

**Company Overview**

British American Tobacco Bangladesh Company Ltd. (BATBC), a subsidiary of BAT Plc – world's leading tobacco group with brands sold in 200 markets around the globe, has been operating since 1910 in the country. The core activities of the Company are manufacturing and marketing of cigarettes. It also exports tobacco leaves. The Company basically models its operation as 'from crop to consumer'. It designs its product line to focus various customer segments based on their income level e.g., premium segment (Benson & Hedges), high segment (John Player Gold Leaf, Pall Mall and Capstan), medium segment (Star and Star Next) and lower segment (Pilot, Hollywood and Derby). The Company has its head office and the cigarette factory in Dhaka, a green leaf threshing plant in Kushtia, a green leaf redrying plant in Manikganj.

**Revenue Composition and Growth:**

| Particulars (BDT billion) | 2013  | 2014  | 2015  | 2016  | 2017  | 5 Year CAGR |
|---------------------------|-------|-------|-------|-------|-------|-------------|
| Gross Turnover            | 109.6 | 126.8 | 143.7 | 165.6 | 204.1 | 17.8%       |
| Growth                    | 21.5% | 15.7% | 13.3% | 15.3% | 23.2% |             |
| Net Turnover              | 31.2  | 35.6  | 39.9  | 43.8  | 51.9  | 13.6%       |
| Growth                    | 13.7% | 14.1% | 11.9% | 9.7%  | 18.8% |             |
| Net Turnover              |       |       |       |       |       | 14.9%       |
| Local                     | 29.3  | 33.2  | 38.0  | 42.3  | 49.9  |             |
| Export (Tobacco Leaf)     | 1.8   | 2.4   | 1.8   | 1.5   | 2.0   |             |

The gross turnover of the Company has increased by 23.2% in 2017 over last year. This increase was driven by value growth resulting from the progressive price and tax policy of the government. In 2017, net turnover from the domestic sales contributed around 96% of the total net turnover and the rest from the leaf export.

**Historical production of cigarette (in million sticks):**

| Particulars | 2013   | 2014   | 2015   | 2016   | 2017   | 5 Year CAGR |
|-------------|--------|--------|--------|--------|--------|-------------|
| Cigarette   | 35,338 | 39,098 | 43,046 | 50,027 | 53,734 | --          |
| Growth      | 17.6%  | 10.6%  | 10.1%  | 16.2%  | 7.4%   | 12.3%       |

The Company cultivates the tobacco leaf, main raw materials for cigarette production, in the country through its 34,500 registered farmers. Along with tobacco leaf, wrapping materials is also an important raw material for the Company. The Company has to procure around 29% of raw materials consumption from foreign sources.

The Company is the highest private sector tax payer of the Country and contributed 74% of the total tax collection of the industry. In 2017, it contributed BDT 164.27 billion as duty, VAT and other levies (total 600.0 bn in last 5 years).

The Firm was enlisted with the DSE in 1977 & CSE in 1996.

| As on     | Sponsor | Govt. | Institution | Foreign | Public |
|-----------|---------|-------|-------------|---------|--------|
| 30-Jun-18 | 72.91%  | 0.64% | 10.44%      | 15.21%  | 0.80%  |
| 31-Dec-17 | 72.91%  | 0.64% | 10.40%      | 15.34%  | 0.71%  |
| 31-Dec-16 | 72.91%  | 0.64% | 11.23%      | 14.41%  | 0.81%  |
| 31-Dec-15 | 72.91%  | 0.64% | 11.49%      | 0.00%   | 14.96% |

