



# CEYLON TOBACCO COMPANY PLC [CTC.N0000]

**MAINTAIN BUY**

## SMOKING PROFITS!!!

**Fair Value: 2019E - LKR 1,525.0 [+36%], 2020E - LKR 1,600 [+43%]**

Total Return with DPS: 2019E - 40% [AER 906%], 2020E - 52% [AER 44%]

CTC records a profit of LKR 4.5Bn, up by 24%YoY for 3Q2019 on the back of a revenue growth of 7% despite a volume drop of 11%YoY. The volume drop in cigarettes is attributable to the higher excise duties. Despite the increase in prices invariably affecting volumes, revenue has picked up with consumers adjusting to the price increases at a faster pace due to the inelastic demand for cigarettes. Earnings for the 3Q2019 was in line with our expectation, thereby, we maintain our earnings target for 2019E and 2020E to LKR 18.5Bn and LKR 19.8Bn, respectively. Furthermore, we maintain our TP for 2019E at LKR 1,525 and rollover the valuation to 2020E with a target price of LKR 1,600 with an annualized return of 44%. **MAINTAIN BUY**

LKR (Mn)	3Q2018	3Q2019	YoY	9M2018	9M2019	YoY
<b>Earnings (LKR 'Mn)</b>						
Gross Revenue	33,062	35,267	+7%	107,487	105,763	-2%
Net Revenue	7,556	8,963	+19%	24,260	25,840	+7%
EBIT	5,838	7,125	+22%	18,553	20,667	+11%
PBT	6,293	7,539	+20%	19,751	21,943	+11%
Net Profit	3,646	4,512	+24%	11,739	13,257	+13%
<b>Balance Sheet (LKR 'Mn)</b>						
Shareholder's Equity	5,359	8,310	+55%	5,359	8,310	+55%
Cash & Cash equivalents	20,153	21,294	+6%	20,153	21,294	+6%
NAVPS	28.6	44.4		28.6	44.4	

### Net revenue up by 19%YoY, margins improve

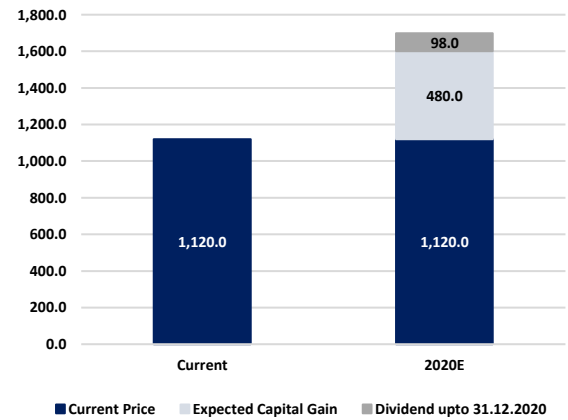
Gross revenue was up by 7%YoY, with the price increase far greater than the tax increase coupled with consumers adjusting to price hikes at a much rapid pace due to the inelastic nature of cigarettes. The higher excise duty was offset by the increase in margins which resulted in a 19% growth in Net revenue. In line with price hikes improving margins, Net revenue/Gross revenue margin for 3Q2019 improves to 25% compared to 23% recorded in the previous comparative quarter. However, on a conservative note we maintain our Gross revenue/Net revenue margin for 2019E and 2020E both at 23%, due to price hikes typically occurring twice a year and has an instantaneous impact resulting in volume degrowth. We maintain our targeted volume drop of 8%YoY as volumes have significantly declined compared to 2018 due to increased prices coupled with sluggish market conditions ensuing lower disposable income.

