Total liabilities were down 2.7%. current account ratio was tight at 1.03 having declined from 1.09 as current account declined at a faster rate of 8.0% compared to a 3.0% decline in current liabilities.
- Ratios saw PBT margins and PAT margins improve to 34.8% and 25.4% respectively from 32.0% and 22.4% in H1-2019. Return on Equity (ROE) was up to 43.3% from 40.8% while Return on Asset improved to 36.1% from 35.4%. this was due to growth in PAT and a retreating balance sheet.
- Revenue contribution was split at 40% domestic market with 60% coming from contract business with new markets of Egypt and Madagascar overperforming, export business and sale of cut-rug. Cut-rug performed extremely well in new markets of Nigeria and South Africa.
- Introduction of Lyft product – nicotine pouches – the product injected an additional KES 100Mn in net revenue in H1-2020. Price repositioning from KES 450 to KES 250 per 20 pack saw a faster product in the market.

P&L (KES Mn)	HY- 17	HY- 18	HY-19	HY-20
Gross Revenues	17,472	17,142	19,228	16,615
Excise Duty & VAT	(7,655)	(8,004)	(7,939)	(6,078)
Net Revenues	9,817	9,138	11,289	10,537
Total Operation Expense	(6,782)	(6,135)	(7,551)	(6,790)
Operating profit	3,035	3,003	3,738	3,747
Finance costs	(210)	(164)	(126)	(81)
PBT	2,825	2,839	3,612	3,666
Tax	(845)	(857)	(1,084)	(987)
PAT	1,980	1,982	2,528	2,679
Interim Dividend	3.50	3.50	3.50	3.50
EPS	19.48	20.14	25.28	26.79

Balance Sheet (KES Mn)	HY- 17	HY- 18	HY-19	HY-20
Capital and Reserves				
Share Capital	1,000	1,000	1,000	1,000
Revaluation Surplus	1,902	1,861	1,756	1,756
Hedging Reserves	-	64	-	
Retained Earnings	3,893	4,736	6,959	6,567
Shareholders' Funds	6,795	7,661	9,715	9,323
Non-Current Liabilities	3,371	3,387	1,871	1,861
	10,166	11,048	11,586	11,184
Assets				
Non-Current Assets	9,373	9,161	10,685	10,867
Working Capital				
Current Assets	9,988	8,865	11,251	10,353
Current Liabilities	(9,195)	(6,978)	(10,350)	(10,036)
Networking Capital	793	1,887	901	317
	10,166	11,048	11,586	11,184

- Over the pandemic period, the export market was not affected due to pre-agreed agreement with logistic companies. However, they were faced with delays in delivery of part of the raw materials required for production.

- Cash generated from operations declined by 86.3% due to:
  i. Leaf Purchase – The company does a one-off purchase of leaves between November and February leading to high cash utilization. Farmers were paid over KES 1.5Bn on leaves procured.
  ii. Timing of receivables from the Nigerian and DRC markets which had a challenge currency change, this pushed days receivable to a high of 6.-70 days from the long-term average of 30-45 days.

We expect the operating cash situation to reverse in H2-2020.

BAT will continue facing tough business environment caused by

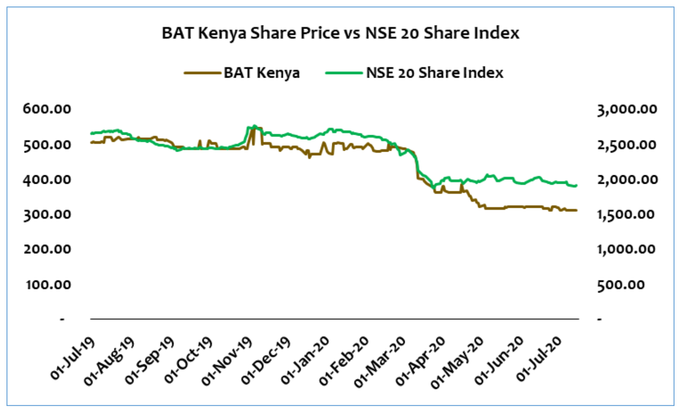
- Stretch consumers due to increase in pieces necessitated by regulation changes,
- Illicit trades – market share on illicit cigarette stands at 11% as at end of 2019 with high infiltration of cigarettes from Uganda;
- Regulatory overreach – increase in taxes and duties on the products will continue putting pressure on prices. Excise duty of 20% imposed in 2019 was passed to consumers.

H2-2020 Business Focus

- Tactical strategic change necessitated by current business environment. During the period, the company was operating on a 30% business environment. This has since improved to 60% with the changes in curfew times and reopening of county borders. With current operating environment, the company will need to ensure product placement, sales and distribution remains a key focus in revenue generation.
- Fight on illicit trade – Fight on illicit trades will aid in ensuring high sales and volumes movement.
- Portfolio transformation - transforming local brands to international recognized brand to continue with the transformation of Sportsman brand to Rothmans – King Size.
- Accelerate LYFT – Factory launch and resole regulatory challenges will open up marketing and advertising avenues that will aid with pushing product sales.

% Growth Change	HY- 17	HY- 18	HY-19	HY-20
Profit and Loss				
Net Revenues	-5.6%	-6.9%	23.5%	-6.7%
Operating Expense	-6.5%	-9.5%	23.1%	-10.1%
Operating profit	-3.3%	-1.1%	24.5%	0.2%
PBT	-7.9%	0.5%	27.2%	1.5%
PAT	-7.8%	0.1%	27.5%	6.0%
EPS	-9.3%	3.4%	25.5%	6.0%
Balance Sheet				
Shareholders' Funds	6.2%	12.7%	26.8%	-4.0%
Total Liability	14.0%	-17.5%	17.9%	-2.7%
Total Asset	5.7%	8.7%	4.9%	-3.5%

Key Ratios	HY- 17	HY- 18	HY-19	HY-20
Operating Margins	30.9%	32.9%	33.1%	35.6%
PBT Margins	28.8%	31.1%	32.0%	34.8%
PAT Margins	20.2%	21.7%	22.4%	25.4%
ROE	44.2%	38.3%	40.8%	43.3%
ROA	32.0%	27.6%	35.4%	36.1%
Current Ratio	1.09	1.27	1.09	1.03



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Analysts' stock ratings are defined as follows:

- **Buy** – A buy rating reflects 1) An analyst has a bullish conviction on a stock 2) A 10% or greater expected return.
- **Accumulate** – An accumulate rating reflects 1) An analyst has a lesser bullish conviction on a stock 2) Expected return falls between 5% and 10%.
- **Hold** – A hold rating reflects 1) An analyst has a neutral conviction (lack of bullish or bearish conviction) on a stock 2) Expected return falls within the range of -5% to +5%.
- **Speculative Buy** – A speculative buy rating reflects 1) An analyst has a bullish conviction accompanied by a substantially higher than normal risk 2) Expected return falls above 10%.
- **Sell** – A sell rating reflects 1) An analyst has a bearish conviction on a stock 2) Expected return falls below 5%.

*Expected Return (ER) represents the sum total of both capital appreciation and the dividend yield.

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