**Company Fundamentals**

|                                   |                   |
|-----------------------------------|-------------------|
| Market Cap (BDT mn)               | 198,102.0         |
| Market weight                     | 5.9%              |
| No. of Share Outstanding (in mn)  | 60.0              |
| Free-float Shares                 | 27.1%             |
| Paid-up Capital (BDT mn)          | 600.0             |
| 3-month Average Turnover (BDT mn) | 33.9              |
| 3-month Return                    | -4.1%             |
| Current Price (BDT)               | 3,299.9           |
| 52-week price range (BDT)         | 2,765.0 - 3,838.0 |
| Sector's Forward P/E              | 18.2              |

|  | 2015 | 2016 | 2017 | 2018 (6M Ann) |
|--|------|------|------|---------------|
|--|------|------|------|---------------|

**Financial Information (BDT mn):**

|                  |        |        |        |        |
|------------------|--------|--------|--------|--------|
| Net Sales        | 39,895 | 43,754 | 51,964 | 58,820 |
| Gross Profit     | 18,682 | 19,863 | 24,783 | 30,989 |
| Operating Profit | 13,201 | 13,927 | 17,802 | 25,094 |
| Profit After Tax | 5,846  | 7,582  | 7,830  | 11,650 |
| Assets           | 29,591 | 35,348 | 46,415 | 60,489 |
| CAPEX            | 2,691  | 3,550  | 8,030  | 2,283  |
| Long Term Debt   | --     | --     | --     | --     |
| Short Term Debt  | --     | 1,500  | 3,058  | 12,312 |
| Equity           | 14,610 | 18,883 | 23,112 | 25,337 |

**Margin:**

|                  |       |       |       |       |
|------------------|-------|-------|-------|-------|
| Gross Profit     | 46.8% | 45.4% | 47.7% | 52.7% |
| Operating Profit | 33.1% | 31.8% | 34.3% | 42.7% |
| Pretax Profit    | 31.2% | 30.1% | 32.3% | 40.1% |
| Net Profit       | 14.7% | 17.3% | 15.1% | 19.8% |

**Growth:**

|                  |       |       |       |       |
|------------------|-------|-------|-------|-------|
| Net Sales        | 11.9% | 9.7%  | 18.8% | 13.2% |
| Gross Profit     | 14.5% | 6.3%  | 24.8% | 25.0% |
| Operating Profit | 14.4% | 5.5%  | 27.8% | 41.0% |
| Net Profit       | -6.9% | 29.7% | 3.3%  | 48.8% |

**Profitability:**

|     |       |       |       |       |
|-----|-------|-------|-------|-------|
| ROA | 20.6% | 23.4% | 19.2% | 21.8% |
| ROE | 44.8% | 45.3% | 37.3% | 48.1% |

**Operating Efficiency Ratio:**

|                |      |      |      |      |
|----------------|------|------|------|------|
| Inventory TO*  | 4.5  | 3.9  | 3.3  | 2.7  |
| Receivable TO  | 29.5 | 43.7 | 30.8 | 31.6 |
| A/C Payable TO | 2.9  | 3.0  | 3.0  | 2.6  |
| Total Asset TO | 1.4  | 1.3  | 1.3  | 1.1  |
| Fixed Asset TO | 3.1  | 3.0  | 2.9  | 2.6  |

**Leverage:**

|               |      |       |       |       |
|---------------|------|-------|-------|-------|
| Debt Ratio    | 0.0% | 5.1%  | 6.6%  | 20.4% |
| Debt-Equity   | 0.0% | 9.5%  | 13.2% | 48.6% |
| Int. Coverage | 92.6 | 275.8 | 92.8  | 72.5  |

**Dividend History:**

|                 |       |       |       |     |
|-----------------|-------|-------|-------|-----|
| Dividend (C/B)% | 550/- | 600/- | 600/- | -/- |
| Dividend Yield  | 1.9%  | 2.4%  | 1.8%  | -/- |
| Dividend Payout | 56.4% | 47.5% | 46.0% | -/- |

