

**CEYLON TOBACCO COMPANY PLC [CTC.N0000]****MAINTAIN BUY****A MATCH MADE IN HEAVEN****Fair Value: 2019E - LKR 1,525 [+17%]**

Total Return with DPS 2019E: +20% [AER of 66%]

CTC records a profit of LKR 4.7Bn, up by 8%YoY for 2Q2019 on the back of stringent operating cost control measures. In line with expectations, consumers shifted to cheaper substitutes due to the tax driven price increases during Aug 2018 and Mar 2019. Two price hikes within a span of 8 months, tough economic conditions and subsequent tourism hit following Easter Sunday attacks led to a drop-in sales volume by 21.5%. However, it was offset by margin gains through price hikes and operational efficiencies. First Capital Research maintains a profit target of LKR 18.5Bn and TP of LKR 1,525 with a total return of 20% (including a DY of 3%). **MAINTAIN BUY**

LKR (Mn)	2Q2018	2Q2019	YoY	6M2018	6M2019	YoY
Earnings (LKR 'Mn)						
Gross Revenue	38,854	36,216	-7%	74,425	70,496	-5%
Net Revenue	8,675	8,586	-1%	16,704	16,877	+1%
EBIT	6,857	7,181	+5%	12,715	13,542	+7%
PBT	7,230	7,590	+5%	13,458	14,404	+7%
Net Profit	4,356	4,684	+8%	8,093	8,745	+8%
Balance Sheet (LKR 'Mn)						
Shareholder's Equity	7,082	7,546	+7%	7,082	7,546	+7%
Cash & Cash equivalents	22,005	19,310	-12%	22,005	19,310	-12%
NAVPS	37.8	40.3		37.8	40.3	

Net revenue broadly unchanged, margins improve

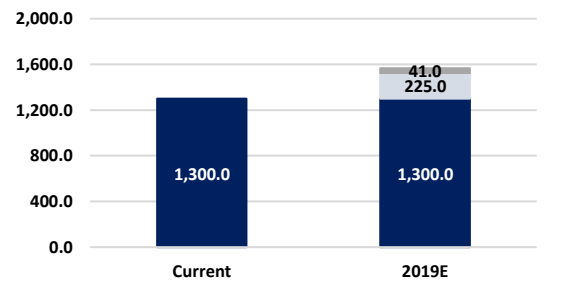
The fall in Gross revenue by 7%YoY was mainly due to the price hikes which led to a volume drop with consumers shifting to cheaper substitutes. The tax driven price increases were offset by the increase in margins which resulted in a mere 1%YoY drop in Net revenue. Volumes were further hampered with the slowdown in economic activities post Easter Sunday attacks which slowed consumer spending and tourist arrivals into the country. As the country situation has greatly improved since April 2019, we expect sales revenue (net) to normalize due to the inelastic nature of cigarettes. In line with the price hikes improving margins, Net revenue/Gross revenue margins for 2Q2019 stood at 24% similar to 1Q2019 while improving from 22% in the previous comparative quarter. Despite the margin improvement, it was counterbalanced by the volume drop with the adverse reaction of the consumers in the short to medium term. Despite stronger margins in the 1H2019 with a further price hike on the cards and the government tax revenue requirement, we on a conservative note maintain our Gross Revenue/Net Revenue margins for 2019E at a moderate of 23% marginally higher than 2018 (22%), while also maintaining a volume drop of 8%YoY, thereby, we maintain our estimated net revenue forecast of LKR 37.6Bn for 2019E.

EBIT margin improves to 84% during 2Q2019

CTC operating expenses dipped by 22%YoY following a decline in raw materials used by 42%YoY coupled with the dip in other operating expenses by 31%YoY. CTC has been consistent in their lean measures in order to remain resilient against the cheaper illicit market such as Beedi and illegally smuggled cigarettes. The decline in raw material costs especially wrapping materials were impacted by the significant exchange rate devaluation, however, with the 100% local leaf usage this has brought down the raw material cost significantly.

