

Company Overview

British American Tobacco Bangladesh Company Ltd. (BATBC), a subsidiary of British American Tobacco (BAT) Plc, UK – world's leading tobacco group with brands sold in 200 markets around the globe, has been operating in the country since 1910. 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 in Dhaka, and the cigarette factory, a green leaf threshing plant, in Kushtia, and a green leaf redrying plant in Manikganj.

Revenue Composition and Growth:

Particulars (BDT billion)	2016	2017	2018	2019	5 Year CAGR
Gross Turnover	165.6	204.1	233.1	269.9	
Growth	15.3%	23.2%	14.2%	15.8%	16.3%
Net Turnover	43.8	51.9	54.6	56.8	
Growth	9.7%	18.8%	5.2%	4.0%	9.8%
Net Turnover					
Local	38.0	42.3	52.5	53.0	9.8%
Export (Tobacco Leaf)	1.8	1.5	2.2	3.7	8.8%
Local Sale (bn sticks)	48.34	53.20	51.42	50.74	
Growth	13.6%	10.1%	-3.3%	-1.3%	5.4%
Price~ (per bn sticks)	3.43	3.84	4.53	5.32	
Price Growth	1.4%	12.0%	18.1%	17.3%	10.3%
Export (mn kg)	7.29	8.86	9.18	15.53	
Growth	--	21.5%	3.6%	69.2%	28.7%*

*3-year CAGR; ~Derived data

Actual Production (in million sticks):

	2016	2017	2018	2019	5 Year CAGR
Cigarettes	50,027	53,734	49,326	50,151	5.1%

The Company cultivates the tobacco leaf, main raw materials for cigarette production, in the country through its 38,000 registered farmers. Along with tobacco leaf, wrapping materials is also an important raw material for the Company. The Company procured around 20% of its consumed raw materials (leaf and wrapping materials) from foreign sources which was 38% in last year.

The Company is the highest private sector tax payer of the Country and contributed around 8% of the total tax collection by the government. In 2019, it contributed BDT 226.30 billion as duty, VAT and other levies (total 828.71 bn in last 5 years).

Shareholding Structure:

The Firm was enlisted with the DSE in 1977 & CSE in 1996. Historical shareholding structure is shown in following table:

As on	Sponsor	Govt.	Institution	Foreign	Public
29-Feb-20	72.91%	0.64%	10.15%	13.74%	2.56%
31-Dec-19	72.91%	0.64%	9.95%	14.03%	2.47%
31-Dec-18	72.91%	0.64%	9.36%	16.39%	0.70%
31-Dec-17	72.91%	0.64%	10.40%	15.34%	0.71%

Company Fundamentals

Market Cap (BDT mn)	163,368.0
Market Weight Sector Weight	6.29% 78.2%
Free-float (Public + Inst. + Foreign)	27.1%
No. of Shares Outstanding (mn)	180.0
Paid-up Capital (BDT mn)	1,800.0
3 Months Average Turnover (BDT mn)	29.2
3-month Return (Dividend & Free-float Adjusted)	-10.4%
Current Price (BDT)	907.6
52-Week Price Range (BDT)	821.6 - 1,340.0
Sector Forward P/E	14.0

	2017	2018	2019	2020 (3M Ann.)
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Financial Information (BDT mn):

Sales	51,964	54,640	56,821	72,394
Gross Profit	24,783	27,544	26,849	37,660
Operating Profit	17,802	20,820	18,767	26,474
Profit After Tax	7,830	10,012	9,246	12,147
Cash & Cash Equiv.	978	1,634	5,394	6,311
Assets	46,415	56,544	59,430	65,539
CAPEX	8,030	6,979	3,216	140
Long Term Debt	-	-	1,412	1,369
Short Term Debt	3,058	5,180	391	342
Equity	23,112	29,529	35,793	38,830
Retained Earnings	22,448	28,864	33,929	36,965

Margin:

Gross Profit	47.7%	50.4%	47.3%	52.0%
Operating Profit	34.3%	38.1%	33.0%	36.6%
Pretax Profit	32.3%	35.3%	30.6%	34.7%
Net Profit	15.1%	18.3%	16.3%	16.8%

Growth:

Sales	18.8%	5.2%	4.0%	27.4%
Gross Profit	24.8%	11.1%	-2.5%	40.3%
Operating Profit	27.8%	17.0%	-9.9%	41.1%
Net Profit	3.3%	27.9%	-7.6%	31.4%

Profitability:

ROA	19.2%	19.4%	15.9%	19.4%
ROE	37.3%	38.0%	28.3%	32.6%

Operating Efficiency:

Inventory Turnover	3.3	3.0	3.2	3.7
Receivable Turnover	30.8	16.8	16.8	33.6
A/C Payable Turnover	3.0	2.6	2.6	2.6
Total Asset Turnover	1.3	1.1	1.0	1.2
Fixed Asset Turnover	2.9	2.3	2.0	2.5

Leverage:

Debt Ratio	6.6%	9.2%	3.0%	2.6%
Debt-Equity	13.2%	17.5%	5.0%	0.9%
Int. Coverage	92.8	43.9	39.8	398.1

Dividend History:

Dividend (C/B)%	600/-	500/200	400/-	/-
Dividend Yield	1.8%	10.2%	20.1%	--
Dividend Payout	137.9%	89.9%	77.9%	--

Valuation:

Price/Earnings	20.9	16.3	17.7	13.4
Price/BV	7.1	5.5	4.6	4.2
EPS (BDT)	43.5	55.6	51.4	67.5
NAVPS (BDT)	128.4	164.1	198.9	215.7

Industry Overview

Bangladesh is ranked among the top tobacco consuming countries in the world. The tobacco industry is highly regulated in Bangladesh with tobacco subject to extensive product, marketing and taxation requirement. More than 95% of tobacco related products are produced and manufactured domestically by both local and foreign manufactures.

According to a study conducted in collaboration with the University of Dhaka, **tobacco use caused nearly 126,000 deaths accounting for 13.5% of deaths from any cause in Bangladesh in 2018.** Approximately 1.5 million adults were suffering from diseases attributable to tobacco use and nearly 61,000 children were suffering from diseases due to exposure to secondhand smoke. **The estimate of the direct healthcare costs attributable to tobacco use amounted to BDT 83.9 billion annually,** 76% of which was paid by tobacco users' households and 24% was financed through the public health sector budget, representing nearly 9% of total government health expenditure in the fiscal year 2018-19. The annual productivity loss, due to morbidity and premature mortality from tobacco-related diseases, was estimated to be BDT 221.7 billion. **The total annual economic cost thus amounted to BDT 305.6 billion (\$3.61 billion), equivalent to 1.4 % of the GDP of Bangladesh in 2017-18.**

The total economic contribution of the tobacco sector (in terms of household final consumption expenditure, private and public domestic investment and net export) to the GDP in Bangladesh was estimated at BDT 229.1 in 2016-17 fiscal year in 2018 prices. This is BDT 76.5 billion short of the estimated total cost of tobacco, BDT 305.6 billion. Tobacco thus appears to be causing significant net economic loss to Bangladesh.

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 66.6% and 20.5% of market share respectively.** Smaller domestic companies include Abul Khair Leaf Tobacco, Alpha Tobacco Company, Nasir Gold Tobacco Company, and Sonali Tobacco. **In 2018, 91.6 billion cigarettes were sold in Bangladesh.**

According to Department of Agriculture Extension (DAE), tobacco acreage in Bangladesh is increasing. The main raw material of cigarette is tobacco leaf. The cultivation of tobacco leaves are concentrated main in Rangpur, Kustia and some parts of hill tracks. According to a study conducted by Progga, **some 60 to 65 per cent of the bidi workers are children aged between four and 14 years and low paid.**

Bangladesh is one of the largest tobacco consuming countries in the world. According to Tobacco Free Kids, **35.3% of all adults (age 15+) use any tobacco products (men 46.0%; women 25.2%); 18.0% smoke tobacco (men 36.2%; women 0.8%) and 20.6% of adults use smokeless tobacco (men 16.2%; women 24.8%).** 42.7% of adults who work indoors are exposed to secondhand smoke in the workplace, 49.7% of those who visit restaurants are exposed there, and 44.0% of adults who use public transport are exposed while on it.