**Valuation:**

|                |       |       |       |       |
|----------------|-------|-------|-------|-------|
| Price/Earnings | 35.9  | 27.7  | 26.4  | 16.7  |
| Price/BV       | 14.4  | 11.1  | 9.0   | 7.7   |
| EPS (BDT)      | 97.4  | 126.4 | 130.5 | 194.2 |
| NAVPS (BDT)    | 243.5 | 314.7 | 385.2 | 422.3 |

\* TO= Turnover

## Industry Overview

Bangladesh is ranked among the top tobacco consuming countries in the world. More than 95% of tobacco related products are produced and manufactured domestically by both local and foreign manufactures. According to a study conducted by Human Development Research Centre (HDRC) and Campaign for Tobacco-Free Kids, **cigarette markets are dominated by two firms - BATBC (largely focus on premium price brands) and Dhaka Tobacco Industries (lower price brands) which accounted for 46% and 40% of market share respectively.**

According to a study conducted by Progga, **there are 117 bidi factories in Bangladesh**, employing around 65,000 workers who produce 48.65 billion sticks annually. **Some 60 to 65 per cent of the bidi workers are children aged between four and 14 years and low paid**, according to the study. Working in the bidi factories stands fourth among the government-listed 38 hazardous jobs those are prohibited for the children. Besides, Bangladesh has ratified ILO Convention no. 182 in 2001 that deals with the hazardous child labour.

According to Department of Agriculture Extension (DAE), **tobacco acreage in Bangladesh nearly doubled from 72,000 acres in 2007-08 to 115,000 acres in 2015-16** and production increased more than doubled from 40,000 tonnes to 88,000 tonnes. Tobacco cultivation occupies around 0.6% of the total cultivable land in Bangladesh.

According to The Global Adult Tobacco Survey of 2009 report, **more than 41.3 mn people in Bangladesh use tobacco whereas another 42 mn people are victims of secondary smoking.** According to the WHO, **Bangladesh earns around Taka 24.00 billion per year from the tobacco sector, but the country incurs yearly loss about Taka 50.00 billion as treatment cost for fatal diseases.** Country's 51 per cent of the tobacco products fail to display the guided graphical health warning (GHW) though the government made it mandatory.

The industry had marginal volume growth over the last year as the consumers are moving from bidi to cigarette while total tobacco industry is in decline. The growth dynamics of the industry varied across the 4 price segments. The Low segment experienced growth in 2016 while High and Medium segments declined. **The industry growth will be driven by Low segment due to government pricing policies and continued migration from bidi.**

The tobacco Industry includes combustible cigarettes and bidi. Currently, **bidi industry occupies around 30% of total tobacco industry whereas Government is getting less than 3% of the industry revenue.** The size of total tobacco industry is shrinking but the market share of cigarettes is increasing as the consumers are moving from bidi to cigarette. However, the cigarette industry is highly taxed compared to the bidi industry.

**To discourage the use of tobacco, the Government imposes higher VATs and taxes on product level and corporate level.** The Government also passed the Tobacco Control Law Amendment Bill with stricter policy.

In the national budget 2018-19, the Government has **withdrawn the 25% export duty on tobacco export to encourage export and discourage local consumption.** The budget fixed the price of 20 sticks of filter bidi at BDT 15 from existing BDT 12. **Supplementary duty of cigarette and bidi paper increased from existing 20% to 25% which will increase**

**the cost of finished products.** The budget increased the supplementary duty on low and medium segment cigarettes to 55% & 65% from existing 52% & 62% respectively. The budget also increased the price of low segment for every 10 sticks cigarette to BDT 32 and medium segment for every 10 sticks cigarette to BDT 48. **The budget increased the price of high segment and premium segment for every 10 sticks of cigarettes at BDT 75 and BDT 101 respectively and kept the supplementary duty to existing 65%.**