We maintain TP of LKR 1,525 for 2019E – MAINTAIN BUY

We expect CTC earnings to grow at a CAGR of c.8% through 2018-2021E. With a fair value of LKR 1,525 and dividend yield of 3%, CTC provides an AER of 66% for Dec 2019. **MAINTAIN BUY**



■ Current Price ■ Expected Capital Gain ■ Dividend upto 31.12.2019

FIRST CAPITAL RESEARCH

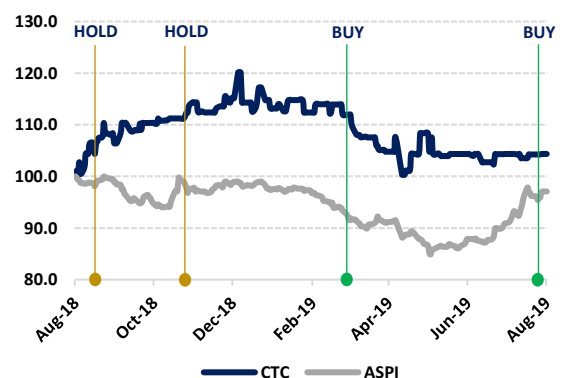
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KEY DATA

CSE Ticker	CTC.N0000
Bloomberg Ticker	CTC SL
Share Price (LKR)	1,300
52w High (LKR)	1,497
52w Low (LKR)	1,246
Avg. Daily Volume (Shares)	3,820
Avg. Daily Turnover (LKR)	5,130,124
Issued Share Capital (Shares 'Mn)	187
Market Cap (LKR 'Mn)	243,521
Market Cap (USD 'Mn)	1,376

*1 USD = LKR 177

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

Price movement of CTC vs ASPI and past recommendations**Minimum Return for BUY:**

Buy Below [AER of 16.83% with DPS]: LKR 1,479 (2019E)
 CTC categorized as "Grade B" counter (Refer page 09 for recommendation criteria of Grade A, B & C stocks)

Disclosure on Shareholding:

First Capital Group does not hold shares of 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
Lower end											**
Capstan	8	9	9	10	10	10	11	20	20	20	20
Low Priced - Mid range											
Navy Cut	-	-	-	-	-	-	-	-	-	40	45
Bristol	-	-	-	20	20	20	22	22	33	40	45
High Priced - Mid range											
John Player Gold Leaf	23	25	25	28	30	33	35	42	50	55	65
Premium											
Dunhill Switch	26	28	30	34	35	37	40	45	55	60	70
Dunhill Light	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	55	70

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

Estimate Revision

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

Valuation Table

P/E 31 December	2015	2016	2017	2018	2019E	2020E	2021E
Estimates (LKR 'Mn)							
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	29,795	31,982	35,094
Net Profit	10,634	12,559	14,586	17,004	18,512	19,802	21,638
EPS (LKR)	56.8	67.1	77.9	90.8	98.8	105.7	115.5
YoY Growth (%)	23%	18%	16%	17%	9%	7%	9%
Valuations							
PER (x)	22.9x	19.4x	16.7x	14.3x	13.2x	12.3x	11.3x
PBV (x)	84.4x	69.9x	53.3x	45.4x	38.7x	33.5x	29.1x
DY (%)	3.1%	4.4%	5.1%	6.4%	5.0%	7.6%	8.2%

Valuation Summary

Expected CTC price for 2019E	
PER based target price	1,482
DCF Valuation based target price	1,569
Average Target Price	1,525
Target price after Rounding off	1,525

Return	
Target Price	1,525
Current Price	1,300
Capital Gain (LKR)	225
Dividend (LKR) 2019E	41
*Adjusted dividend for 2019E	
Capital Gain %	17%
Dividend Yield %	3%
Total Return %	20%
Annualized Return %	66%