The Global Adult Tobacco Survey (GATS) 2017 revealed the social gradient in tobacco use in Bangladesh in which prevalence increases with decreasing socioeconomic status:

24% of those in the highest wealth quintile use tobacco compared to 48% of those in the lowest wealth quintile.

According to WHO, **cardiovascular diseases – heart-related conditions – are the top tobacco-related cause of death in Bangladesh,** killing 66,749 people on average every year – a whopping 41% of all tobacco-related deaths in Bangladesh. Another major reason for premature death in the country, cerebrovascular diseases – conditions that caused insufficient blood supply to the brain – cause 24% of tobacco-related deaths.

Tobacco usage among those aged 15 and above in Bangladesh dropped by 18.5% in the last eight years till 2017, according to the Global Adult Tobacco Survey (GATS). In 2009, over 43% of the country's population aged 15 and above (about 41.3 million) used various smoking and smokeless tobacco products, like cigarette and "Jorda". But it came down to 35.3% (about 37.8 million) in 2017. Some government initiatives -- such as amendment of tobacco law and pictorial health warning on all tobacco packaging and anti-tobacco campaigns by different non-government organisations worked as the key factors behind the decline, it said.

According to GATS, **over 20% of the country's populations currently use smokeless tobacco** -- mostly betel quid (paan) with chewing tobacco and powdered tobacco (gul); 18% use smoking tobacco products, mostly cigarettes and bidi. It also found that tobacco usage among the male population reduced more (20.8 percent) than that of females (12.2 percent). Besides, exposure to second-hand smoke at home and public places -- like markets and restaurants -- and workplace also reduced notably.

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 2020-21, the Government fixed the price of 20 sticks of filter bidi at BDT 19 from existing BDT 17. The budget also increased the price of low segment for every 10 sticks cigarette to BDT 39 and premium segment for every 10 sticks cigarette to BDT 128 higher by 5.4% & 4.1% respectively over last year.

In 2019, the overall legal cigarette industry volume declined by 5% over last year. In fact, the low segment cigarettes continued to register a decline from July 2018 onwards, due to an unprecedented price increase causing consumers to shift to cheaper illicit cigarettes and leading to sharp volume decline across this product category. **In 2019, Government revenue growth from the legal industry was +16% (Jan-Dec 2019) YoY.** Historically, **government revenue from the legitimate cigarette and tobacco industry has been growing at 15-17% per annum,** where the lower segment contributed to the bulk of the revenue.

Investment Positives

- Considering the health-risk and harmful effects of tobacco products, to maintain compliance with global anti-smoking policy and to reduce the use of tobacco, the government in the **national budget for the FY 2020-21 increased the price of cigarettes in the three segments except medium segment. Due to relatively price inelastic nature of the demand of cigarettes, the demand may not diminish to the same proportion to the price hike.** As a result, the

revenue of the Company is expected to witness higher growth driven by government led price hike. Historical changes in prices and supplementary duty are shown in the following table:

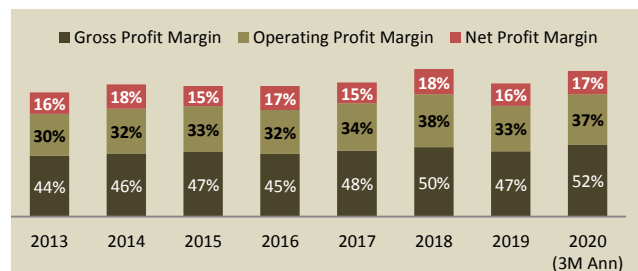
Segment-wise Minimum Price Slab of Cigarette (for 10 sticks) Determined by the Government						
	2016-17	2017-18	2018-19	2019-20	2020-21	5-yr CAGR
Low	23	27	32	37	39	
Growth	28%	17%	19%	16%	5%	16.7%
Medium	45	45	48	63	63	
Growth	15%	0%	7%	31%	0%	10.1%
High	70	70	75	93	97	
Growth	1%	0%	7%	24%	4%	7.1%
Premium	70.0	70.0	101	123	128	
Growth	0%	0%	44%	22%	4%	12.8%

Segment-wise SD Rate of Cigarette Determined by the Government					
	2016-17	2017-18	2018-19	2019-20	2020-21
Low	50%	52%	55%	55%	57%
Medium	60%	62%	65%	65%	65%
High	62%	65%	65%	65%	65%
Premium	64%	65%	65%	65%	65%

Source: Budget Speech of respective years

- Gross revenue of the Company grew by 15.76% in 2019 over last year driven by mix improvement & major price increase by the government in top three segments with effect from July 2019 despite 1.3% decline in volume sales in 2019.** Segment wise performance is given below:
 - The premium segment, Benson & Hedges, **upholds the volume growth** despite price hike by the government by 17% in 2019 over last year (source: annual report 2019).
 - The high segment, **John Player Gold Leaf, has registered 12% volume growth in 2019** over 2018 regardless of government led price hike by 24%.
 - The medium segment, **overall volume growth for STAR has increased in 2019** over last year although 31% prices hike in June 2019.
 - However, **sales of low segment volume witnessed de-growth of 14% due to an unprecedented price increase** causing consumers to shift to cheaper bidi and illicit cigarettes. The government increased 30% price in June 2018 and 6% in June 2019 for the low segment. Meanwhile, **to keep the customers in parallel price range, the Company has introduced new strategic brand Royal at BDT 5.0 per stick in the second half of 2019.**
- BATBC is leading the Bangladesh tobacco market with **66.6% market share** (source: tobaccofreekids.org). The Company displayed exceptional performance over the years despite the external challenges. **The 5-year CAGR (compound annual growth rate) of gross revenue and net revenue was 16.3% & 9.8% respectively.** This was driven by price increase enforced on the legal cigarette industry by the government in the form of VAT, HDSC and Supplementary Duty.
- Profitability of the Company has seen a significant improvement over the years.** This was due to progressive growth of brand mix, productivity savings, establishing an efficient supply chain management and effective cost control measures taken throughout the Country helped the

Company to reduce per unit cost. However, **the margin is expected to improve in the coming quarters as the government kept the duty structures unchanged from previous year against price hike of cigarettes in each segment in the budget for 2020-21.**



- The Company has been **investing a considerable amount as capital expenditure** over the years in the form of purchase of property, plant and equipment (PP&E) to enhance the capacity to support the high volume growth. **The Company's manufacturing capacity has been scaled up** and also modified to cater to the diverse needs and demands for different packs, formats, etc. To mobilize the required investments for meeting the growing demands of this diverse market, a series of productivity initiatives were undertaken to improve machine efficiency over the last couple of years. Historical CAPEX in percentage of property, plant and equipment (PPE) are shown in the following table:

Particulars (BDT bn)	2015	2016	2017	2018	2019	2020 (3M)
PP&E	13.7	15.4	20.9	26.5	29.5	29.3
Growth	14%	13%	36%	27%	12%	-1%
CAPEX	2.7	3.6	8.0	7.0	3.2	0.1
% of PPE	20%	23%	38%	26%	11%	0%
Depreciation	0.9	1.3	1.5	1.3	1.3	--
% of PPE	7%	8%	7%	5%	4%	--