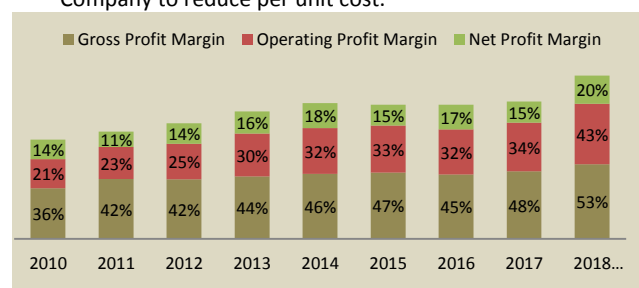
## Investment Positives

- **The Company registered a significant growth of 42.7% in net profit in the first half of 2018 than that of last year due to the increased gross turnover by 13.7%, improved gross profit margin from 48.1% to 52.7% and decrease of operating expenses to 10.0% from 11.1% in percentage of sales.** Gross profit margin improved due to the efficient supply chain management and effective cost control measures taken by the Company.
- The Company displayed exceptional performance over the years despite external challenges. **5 year CAGR (Compound Annual Growth Rate) of net turnover and profit after tax of the Company was 13.6% & 14.71% respectively.** This was driven by the volume growth in all the segments along with the government's initiative to limit downtrading by reducing the price gap between the top segments and low segment.
- BATB's volume growth was achieved through a focused strategy to support the business through innovations which was based on consumers preferred quality products. The contribution of low segment accounts for around 75% but the premium segment registered 32% growth in 2017.

| Particulars | Contribution |      |      | Growth* |      |      | 3-yr CAGR |
|-------------|--------------|------|------|---------|------|------|-----------|
|             | 2015         | 2016 | 2017 | 2015    | 2016 | 2017 |           |
| Premium     | 5%           | 5%   | 6%   | 9%      | 14%  | 32%  | 18%       |
| High        | 8%           | 5%   | 6%   | -13%    | -29% | 32%  | -6%       |
| Medium      | 13%          | 11%  | 13%  | -21%    | -4%  | 30%  | -1%       |
| Low         | 74%          | 79%  | 75%  | 20%     | 21%  | 4%   | 15%       |

\*Segment wise volume growth was derived from the percentage of volume share in each segment as per annual reports of the Company.

- Profitability of the Company has seen a significant improvement over the years. This was because of establishing an efficient supply chain management, effective cost control measures and productivity savings initiatives throughout the Country which helped the Company to reduce per unit cost.



- **The Company has invested a significant amount of BDT 8.0 billion in 2017 as capital expenditure in the form of purchase of property, plant and equipment to enhance the capacity to support the high volume growth.** Historical CAPEX in percentage of property, plant and equipment (PPE) are shown in the following table:

| Particulars (BDT bn) | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 (HY) |
|----------------------|------|------|------|------|------|-----------|
| PPE                  | 8.5  | 12.0 | 13.7 | 15.4 | 20.9 | 23.8      |
| Growth               | 45%  | 41%  | 14%  | 13%  | 36%  | 14%       |
| CAPEX                | 3.4  | 4.4  | 2.7  | 3.6  | 8.0  | 2.3       |
| % of PPE             | 40%  | 37%  | 20%  | 23%  | 38%  | 10%       |
| Depreciation         | 0.8  | 0.9  | 0.9  | 1.3  | 1.5  | --        |
| % of PPE             | 9%   | 8%   | 7%   | 8%   | 7%   | --        |

- The Government has withdrawn the 25% export duty on tobacco export in FY 2018-19 which will have a positive impact on the export earnings of the Company.

| Particulars (BDT bn) | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 (HY)* |
|----------------------|------|------|------|------|------|------------|
| Leaf tobacco export  | 1.9  | 2.4  | 1.9  | 1.5  | 2.0  | 2.1        |
| Growth               | -24% | 30%  | -23% | -21% | 37%  | 6.1%       |

\*Growth for 2018 is calculated for six month than that of last year.