### EBIT margin improves during 3Q2019

In spite of operating expenses increasing by 7%YoY, EBIT margin improved to 80% on the back of net revenue growth amounting to 19%YoY. The raw material cost for 3Q2019 fell by 9%YoY to record at LKR 547Mn. Notably, raw material cost primarily wrapping materials used to be significantly impacted by exchange rate devaluation, however, with 100% local leaf usage the raw material cost for 9M2019 has dipped by 22%. The increase in other operating expenses by 11%YoY to record at LKR 910Mn is attributable to the increase in constructive liabilities and obligations on behalf of key business partners (such as auditors, legal, technical and advisory fees etc.) in the value chain. First Capital Research targets an EBIT margin of 79% for both 2019E and 2020E.

### TP for 2020E at LKR 1,600 – MAINTAIN BUY

We maintain our earnings target and rollover valuation to 2020E with a TP of LKR 1,600 with a total return of 52% (including a dividend yield of 9%). We expect CTC earnings to grow at a CAGR of c.8% for 2018-2021E. **MAINTAIN BUY**



### FIRST CAPITAL RESEARCH

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### KEY DATA

CSE Ticker	CTC.N0000
Bloomberg Ticker	CTC SL
Share Price (LKR)	1,120.0
52w High (LKR)	1,496.7
52w Low (LKR)	1,050.0
Avg. Daily Volume (Shares)	5,658
Avg. Daily Turnover (LKR)	6,819,491
Issued Share Capital (Shares 'Mn)	187.32
Market Cap (LKR 'Mn)	209,803
Market Cap (USD 'Mn)	1,166

\*1 USD = LKR 180

Price Performance (%)	1 mth	3 mths	12mths
CTC	7%	-14%	-20%
ASPI	4%	0%	0%

### Price movement of CTC vs ASPI and past recommendations



Source: CSE

#### Minimum Return for BUY:

**Buy Below [AER of 16% with DPS]: LKR 1,430.0**

CTC categorized as 'Grade B' counter (Refer page 10 for Recommendation criteria of Grade A, B & C Stocks)

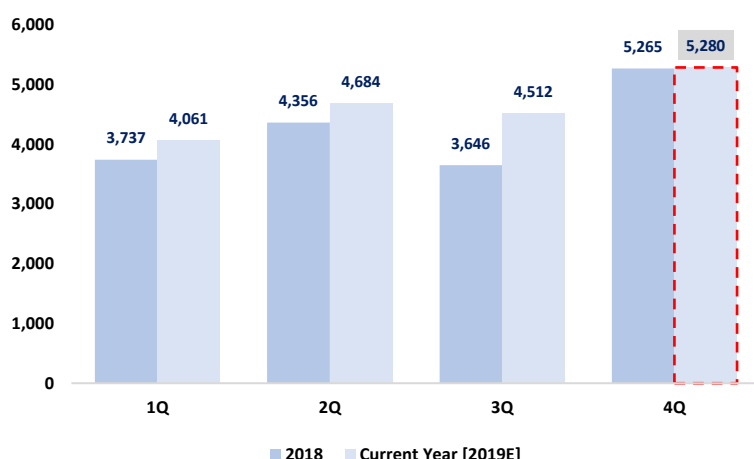
#### Disclosure on Shareholding:

First Capital Group does not hold shares in CTC and will not trade in this share for three trading days following the issue of this document.

CTC Product Portfolio of Key Brands [LKR per stick]												
Brands	2012		2013		2014	2015	2016		2017	2018	2019	
	Apr	Oct	Apr	Jun	Oct	Oct	Jan	Oct	Nov	Aug	Mar	Oct
Lower end												
Capstan	8	9	9	10	10	10	11	20	20	20	20	20
Low Priced - Mid range												
Navy Cut	-	-	-	-	-	-	-	-	-	40	45	55
Bristol	-	-	-	20	20	20	22	22	33	40	45	55
High Priced - Mid range												
John Player Gold Leaf	23	25	25	28	30	33	35	42	50	55	65	65
Premium												
Dunhill Switch	26	28	30	34	35	37	40	45	55	60	70	70
Dunhill Light	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	55	70	70

Source: CTC and First Capital Research  
 \*\*subsequent to price hike in Oct 2019

