

# BAT Malaysia managing director has work cut out

Stabilising the company and bringing it back to growth are Stoel's top priorities this year

BY KANG SIEW LI

KUALA LUMPUR: Erik Stoel on June 1, 2016 replaced Stefano Clini as managing director of British American Tobacco (M) Bhd (BAT Malaysia), marking his return to the country after stepping down as sales and marketing director of the company five years ago.

His appointment came at a difficult time for the company when the tobacco industry was still reeling from the steep excise increase in November 2015. Almost one year in, Stoel's job isn't getting easier.

Except for the fourth quarter ended Dec 31, 2016 (4QFY16), the company has been witnessing a consistent decline in net profit since 1QFY16. Its net profit for 1QFY17 continued to fall by 33.8% to RM114.23 million from RM172.61 million a year ago on lower sales volume.

Since June 2016, BAT Malaysia has lost RM1.16 billion in market capitalisation.

While maintaining its market leadership as a premium brand, BAT Malaysia's Dunhill brand also saw its market share fall 3.9% to 42.2% last year due to down-trading by smokers to cheaper or sometimes illegal alternatives.

Rising illegal cigarette trade has been blamed for the overall decline. According to Stoel, BAT Malaysia's biggest competitor is actually the illegal cigarette industry, and not rivals Japan Tobacco International and Philip Morris International.

"The illegal cigarette industry is bigger than the three legal players in Malaysia combined, and they (illegal tobacco players) absolutely do not play by

any rules or within the laws. They are ruthless in pricing, with their brands selling for RM3.50 to RM5 per 20-stick pack compared with legal cigarettes which are priced at RM12 to RM17, below the minimum price regulation of RM10," Stoel told *The Edge Financial Daily* in an email interview.

"[For] every pack we sell, we contribute approximately RM8 to the government budget, and clearly they (illegal tobacco players) do not.

"They do not comply with any marketing restriction and, worse still, the products are unregulated. Our products, on the other hand, have to comply with tar and nicotine levels imposed by the ministry of health. In short, any new legislative restriction for the legal industry is another home run for the cigarette black market," he said.

The country's three major tobacco players have pointed to the "shock" excise duty increase on tobacco in 2015 in causing illegal cigarette trade to jump from 36.9% in 2015 to 57.1% in December 2016, based on a latest study conducted by Nielsen Malaysia.

**Stoel:** We pride ourselves on the fact that our strong insights into Malaysian consumers have always allowed us to deliver leading high-quality brands to our discerning consumers.



"It was thus a relief that Second Finance Minister Datuk Seri Johari Abdul Ghani clarified that the government is not looking to increase cigarette taxes at this point in time and

Stoel said there are clear indications that it still continues to grow.

"We all know how stretched the purses of Malaysians currently are, and this means that many consumers have opted for illegal alternatives that are three to four times cheaper than legal cigarettes and which are easily available everywhere," he said.

News of a proposal by Deputy Health Minister Datuk Seri Dr Hilmi Yahaya to increase cigarette prices to RM21.50 per 20-stick pack caused an unpleasant surprise to BAT Malaysia recently.

"The fall in our share price given all the news about increasing cigarette prices to RM21.50 caused a clear concern among our shareholders and investors, and as a result, we saw the value of their shares take a huge dip," said Stoel.

actually smoking since they are completely unregulated.

**TEFD:** How different is the Malaysian tobacco market from the markets that you have worked in?

**Stoel:** I have worked in nine different countries over my 22 years for BAT. Each market is unique. South Korea, my previous assignment, for example, was extremely challenging in terms of competition, because consumers continuously want to try new things and therefore expect innovation all the time. Every month, you would witness about five or more competitive

that the government will focus on curbing the illegal industry. Luckily for us and our shareholders, this helped to address that concern and recover part of the loss in share price," he noted.

"Simplistic proposals like that which choose to ignore the reality of the big cigarette black market can be very detrimental not just to revenue collection, but also to health goals," said Stoel, adding that more than half the cigarettes consumed in Malaysia are illegal.