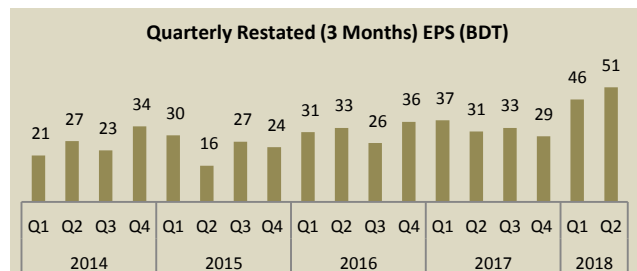
- The demand of cigarettes used to increase during the election periods as generally it is used as a prop for promotion. As the national election of the country is scheduled to be held in the early in 2019, it is expected that the sales volume of cigarettes will rise in that time.
- BATBC has established a handsome dividend policy over the years. In 2017, dividend payout ratio was 46% which was 56% in 2015 where dividend yield was 1.8% in 2017 which was 1.9% in 2015.

#### Investment Negatives

- International tobacco manufacturer, Japan Tobacco (JT) Group, is going to acquire the tobacco business of Akij Group with an estimated amount of BDT 124.8 billion or USD 1.48 billion, the second largest tobacco company in Bangladesh. Akij holds about a 20% share of the cigarette market in Bangladesh, the eighth largest cigarette market in the world, with volumes exceeding 86 billion units and growing by about 2.0% year-on-year, according to the figures coming from Japan Tobacco. With this acquisition, JT is expected to become a major rival in the local market for other international tobacco manufacturers like British American Tobacco.**
- Major raw materials for the production of cigarettes are tobacco leaf which is mainly procured from local source. **Materials consumed accounted for 79% of its total costs of goods sold and around 28% of the raw and wrapping materials of material consumed are imported.** Hence, fluctuations in the prices of materials and related foreign currency exchange rate might hamper the profitability of the company. As per Bangladesh Bank data, from January 2017 to April 2018, BDT depreciates by 5.69% against USD and the trend is still prevailing.
- The Company is operated in a strict regulatory environment, particularly in the area of supplementary duty and corporate tax rate. In Bangladesh, cigarette, bidi, zarda, chewing tobacco or other tobacco products manufacturing company are paying the highest corporate tax rate of 45%. **Moreover, in the national budget 2017-18 the Government imposed an additional 2.5% surcharge on top of the current tax rate which is squeezing the bottom line of the Company.** Yearly segment wise SD (supplementary duty) rate of cigarette are shown in the following table:

| Year    | Low Segment | VFM (Value For Money) | ASP (Aspirational Premium Segment) | Premium Segment |
|---------|-------------|-----------------------|------------------------------------|-----------------|
| 2018-19 | 55%         | 65%                   | 65%                                | 65%             |
| 2017-18 | 52%         | 62%                   | 65%                                | 65%             |
| 2016-17 | 50%         | 60%                   | 62%                                | 64%             |
| 2015-16 | 48%         | 60%                   | 61%                                | 63%             |
| 2014-15 | 43%         | 60%                   | 61%                                | 61%             |
| 2013-14 | 39%         | 56%                   | 59%                                | 61%             |
| 2012-13 | 36%         | 55%                   | 58%                                | 60%             |
| 2011-12 | 33%         | 53%                   | 56%                                | 58%             |

- Illegal cigarette brands remain a threat to the growth of the tobacco manufacturing companies in the country. Meanwhile, the government has conducted a few successful enforcements against illegal cigarettes during the second half of 2017 and will make it continue in the coming years. This will help to eliminate the illegal cigarettes brand from the market which eventually increases the sales volume of the registered companies' cigarettes like BATBC.
- BATBC has an ongoing case where Revenue Board is demanding BDT 19.24 bn in retrospective excise duty and VAT from BATBC alleging that it evaded taxes by selling its Pilot and Bristol brand cigarettes at lower prices declaring the two brands in lower grade ones though those are medium grade ones. The matter is now before the Appellate Division for admission hearing.
- Bangladesh was the first country to sign the WHO Framework Convention on Tobacco Control (FCTC) in 2003 which is the world's first health treaty against the global tobacco epidemic. Moreover, the Government of Bangladesh (GoB) is committed to a "tobacco-free Bangladesh" by 2040 which should cast negative impact for the cigarette making companies like BATBC.