- The Government has withdrawn the 25% export duty on tobacco export in FY 2018-19 which are playing a positive role on the export earnings of the Company. Besides, to increase the revenue mix and ensure diversification, **the Company aims to explore export opportunities for exporting factory made cigarettes in 2020 which will open up the enormous potential of business growth. In 2019, BATB exported 70 mn sticks to China and East Asia with the 'Made in Bangladesh' tag.** The initial response has been quite encouraging and, together with state-of-the-art manufacturing facility and excellent leaf quality, have created an avenue for export of factory-made cigarettes across other potential markets too in 2020. Meanwhile, **the leaf export performance improved significantly, especially in H2'19 fueled by the 10% export duty withdrawal in June.**

Particulars	2015	2016	2017	2018	2019	2020 (3M)*
Leaf tobacco export (BDT bn)	1.9	1.5	2.0	2.2	3.7	0.3
Growth	-23%	-21%	37%	8%	70%	-8%
Contribution to revenue	4.7%	3.4%	3.9%	4.0%	6.5%	1.5%

*Growth for 2020 is calculated for three month than that of last year.

- BATBC had 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

medium grade cigarettes (Pilot and Bristol brand) at lower prices declaring the two brands in lower grade ones. The Company has informed in its annual report of 2019 that **the demand from LTU of NBR has been declared illegal as per the judgment of the Appellate Division of the Supreme Court of Bangladesh.** Therefore, at present, there is no claim against BAT Bangladesh.

Investment Negatives

- In 2019, net profit has declined by 7.65% over last year because of increase in manufacturing and operating expenditure. **Gross margin has dropped to 47.3% in 2019 which was 50.4% in last year as the low segment volumes suffered a significant dip due to the high price increase announced in the 2018 national budget coupled with incremental material cost (led by inflation and higher product costs globally). Cost of sales & operating expenses increased to cater to the improved top segment mix and field force capability enhancement.**
- The government-led price hike impacted the category volumes through the growth of illegal and cheaper cigarettes in the market.** Illegal cigarette brands remain a threat to the growth of the tobacco manufacturing companies in the country. The hike in cigarette prices created the scope to flourish the illegal cigarette trade which has jumped exponentially over the past few years where the legally manufactured cigarettes becoming more expensive, consumers have increasingly shifted to smuggled and cheaper cigarettes or bidi.
- The long-term economic impact due to the global pandemic unleashed by Covid-19 is already thought to have tipped the world into recession. Moreover, due to increased healthcare awareness **the overall tobacco consumption might decrease which would have negative impact on the profitability of the Company.**
- International tobacco manufacturer, Japan Tobacco (JT) Group acquired the tobacco business of Akij Group - the second largest tobacco company in Bangladesh. Akij holds about a 20.5% share of the cigarette market in Bangladesh.** With this acquisition, JT is expected to become a major rival in the local market for other tobacco manufacturers like British American Tobacco.
- Major raw materials for the production of cigarettes are tobacco leaf which is cultivated in the local land. **Raw materials cost accounted for 79% of its total costs of goods sold and cost of tobacco leaf accounted for 33% of total costs of goods sold.** Hence, adversity in weather and/or imposition of any government restriction in the production of tobacco leaf may create problem in the supply of tobacco leaf which might hamper the operations of the Company.
- 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% and is also paying an additional 2.5% surcharge on top of the current tax rate which is squeezing the bottom line of the Company.