## Quarterly Earnings Forecast for 2019E



## Estimate Revision

In LKR Mn	2019E - O	2019E - R	% Change	2020E - O	2020E - R	% Change
<b>Earnings Estimate</b>						
Gross Revenue	165,291	165,291	0%	178,770	178,771	0%
Net Revenue	37,629	37,629	0%	40,552	40,552	0%
EBIT	29,795	29,838	+0%	31,982	31,982	+0%
Profit before Tax	31,376	31,419	+0%	33,562	33,563	+0%
Net Profit	18,512	18,537	+0%	19,802	19,802	+0%
Adjusted EPS	98.8	99.0		105.7	105.7	
Growth YoY	9%	9%		7%	7%	
<b>Balance Sheet Estimate</b>						
Shareholders' Equity	6,285	6,286	+0%	7,275	7,276	+0%
Cash & Cash equivalents	21,559	21,483	-0%	23,126	23,127	+0%
<b>Adjusted NAVPS</b>	<b>33.6</b>	<b>33.6</b>		<b>38.8</b>	<b>38.8</b>	
<b>Ratio Estimate</b>						
<b>ROE (%)</b>	<b>295%</b>	<b>295%</b>		<b>272%</b>	<b>272%</b>	
<b>PER (x)</b>	<b>13.2</b>	<b>11.3</b>		<b>12.3</b>	<b>10.6</b>	
<b>PBV (x)</b>	<b>38.7</b>	<b>33.4</b>		<b>33.5</b>	<b>28.8</b>	

## Valuation Table

P/E 31 December	2015	2016	2017	2018	2019E	2020E	2021E
<b>Estimates (LKR 'Mn)</b>							
Net Revenue	26,099	31,748	31,653	32,930	37,629	40,552	44,348
Operating profit	17,517	20,369	23,066	25,903	29,838	31,982	35,068
<b>Net Profit</b>	<b>10,634</b>	<b>12,559</b>	<b>14,586</b>	<b>17,004</b>	<b>18,537</b>	<b>19,802</b>	<b>21,623</b>
EPS (LKR)	56.8	67.1	77.9	90.8	99.0	105.7	115.4
YoY Growth (%)	23%	18%	16%	17%	9%	7%	9%
<b>Valuations</b>							
PER (x)	19.7x	16.7x	14.4x	12.3x	11.3x	10.6x	9.7x
PBV (x)	72.7x	60.2x	45.9x	39.1x	33.4x	28.8x	25.1x
DY (%)	3.6%	5.1%	6.0%	7.4%	5.8%	8.8%	9.5%

## Valuation Summary

Expected CTC price for 2020E	
PER based target price	1,586
DCF Valuation based target price	1,613
<b>Average Target Price</b>	<b>1,599</b>
<b>Target price after Rounding off</b>	<b>1,600</b>

Return	
Target Price	1,600
Current Price	1,120
Capital Gain (LKR)	480
Dividend (LKR) 2020E	98
*Adjusted dividend for 2020E	
Capital Gain %	43%
Dividend Yield %	9%
<b>Total Return %</b>	<b>52%</b>
Annualized Return %	44%

## Discounted Cash flow Valuation

DCF based Valuation	
Enterprise Value	282,043
(-) Debt	-
(+) Cash	20,153
<b>Total Value of Equity</b>	<b>302,196</b>
No. of shares	187
<b>Target Price</b>	<b>1,613</b>

