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## 'A year of hard work' for BAT Malaysia

BY ESTHER LEE

Few can argue that Erik Stoel has assumed the leadership role at British American Tobacco (M) Bhd during one of its most challenging periods in Malaysia.

"It has definitely been a roller-coaster ride," the managing director remarks when asked to describe his experience over the past 1½ years.

Stoel took the helm about seven months after tobacco products were slapped with a whopping 36% excise duty hike in November 2015.

Indeed, since 2015, BAT's annual revenue has shrunk significantly while net profits have almost halved. Billions in market capitalisation have been wiped out to the extent that it was relegated to the FTSE Bursa Malaysia Mid 70 Index from the FBM KLCI last December. It even had to bite the bullet and shut down its manufacturing plant in Petaling Jaya, Selangor, about a year ago.

Net profits will continue to be under pressure if there is no structural shift in dealing with the illegal market, Stoel admits in an exclusive interview with *The Edge*.

"You can see it already in [the results of] 1QFY2018. If everything stays as it is, the market will remain under pressure. Illegal trade is still increasing from a year ago. We have done a reorganisation and [achieved] the right efficiencies, and now, it really comes down to revenue, which is directly related to the volume we sell.

"We believe that over time, one way or another, we will have to find a solution with the government. But [before that happens], the numbers may continue to be under pressure," he says.

### Illegal market biggest problem

Clearly, the illegal market poses the biggest problem to the tobacco industry, as the illicit trade in Malaysia is the highest in the world, commanding a staggering 63% of total market volume.

For the first quarter ended March 31 this year, BAT's revenue declined 14.8% to RM638 million from a year ago while net profit slipped 16.1% to RM95.84 million.

BAT has attempted to halt the slide and, according to Stoel, has transformed in recent times from a company that was dependent on its premium Dunhill brand to having a portfolio that is more balanced.

It has done a lot of work on Peter Stuyvesant, its most resilient brand in the aspirational segment. BAT also introduced the value-for-money (VFM) brand Rothmans to help strengthen its portfolio and reduce incidences of downtrading to illegal competitors.



Stoel: We're competing with illegal products that are three times cheaper

### 5-year financial performance

	2013	2014	2015	2016	2017
Revenue (RM mil)	4,517.2	4,796.0	4,581.5	3,756.4	3,002.3
Operating income (RM mil)	1,125.3	1,233.9	1,241.0	820.7	658.5
Net profit (RM mil)	823.4	902.0	910.1	721.3	492.6
EPS (sen)	288	316	319	228	176
ROE (%)	165.81	174.73	169.98	124.36	98.97
Dividend payout ratio (%)	97.78	97.81	97.89	110.05	124.61

"Everything needs to be looked at because the value equation has changed. We're competing with illegal products that are three times cheaper," says the Dutchman.

Despite the challenging landscape, BAT's premium Dunhill brand managed to increase its legal market share by 0.7% year on year to 38.2% in 1Q2018. Meanwhile, Rothmans, which BAT ventured into in 4Q2017, lifted BAT's VFM market share by 1.2 percentage points quarter on quarter to 3% in 1Q2018.

While the company can work on being ahead of the competition in the legal market and improving efficiencies to combat the pressure on earnings, it is finding it difficult to offset the external pressure working against it.

"It will be a year of hard work for us. For what we can control, we will do everything. We have done a lot in that respect. But a big focus is on finding ways to consult and

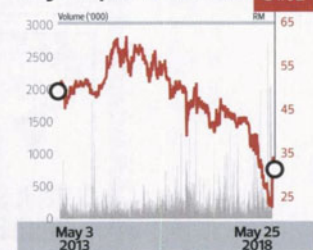
cooperate with the government to improve enforcement as well as the more radical proposals that can increase affordability [of tobacco products]," says Stoel, who has spent more than 20 years in the BAT group and has worked in nine different markets around the world.

Malaysia is on his list of top three most challenging markets.

There are two challenges, he says. The first has to do with the reorganisation and rebuilding of the company while the second is the illegal market — a problem that cannot be directly solved.

"That makes it tough and frustrating. You know a lot of ways to solve it but ultimately, you need people to work with you to get it done. The interesting thing is that a lot of things that we work on can have positive benefits for the country but everybody needs to move in the same direction," Stoel remarks.

### BAT Malaysia 5-year performance



### Affordability a major issue

With the government's recent move to "zerorise" the Goods and Services Tax (GST), some think it could result in an uptick in sales for the cigarette company.

Assuming that the new Sales and Services Tax that has yet to be announced does not drive prices up, Stoel says overall consumer sentiment could improve and influence consumption patterns.

However, there is a big problem with affordability.

Subtracting the 6% GST, a packet of Dunhill cigarettes would cost close to RM11 less than the current price of RM17. But the price gap between illegal and legal cigarettes is still a massive RM11.

"The gap is still too big and that's exactly why, if we can, we would like to sit down with the government and talk about more structural issues. Affordability is a clear agenda of the government and I think we should work closely together to see if we can find alternative means to address affordability and in one go, take a big chunk out of the illegal trade," stresses Stoel.

To improve the affordability of cigarettes, BAT has advocated "kiddy packs", or small packs, as it believes the move would also help stem the high level of illegal cigarette trade. BAT intends to continue pushing for small packs as it sees it as a quick fix or at least a step forward in addressing the structural issue of the illegal market.

In addition, it is hoping to work with the new government which, in its election manifesto, promised to tackle the illegal trade.

"It is an interesting topic. You can fix this but it requires a certain amount of effort and integration and it requires some big decisions," says Stoel.

BAT's dividend yield is at an attractive 5.19%, based on last Friday's close of RM31.62. The company has been consistently paying out more than 90% of its earnings in dividends.