"More often than not, it has been said that the legal industry cites high levels of illegal cigarette trade in order to avoid excise increases or further regulations. But the reality is illegal cigarette trade by whatever measurements we choose to use is undeniably very high, alive, lucrative and damaging for everyone!" Stoel added.

On his outlook for the legal tobacco industry in 2017, Stoel said it is very much dependent on a prudent excise policy by the government, coupled with making the fight against illegal cigarette trade a national agenda.

"This is the only way to recover and stabilise government revenues and the legal industry. There must be relentless enforcement from all agencies at all touchpoints — from [the] point of smuggling entries to point of sales.

"It is common sense to point out that the greater the price gap, the greater the catalyst for black market growth. [Thus,] the more the legal industry is regulated, the more the black market benefits," he added.

"If illicit trade is halved, we believe that it will have a positive impact on the financial performance of all legal players in the industry, including BAT Malaysia," said Stoel, without discussing product launches, and therefore, there was no such thing as "business as usual". While the intensity of this was very tough to manage, at least it was a fair battle, as everybody was selling at competitive prices, working within the same regulatory framework and I hardly had to worry about any cigarette trade operating outside the rules. Illegal cigarettes in South Korea are almost non-existent.

In Malaysia, it is entirely different because our biggest competitor is actually the illegal cigarette industry, bigger than the three legal players in Malaysia combined, and they absolutely

closing the company's earnings estimates for FY17.

On its part, BAT Malaysia has its work cut out to stabilise the company's business and go back to growth this year.

"To do this, firstly, we need to focus on volume or share growth. We are today the No 1 in the legal market, but we need to further improve on our competitive position among all consumers.

"We will further strengthen our brand portfolio. We pride ourselves on the fact that our strong insights into Malaysian consumers have always allowed us to deliver leading high-quality brands to our discerning consumers. Particularly now, it is important that we move forward and continue to invest in our brands and execution in the field," said Stoel.

The company will also continue to improve its operating model to make it a sustainable and competitive one. For one, it started winding down its manufacturing facility in Petaling Jaya last year, which saw 230 employees affected.

"This size of transformation at first glance never sounds like a positive thing, so we have our work cut out in 2017 to make it a journey that counts. We owe it to the people we had to let go in 2016. We transform for a better tomorrow and not just for the sake of it or to cut costs like many alluded to — it is for future business sustainability," said Stoel.

While macroeconomic factors play a part in affecting the business as they impact consumer purchasing behaviour, Stoel said what the company can do is to continue to focus on understanding consumer needs and providing them with a diverse range of quality products to meet their demands.

## Excerpts from The Edge Financial Daily's email interview with Stoel

**TEFD:** After almost a year at the helm of BAT Malaysia, how has it been?

**Stoel:** My return in 2016 was to an environment where the industry was still reeling from the steep excise increase in November 2015. We saw a legal market volume contraction of 25.7% in 2016 versus the previous year, resulting in a 27.8% decline in the group's domestic volume and an 18% reduction in total revenue for 2016. In the case of BAT Malaysia, these numbers were public as it is a public listed company, but other tobacco companies shared a similar fate. These are very sombre results

that clearly require a good plan and hard work to turn it around.

So, yes, there are a few big issues that are not easy to crack and actually require all parties involved to work together because simply said, everybody is losing — the government loses excise revenues, the health agenda of reducing consumption will not materialise, the legal industry loses legal volumes and business is impacted. Additionally for BAT Malaysia, we are forced to restructure our business and consumers because they are exposed to illegal products which are very cheap and affordable, but who knows what they are

do not play by any rules or within the laws.

**TEFD:** How has the decline in the ringgit affected the group?

**Stoel:** The impact on the company from the ringgit's decline is not material as our foreign currency exposure mainly comes from purchases of raw materials in hard currency that is naturally hedged against proceeds from contract manufacturing exports.

Going forward, post closure of our manufacturing facility, we also do not foresee any significant impact.