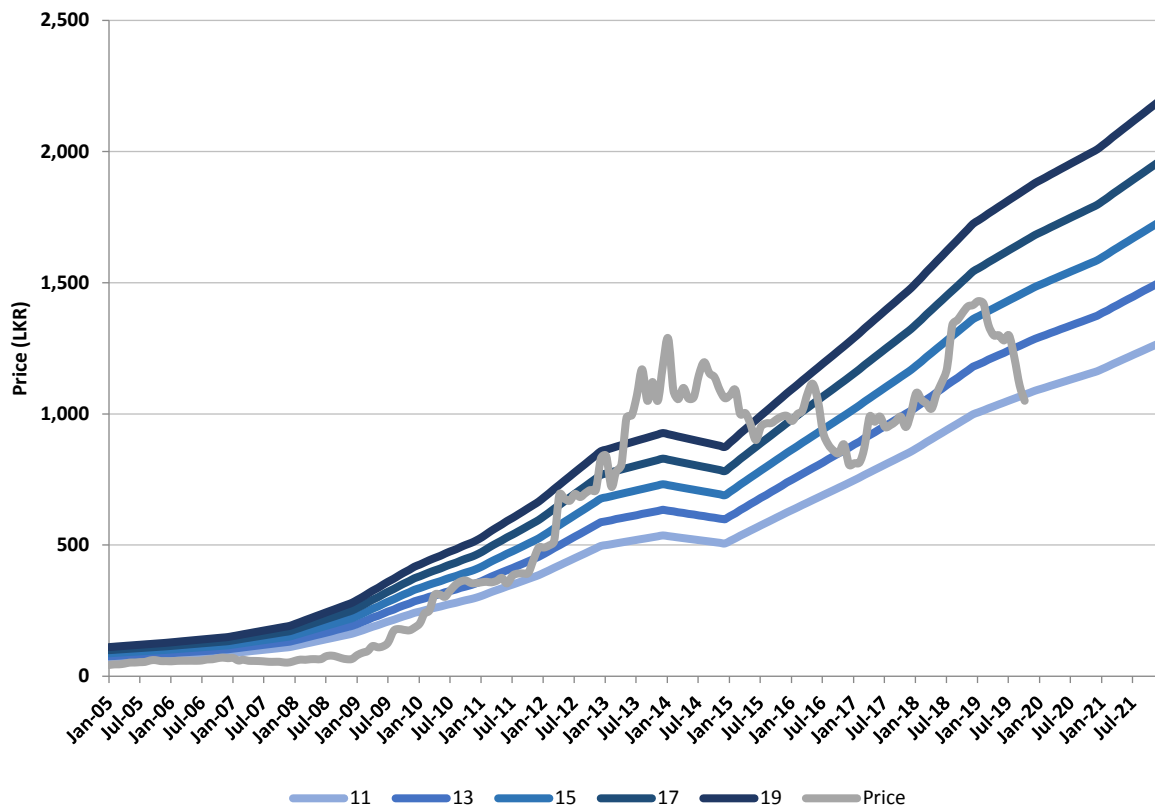
WACC	
Ke	15%
Kd	6%
D/E Assumption	40/60
Terminal Growth (%)	3.0%
<b>WACC</b>	<b>11%</b>

COE	
Rf	8.4%
Rm	16.4%
Growth %	3.0%
$\beta$	0.82
$K_e = R_f + \beta(R_m - R_f)$	15%

## PER Valuation

PER based Valuation	
2020E Earnings (LKR 'Mn)	19,802
No. of Shares ('Mn)	187
<b>2020E EPS</b>	<b>105.7</b>
Expected PER	15x
<b>Price at 15x 2020E Earnings</b>	<b>1,586</b>

