



British American Tobacco (K) Ltd
Valuation Note
24th July, 2016



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British American Tobacco (K) Limited – Valuation Recommendation

We recommend an Accumulate on BAT with a fair value of Kshs 970.6

We recommend an Accumulate on BAT, with a target price of Kshs 969.6, an 18.0% upside from its current price of Kshs 865.0, including a 6.3% dividend yield.

Our recommendation is based on;

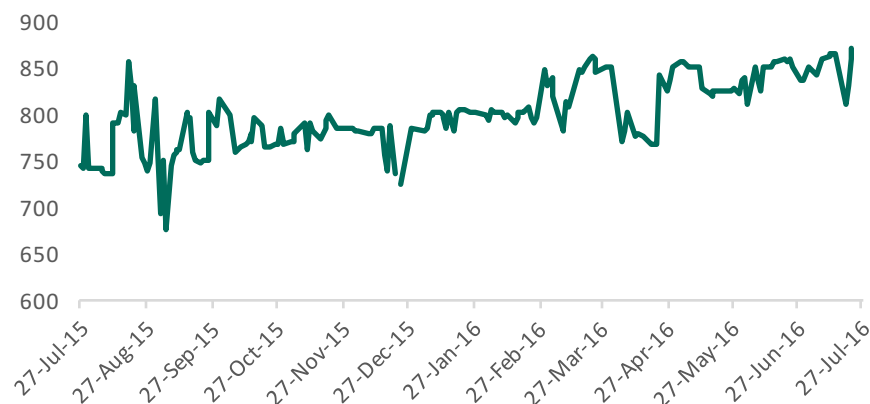
- **Steady Dividend:** Mature company paying out all earnings with stable growth in earnings
- **Steady state growth:** BAT has reached a mature company state, with a flat growth in revenue driven by a steady growth in new number of customers, with customers up-trading in tastes. Export sales growth has grown steady, as the feeder markets' uptake increase.

Risk:

- **Higher excise taxes and increased regulation:** Increased regulation of the sector coupled with frequent excise tax increases will continue to hamper further growth. The Ministry of Health has recently passed new regulations which govern advertising for tobacco products as well as the size of health warnings on cigarette packages.

Recommendation	ACCUMULATE
Fair Value	970.8
Current Price	869.0
Upside / (Downside)	11.7%
Dividend Yield	6.3%
Total Return	18.0%
52 week range	675.0 - 869.0
Forward PE	15.9x
Cost of Equity	17.0%
Cost of Capital	11.5%
Issued Shares (Mns)	0.1

One-year Share Price Performance



Industry Overview

Kenya's Tobacco market has reached maturity, albeit in a highly regulated environment

- The Kenyan Tobacco market is one of the subtle contributors to economic growth, with the overall manufacturing sector contributing 3.5% to economy having grown with a CAGR of 3.9% over the last 5 years
- The key players in the market are British American Tobacco (K) Limited and MasterMind Limited, with indicative market shares of 78.0% and 20.3%, respectively
- Consumers of tobacco products have continued to be exposed to wider product ranges though indistinct, with the consumers in the middle income bracket up-trading in tastes to more premier brands
- However, the sector has been on the limelight for one major reason; Regulation. This encompasses frequent excise tax revisions by the taxman and the tight legislative bills by the Ministry of Health in a bid curb tobacco use
- We expect the market to continue growing at a steady pace with consumer trends continuing changing while regulations continue to deter further growth

British American Tobacco (K) Limited – Valuation Summary

BAT is undervalued at a fair value price of Kshs 970.6 with an expected Total return of 18.0%

Valuation Summary:	Implied Price Weighting		Weighted Value
DCF - Integrated	1,018.5	80%	814.8
EV/EBITDA Multiple	773.9	10%	77.4
PE Multiple	786.6	10%	78.7
Target Price			970.6
Current Price			869.0
Upside/(Downside)			11.7%
Dividend Yield			6.3%
Total Return			18.0%

