BAT Financial Year Ended 31 December 2017 Analysis

Market Data	
Current Share Price (USc)	**2420**
Fair Price (USc)	**1167**
Recommendation	**SELL**
Shares in Issue	**20,633,517.00**
Market cap(US$)	**499,331,111.40**
Year high (USc)	**4000**
Year Low (USc)	**1499.75**
YTD	**-32.80%**
EPS (USc)	**51**
Total Dividend (USc)	**51**
Dividend Yield	2%
Annual Dividend Payout	100%

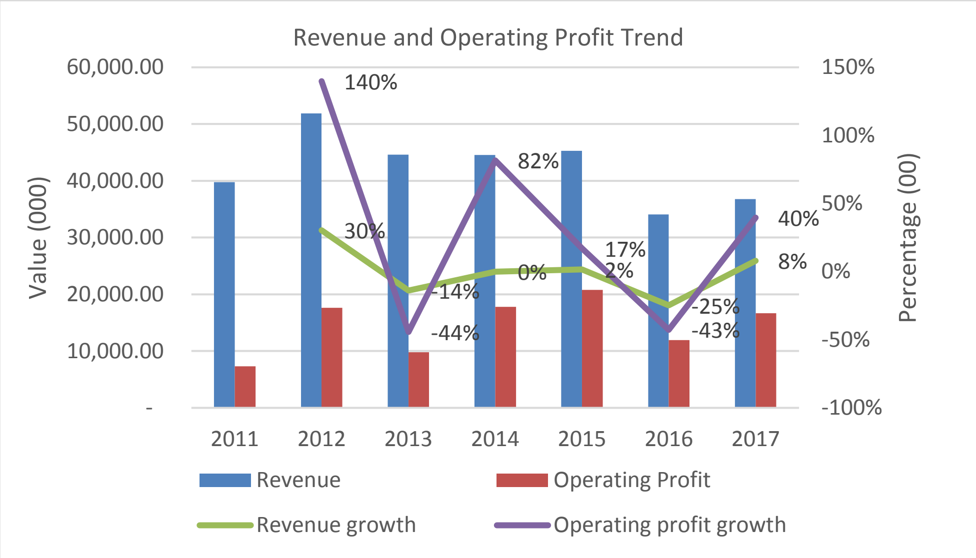
Income Statement	FY2017 '000'	FY 2016 '000'	% Change
Revenue	36,760.00	34,068.00	**7.9%**
Operating profit	16,646.00	11,952.00	**39.3%**
Profit After tax	10,570.00	8,477.00	**24.7%**
Operating margin	45.3%	35.1%	**29.1%**
Net Profit margin	28.8%	24.9%	**15.6%**
Financial Position			
Total Assets	37,912.00	31,707.00	**19.6%**
Total Liabilites	24,326.00	19,257.00	**26.3%**
Attributable Equity	13,586.00	12,450.00	**9.1%**
Cashflows and Ratios			
Cashflows from Operations	13,957.00	13,407.00	**4.1%**
Cashflows from investing	(389.00)	(440.00)	**-11.6%**
ROE	77.80%	68.09%	**14.3%**
Total Asset Turnover	0.97	1.07	**-9.8%**
CFO/Net Profit	1.32	1.58	**-16.5%**
Debt to Total Assets	64%	61%	**5.6%**

BAT Revenues UP 8%, PAT Up 25%

BAT recorded an 8% growth in revenues to $36.8 million driven by a 10% increase in sales volumes. This was mainly a result of a 460% growth in the low valued products in conjunction with a general volume growth across all categories. This performance was quite commendable for the company given the very tough operating environment in 2017 due to the compounded economic challenges that included shortages of foreign currency, cash shortages and a decrease in disposable income. The operating profit growth was much larger at 39% as the company's restructuring costs savings initiatives bore much fruit leading to a 26% decline in administration costs. Contributing to this lower administration cost was also a once off reversal of tax related provisions of about $500 000 which was driven by a reversal of tax related provisions. Operating and net profit margins were stronger at 45% and 29% respectively and ultimately PAT was up by 24.7% to $10.6 million leading to an EPS of 51c.