PER Chart



Source : CSE, Company Annual Reports, First Capital Research Estimates

## Appendix I: Statement of Income and Expenses

Income Statement (LKR Mn) Y/E 31st December	2015	2016	2017	2018	2019E	2020E	2021E
<b>Gross Revenue</b>	<b>106,491</b>	<b>121,525</b>	<b>139,041</b>	<b>145,298</b>	<b>165,291</b>	<b>178,771</b>	<b>193,416</b>
Government Levies	-80,391	-89,777	-107,387	-112,368	-127,663	-138,219	-149,068
<b>Net Revenue</b>	<b>26,099</b>	<b>31,748</b>	<b>31,653</b>	<b>32,930</b>	<b>37,629</b>	<b>40,552</b>	<b>44,348</b>
Other operating income	23	24	48	81	56	61	67
Raw materials	-2,977	-3,274	-2,676	-2,592	-2,456	-2,452	-2,403
Employee benefits	-1,418	-1,401	-1,293	-1,454	-1,512	-1,573	-1,636
Depreciation and amortization	-214	-218	-237	-172	-213	-230	-248
Other operating expenses	-3,996	-6,510	-4,429	-2,890	-3,666	-4,376	-5,061
<b>Operating profit</b>	<b>17,517</b>	<b>20,369</b>	<b>23,066</b>	<b>25,903</b>	<b>29,838</b>	<b>31,982</b>	<b>35,068</b>
Net interest income	561	850	1,504	1,573	1,581	1,581	1,581
<b>Profit Before Taxation</b>	<b>18,078</b>	<b>21,219</b>	<b>24,571</b>	<b>27,476</b>	<b>31,419</b>	<b>33,563</b>	<b>36,648</b>
Income Tax	-7,444	-8,660	-9,984	-10,472	-12,882	-13,761	-15,026
<b>Profit for the Year</b>	<b>10,634</b>	<b>12,559</b>	<b>14,586</b>	<b>17,004</b>	<b>18,537</b>	<b>19,802</b>	<b>21,623</b>
<b>EPS</b>	<b>56.8</b>	<b>67.1</b>	<b>77.9</b>	<b>90.8</b>	<b>99.0</b>	<b>105.7</b>	<b>115.4</b>

Source : Company Annual Reports, First Capital Research Estimates

**Appendix II: Statement of Financial Position**

Balance Sheet (LKR Mn)	2015	2016	2017	2018	2019E	2020E	2021E
<b>As at 31st December</b>							
<b>Non-Current Assets</b>							
Property plant and equipment	2,063	2,269	2,258	3,082	3,423	3,746	4,049
Intangible assets	9	1	0	0	0	1	1
Net surplus assets on retirement benefit plan	531	652	673	276	276	276	276
Receivables	138	142	126	122	122	122	122
	<b>2,742</b>	<b>3,064</b>	<b>3,057</b>	<b>3,480</b>	<b>3,821</b>	<b>4,144</b>	<b>4,448</b>
<b>Current Assets</b>							
Inventories	3,532	2,068	2,589	2,334	2,655	2,872	3,107
Trade & other receivables	1,020	2,372	1,747	2,242	2,551	2,759	2,984
Cash & cash equivalents	11,378	15,050	17,424	20,153	21,483	23,127	24,720
<b>Total Assets</b>	<b>18,672</b>	<b>22,555</b>	<b>24,817</b>	<b>28,209</b>	<b>30,510</b>	<b>32,902</b>	<b>35,260</b>
<b>Equity and Liabilities</b>							
<b>Equity</b>							
Stated capital	1,873	1,873	1,873	1,873	1,873	1,873	1,873
Retained earnings	1,012	1,612	2,697	3,486	4,413	5,403	6,484
<b>Total equity</b>	<b>2,885</b>	<b>3,485</b>	<b>4,570</b>	<b>5,359</b>	<b>6,286</b>	<b>7,276</b>	<b>8,357</b>
<b>Non-Current Liabilities</b>							
Unfunded retirement benefit obligations		1	1	1	1	1	1
Deferred tax	408	447	507	563	563	563	563
	<b>408</b>	<b>448</b>	<b>508</b>	<b>563</b>	<b>563</b>	<b>563</b>	<b>563</b>
<b>Current Liabilities</b>							
Trade & other payables	10,374	11,992	12,355	12,638	14,011	15,414	16,691
Current tax Liabilities	3,872	4,094	3,896	5,550	5,550	5,550	5,550
Dividends payable	937	2,342	3,278	3,814	3,814	3,814	3,814
Unclaimed dividends	195	194	210	285	285	285	285
	<b>15,378</b>	<b>18,622</b>	<b>19,739</b>	<b>22,287</b>	<b>23,660</b>	<b>25,063</b>	<b>26,340</b>
<b>Total Liabilities</b>	<b>15,786</b>	<b>19,070</b>	<b>20,247</b>	<b>22,850</b>	<b>24,223</b>	<b>25,626</b>	<b>26,903</b>
<b>Total Equity &amp; Liabilities</b>	<b>18,672</b>	<b>22,555</b>	<b>24,817</b>	<b>28,209</b>	<b>30,510</b>	<b>32,902</b>	<b>35,260</b>
<b>NAVPS</b>	<b>15.4</b>	<b>18.6</b>	<b>24.4</b>	<b>28.6</b>	<b>33.6</b>	<b>38.8</b>	<b>44.6</b>