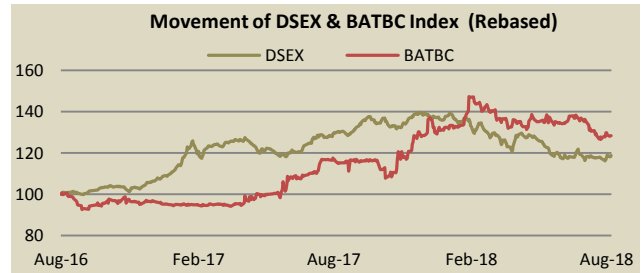
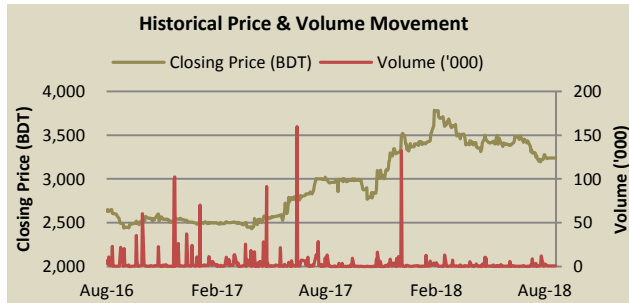


#### Latest Quarter Update – June 2018 (HY)

| Particulars (BDT mn) | Jan-Jun 2018 | Jan-Jun 2017 | Apr-Jun 2018 | Apr-Jun 2017 |
|----------------------|--------------|--------------|--------------|--------------|
| Net Turnover*        | 29,410       | 26,865       | 14,844       | 13,883       |
| Growth               | 9.5%         | --           | 6.9%         | --           |
| Gross Profit         | 15,494       | 12,908       | 7,832        | 6,736        |
| Margin               | 52.7%        | 48.1%        | 52.8%        | 48.5%        |
| Growth               | 20.0%        | --           | 16.3%        | --           |
| Operating Profit     | 12,547       | 9,909        | 6,384        | 5,097        |
| Margin               | 42.7%        | 36.9%        | 43.0%        | 36.7%        |
| Growth               | 26.6%        | --           | 25.3%        | --           |
| Net Profit           | 5,825        | 4,082        | 3,075        | 1,888        |
| Margin               | 19.8%        | 15.2%        | 20.7%        | 13.6%        |
| Growth               | 42.7%        | --           | 62.9%        | --           |

\*Net turnover implies after deduction of supplementary duty and VAT from gross turnover.

- Revenue has increased by 9.5% in the first half of 2018 over the same period of last year due to the increased price in low segment imposed by the government in the 2017-18 national budget and volume growth in all segments.
- Gross profit margin improved significantly in the reported period over last year as the Company has established efficient supply chain management and effective cost control measures.
- Net profit increased by 42.7% in the first half than that of last year due to the improvement in gross profit margin and decrease of operating expenses in percentage of sales.



**Pricing Based on Relative Valuation:**

|                     | Multiple | Value (BDT) |
|---------------------|----------|-------------|
| Sector Forward P/E  | 18.2     | 3,534.3     |
| Sector Trailing P/E | 25.9     | 3,378.4     |

**Concluding Remark**

BATBC is one of the leading corporate houses in the country engaged in manufacturing and marketing of cigarettes. The Company displayed growth in its business performance consistently over the years. The Company is also investing significant capital expenditures over the years to remain the market leader in the industry. It also sustained its profit margin despite having unfriendly regulatory environment.

Source: Annual Reports, DSE website, BATBC's website, WHO, CTFK's website, HDRC's website, the Financial Express, the Daily Star and ILSL Research

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