Impact of SD & VAT and Income Tax					
Particulars (BDT bn)	2016	2017	2018	2019	2020 (3M)
Gross Turnover	165.6	204.1	233.1	269.9	86.3
SD & VAT	121.9	152.2	178.5	213.0	68.2
SD & VAT in % of Turnover	74%	75%	77%	79%	79%
Pre-tax Profit	13.2	16.8	19.3	17.4	6.3
Income Tax Expense	5.6	8.9	9.3	8.2	3.2
Tax in % of Pre-tax Profit	42%	53%	48%	47%	51%

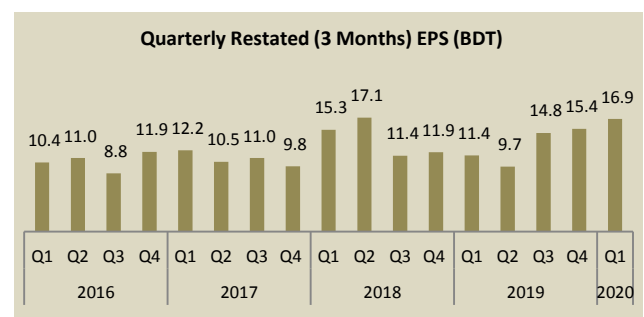
- Bangladesh was the first country to sign the WHO Framework Convention on Tobacco Control (FCTC) in 2003 which is the world's first health treaty against the global tobacco epidemic. Moreover, the Government of Bangladesh (GoB) is committed to a "tobacco-free Bangladesh" by 2040 which should cast negative impact for the cigarette making companies like BATBC.

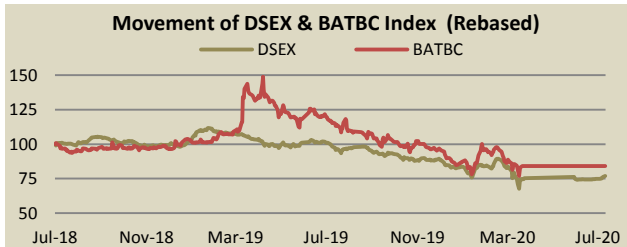
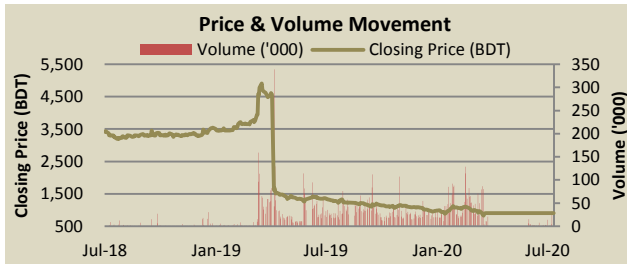
Latest Quarter Update – March 2020 (Q1)

Particulars (BDT mn)	Jan-Mar 2020	Jan-Mar 2019	Growth
Net Turnover*	18,099	12,325	46.8%
Gross Profit	9,415	5,681	65.7%
<i>Margin</i>	<i>52.0%</i>	<i>46.1%</i>	
Operating Profit	6,619	4,437	49.2%
<i>Margin</i>	<i>36.6%</i>	<i>36.0%</i>	
Net Profit	3,037	2,059	47.5%
<i>Margin</i>	<i>16.8%</i>	<i>16.7%</i>	
EPS (BDT)	16.87	11.44	47.5%

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

- Net Revenue has increased by 47% in the first quarter of 2020 over the same period of last year due to the increase in sales quantity of sticks. **The sale of volume of sticks increased by 32.31% to 16.71 bn which was 12.63 bn over the same period of last year.**
- Gross profit margin has jumped to 52% during the reported period which was 46% in the same period of last year due to the **decline in raw and packing materials cost.**
- Operating expenses increased to 15.45% of net turnover during the reported period which was 10.1% over the same period of last year due to cater to **the improved top segment mix and field force capability enhancement.**
- Net profit has increased by 47.5% during the reported period than that of last year due to higher sales volume and increased gross profit margin.





Pricing Based on Relative Valuation:		
	Multiple	Value (BDT)
Sector Forward P/E	14.1	950.6
Sector Trailing P/E	18.0	925.1

Concluding Remark

Despite numerous challenges in the legal cigarette industry of Bangladesh, the Company was able to maintain steady business growth 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, newspaper news, tobaccofreekids and ILSL Research

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