Source : Company Annual Reports, First Capital Research Estimates

**Appendix III: Statement of Cash flow**

<b>Cashflow Statement (LKR Mn)</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>
<b>Y/E 31st December</b>							
<b>Cash Flow from Operating Activities</b>							
Profit before tax	18,078	21,219	24,571	27,476	31,419	33,563	36,648
Adjustments for:							
Depreciation & amortization expenses	214	218	237	172	213	230	248
Net interest Income	-561	-850	-1,504	-1,573	-1,581	-1,581	-1,581
<b>Operating profit before working capital changes</b>	<b>17,702</b>	<b>20,571</b>	<b>23,283</b>	<b>26,062</b>	<b>30,051</b>	<b>32,212</b>	<b>35,315</b>
Increase/(Decrease) in Inventories	-467	1,465	-526	252	-321	-217	-235
Increase/(Decrease) in Trade & Other Receivables	-75	-1,356	619	-506	-309	-208	-226
Increase/(Decrease) in Trade & Other Payables	3,250	1,618	361	297	1,373	1,402	1,277
<b>Net Change in Working Capital</b>	<b>2,708</b>	<b>1,726</b>	<b>455</b>	<b>43</b>	<b>744</b>	<b>978</b>	<b>816</b>
<b>Operating Activities</b>							
Cash generated from operations	20,410	22,297	23,738	26,105	30,795	33,190	36,131
Income taxes paid	-6,638	-8,381	-10,121	-8,778	-12,882	-13,761	-15,026
<b>Net Cash Generated from Operating Activities</b>	<b>9,962</b>	<b>13,916</b>	<b>13,616</b>	<b>17,777</b>	<b>17,913</b>	<b>19,429</b>	<b>21,105</b>
<b>Investing Activities</b>							
Purchase of PPE	-563	-420	-226	-996	-551	-551	-549
Interest received	561	823	1,504	1,573	1,581	1,581	1,581
<b>Net Cash Generated from Investing Activities</b>	<b>10</b>	<b>424</b>	<b>1,279</b>	<b>577</b>	<b>1,027</b>	<b>1,027</b>	<b>1,029</b>
<b>Financing Activities</b>							
Dividends paid	-7,596	-10,663	-12,507	-15,623	-17,610	-18,812	-20,541
Unclaimed dividends paid	-7	-4	-15	-2	0	0	0
<b>Net Cash Generated from Financing Activities</b>	<b>-7,603</b>	<b>-10,667</b>	<b>-12,522</b>	<b>-15,625</b>	<b>-17,610</b>	<b>-18,812</b>	<b>-20,541</b>
<b>Net Increase in Cash and Cash Equivalents</b>	<b>2,368</b>	<b>3,673</b>	<b>2,374</b>	<b>2,729</b>	<b>1,330</b>	<b>1,644</b>	<b>1,593</b>
<b>Cash and Cash Equivalents at the Beginning</b>	<b>9,010</b>	<b>11,378</b>	<b>15,050</b>	<b>17,424</b>	<b>20,153</b>	<b>21,483</b>	<b>23,127</b>
<b>Cash and Cash Equivalents at the End</b>	<b>11,378</b>	<b>15,050</b>	<b>17,424</b>	<b>20,153</b>	<b>21,483</b>	<b>23,127</b>	<b>24,720</b>