<u>Cost of equity assumptions</u>	
10-year government bond yield	13.0%
Mature market risk premium	6.7%
Beta	0.60
Cost of equity	17.0%
<u>Cost of debt assumptions</u>	
Cost of debt	6.0%
Tax rate	30.0%
After tax cost of debt	4.2%
Target Debt/Equity ratio	75.0%
Debt/Capitalization ratio	42.9%
WACC	11.5%
<u>Terminal assumptions</u>	
Terminal Beta	1.0
Stable growth rate	5.0%
Terminal WACC	11.5%

British American Tobacco (K) Limited – Intrinsic Valuation

We arrive at a Target price of Kshs 1,018.5, representing an upside of Kshs 17.2%

	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20
EBIT		8.1	8.6	9.0	9.5	10.0
After Tax EBIT		5.7	6.0	6.3	6.7	7.0
Capex		0.9	1.1	1.2	1.2	1.3
Depreciation & Amortization		0.6	0.6	0.6	0.7	0.7
Changes in WC		2.0	(0.4)	(0.5)	(0.3)	(0.4)
Reinvestment		2.3	0.2	0.0	0.3	0.2
FCFF		3.3	5.8	6.3	6.4	6.9
Terminal value						110.3
Discount rate		1.0	0.9	0.8	0.7	0.6
Net cash flow		3.2	5.0	4.8	4.4	72.5
No of shares (millions)	0.1					
PV of operating assets	89.9					
Add: Cash	0.1					
Less: Borrowings	3.0					
Net Cash	87.0					
12 Month Target Price	1,018.5					
Current Price	869.0					
Upside	17.2%					

British American Tobacco (K) Limited – Relative Valuation

BAT is overvalued based on both PE and EV/EBITDA multiples

Relative Valuation	PE		EV/EBITDA	
Period	2015	2016E	2015	2016E
BAT Kenya	17.5x	15.9x	10.5x	10.0x
EASTERN TOBACCO	6.5x	5.5x	3.2x	2.7x
ADRIS GRUPA DD	2.6x	27.2x	N/A	9.4x
CEYLON TOBACCO CO PLC	17.6x	13.9x	10.2x	7.8x
PHILIP MORRIS CR AS	13.6x	15.3x	7.6x	7.9x
BRITISH AMERICAN TOBACCO ZIM	16.2x	0.0x	11.2x	0.0x
Average	15.8x	12.4x	9.7x	5.6x

PE	
Implied Metric	15.8x
Fair Value	786.6

EV/EBITDA	
Implied Metric	9.7x
Fair Value	773.9

British American Tobacco (K) Limited – Summary Financials

Summary of the financial statements and key ratios

Income Statement	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20
Total Revenue	21.0	22.3	23.6	24.9	26.3	27.7	29.2
EBITDA	6.8	8.3	8.7	9.2	9.7	10.2	10.7
EBIT	6.4	7.7	8.1	8.6	9.0	9.5	10.0
PBT	6.1	7.1	7.8	8.3	8.7	9.1	9.6
PAT	4.3	5.0	5.5	5.8	6.1	6.4	6.7
EPS	42.6	49.8	54.7	57.7	60.6	63.8	66.9
DPS	42.5	49.5	54.7	57.7	60.6	63.8	66.9

Balance Sheet	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20
Total Non-Current Assets	9.3	9.1	9.4	10.0	10.5	11.1	11.7
Total Current assets	8.7	8.9	10.2	11.0	11.8	12.2	12.7
Total Assets	18.0	18.0	19.6	21.0	22.3	23.4	24.4
Total Non-Current Liabilities	2.9	3.2	3.0	3.9	5.0	5.8	6.8
Total Current Liabilities	6.9	5.9	7.8	8.3	8.5	8.7	8.7
Total equity	8.1	8.9	8.9	8.9	8.9	8.9	8.9
Total liabilities and Equity	18.0	18.0	19.6	21.0	22.3	23.4	24.4

Ratios	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20
Return on Assets	23.7%	27.7%	27.9%	27.5%	27.1%	27.3%	27.4%
Return on Equity	52.4%	56.2%	61.8%	65.1%	68.4%	72.0%	75.6%
EBITDA Margin	32.4%	37.2%	36.7%	36.7%	36.7%	36.7%	36.7%
Net Margin	20.2%	22.4%	23.2%	23.1%	23.0%	23.0%	22.9%
Asset Turnover	1.2x	1.2x	1.2x	1.2x	1.2x	1.2x	1.2x

END