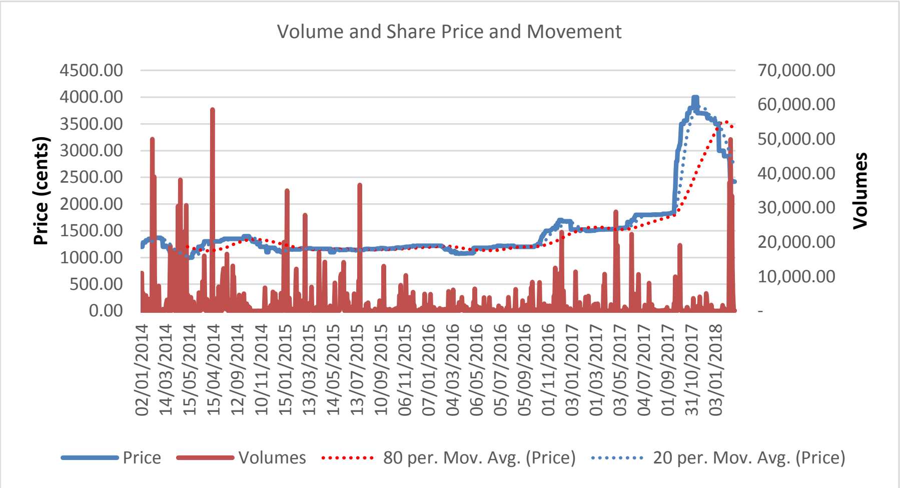
Cash flow from operations recorded 13% increase mostly attributed to growth in net profits and in current liabilities (due to delays in making foreign payments to related parties). Although the CFO/Net Income ratio is still good at 1.3, it came off by 16.5% due to the relatively large growth in Net profit. The asset turnover ratio remained strong at 0.97 but was however affected by a substantial growth in cash balances due to delays in remitting dividend to the shareholder.

ROE continues to grow substantially as the company has maintained a very high dividend payout policy which has been depleting the equity levels. A final dividend of 29 cents per share was declared bringing the total dividend for 2017 to 51cents and a total payout ratio of 100%.



The graph above indicates an overall negative trend in revenue and profit trends with the years 2013 and 2016 having the worst performance post dollarization. Since 2011, Revenue has recorded a Compounded Average Growth rate (mean average growth) of -1.3% whilst Operating profit has recorded a CAGR of 14.6% which is quite commendable given the depressed operating environment and low disposable incomes.

Technical Analysis



The graph indicates that between 2014 and 2016, the BAT share was basically in the range of $10 and $14 before it took a sharp price hike in 2017 to reach an all-time high of $40 which was then followed by sharp decline to the current levels. Since then, the counter has taken a downward turn and the short term moving average is trending below the long term moving average, an indication of a downward trend. In light of this, the counter may be seen to continue to soften in line with the general market correction in prices.

Investment case

- The company has been paying a regular dividend to its shareholders on both an interim and full year basis. The company has one of the highest payouts on the ZSE as has been observed in its latest results where total dividend payout is 100%.
- BAT is the leading cigarette manufacturer and distributor in the country and commands a market share of about 80%.
- Through its sizeable expenditure in marketing efforts, the company has managed to achieve a commendable volumes growth across all its brands. In addition, its savings initiatives during the year led to an even larger growth in profits. Given such a good performance under the current depressed conditions, the outlook of the company is therefore quite strong under an improved economic climate that is expected in the near future given the new political dispensation.
- It has a very wide product range that appreciates the eclectic diversity in its consumers. Its low valued range has been very key to overall performance in the prevailing environment where disposable incomes are quite depressed.
- Their product have a relatively high inelastic demand.
- The changing Indigenization law is likely to be beneficial to the company through reducing expenditures towards the Tobbacco Empowerment Trust programmes which were initiated to comply with the Indigenization laws.
- The counter is tightly vey held. This factor has been very key in keeping the price of the stock at prices that largely defy its fundamentals.

Investment Concerns

- The country's porous borders have led to a rampant smuggling and trading of illicit cigarettes thereby posing a threat to formal traders such as BAT as these cigarettes are sold at predatory prices.
- The very high dividend payout ratios, 121% in 2015, 124% in 2016 and 100% in 2017 that have been eating into the company's retained earnings are an indicator that the company currently has very limited investment opportunities.
- The significant increase in trade payables indicates that the company continues to face challenges in making payments to its foreign suppliers. This could affect future supply of key raw materials and possibly increase cost of sales.

Valuation and Recommendation

The operating environment is expected to remain challenging for the business particularly due to the foreign currency shortages that have affected general economic activity and disposable incomes. Inspite of these challenges, the company's dedication to remain focused on growing its market coverage and effective cost management enabled it to have a rapid turnaround from the poor performance in 2016 to a commendable one in 2017. Going forward, the company is expected to remain focused on these key pillars and given the change in the political climate, the future poses very bright prospects for market leaders like BAT who are well positioned to benefit from growth in economic activity. In our valuation, we gave a greater weight to the Dividend Discount Growth model as the company has a very predictable dividend payout policy. With the use of multiple growth rate stages in dividend this method indicates a fair value of $11.32. The Relative valuation method was also used by comparing BAT's current TTM P/E of 47x against a close peer TTM P/E of 30x (adjusted upwards to reflect BAT Zimbabwe's stronger relative growth in EPS over the past 5 years). Both methods indicate that BAT is currently gross overvalued and indicate a weighted fairvalue of $11.67 cents per share which is 52% lower than the current trading price. We therefore give a SELL recommendation.