Source : Company Annual Reports, First Capital Research Estimates



## Appendix IV: Top 20 Shareholders

Top 20 shareholders - (% held)	3Q2019	2Q2019	QoQ	3Q2018	YoY
British American Tobacco International Holdings BV	84.1%	84.1%	-	84.1%	-
Philip Morris Brand SARL	8.3%	8.3%	-	8.3%	-
Pershing LLC S/A Averbach Grauson & Co.	1.0%	0.9%	0.2%	0.9%	0.2%
Northern Trust Company S/A - Fundsmith Emerging Equities Trust PLC	0.6%	0.6%	-	0.6%	-
SSBT-BMO Investments 11 (Ireland) Public Limited Company	0.7%	0.7%	0.0%	0.6%	0.1%
RBC Investor Services Bank - COELI SICAV	0.4%	0.5%	-0.1%	0.5%	-0.1%
CB NY S/A Allan Gray Frontier Markets Equity Fund Limited	0.0%	0.4%	-0.4%	0.5%	-0.5%
SSBT-AL Mehwar Commercial Investments LLC	0.0%	0.3%	-0.3%	0.3%	-0.3%
BBH-Matthews Emergine Asia Fund	0.2%	0.2%	0.0%	0.2%	0.0%
JPMBL SA-Kapitalforeningen Emerging Markets Long Term Economic In	0.2%	0.2%	-	0.2%	0.0%
Mrs Jasbinderjit Kaur Piara Singh	0.2%	0.2%	-	0.2%	-
HSBC INTL NOM LTD- SSBT-BMO-LGM- Frontier Markets Equity Fund	0.1%	0.1%	-	0.1%	-
Miss Neesha Harnam	0.1%	0.1%	-	0.1%	-
SSBT-Frank Russel Trust Company Comingled Benefit Fund Trust GNA	0.1%	0.1%	-	0.1%	-
HSBC INTL NOM Ltd - SSBT - Deutsche Bank AG Singapore A/C 01	0.1%	0.1%	-	0.1%	-
PICTET and CIE (Europe) SA S/A Lloyd George Indian Ocean Master Fun	0.1%	0.1%	-	0.1%	-
Harnam Holdings SDN BHD	0.1%	0.1%	-	0.1%	-
Mellon Bank N.A-Eafon Vance Trust Co. Collective Inv.	0.1%	0.1%	-	0.1%	-
Bank of Ceylon No.1 Account	0.1%	0.1%	-	0.1%	-
Deutsche Bank AG AS Trustee For JB Vantage Value Equity Fund	0.0%	0.1%	-0.1%	0.1%	-0.1%

## Appendix V: Recommendation criteria

Categorization	Company Category	Buy	Hold	Sell
Grade A	S&P SL20 Companies	T.Bill + 5% & Above	T.Bill + 1% & Above	Below T.Bill + 1%
Grade B	Rest of the Companies	T.Bill + 8% & Above	T.Bill + 3% & Above	Below T.Bill + 3%
Grade C	Companies less than LKR 1Bn Market Cap	T.Bill + 11% & Above	T.Bill + 6% & Above	Below T.Bill + 6%

### Weighted Average 1-year T-bill rate during Oct 2019: 8.38%

Categorization	Company Category	Buy	Hold	Sell
Grade A	S&P SL20 Companies	13.38%	9.38%	9.38%
Grade B	Rest of the Companies	16.38%	11.38%	11.38%
Grade C	Companies less than LKR 1Bn Market Cap	19.38%	14.38%	14.38%



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## CORPORATE DEBT SALES

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## EQUITY SALES

<b>CEO</b>	Jaliya Wijeratne	+94 70 2910 042	<b>Negombo</b>	
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