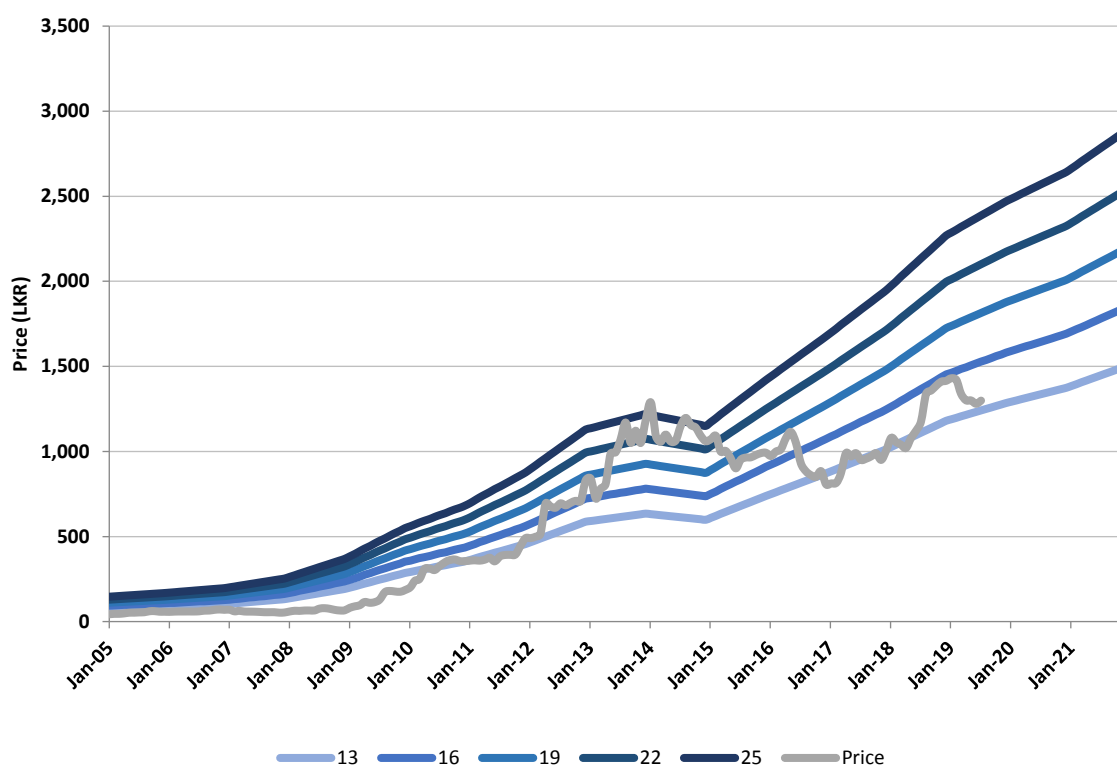
Discounted Cash flow Valuation

DCF based Valuation	
Enterprise Value	272,311
(-) Debt	-
(+) Cash	21,559
Total Value of Equity	293,870
No. of shares	187
Target Price	1,569

WACC	
K_e	15%
K_d	6%
D/E Assumption	40 / 60
Terminal Growth (%)	3%
WACC	11%

COE	
R_f	8.8%
R_m	16.8%
Growth (%)	3.0%
β	0.73
$K_e = R_f + \beta(R_m - R_f)$	15%

PER Valuation



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

PER based Valuation	
2019E Earnings (LKR 'Mn)	18,512
No. of Shares ('Mn)	187
2019E EPS	98.8
Expected Average PER	15.0x
Price at 15.0x 2019E Earnings	1,482

Appendix I: Statement of Income and Expenses

Income Statement (LKR Mn) Y/E 31st December	2015	2016	2017	2018	2019E	2020E	2021E
Gross Revenue	106,491	121,525	139,041	145,298	165,291	178,770	193,415
Government Levies	-80,391	-89,777	-107,387	-112,368	-127,663	-138,218	-149,068
Net Revenue	26,099	31,748	31,653	32,930	37,629	40,552	44,348
Other operating income	23	24	48	81	56	61	67
Raw materials	-2,977	-3,274	-2,676	-2,592	-2,499	-2,383	-2,296
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	-4,445	-5,141
Operating profit	17,517	20,369	23,066	25,903	29,795	31,982	35,094
Net interest income	561	850	1,504	1,573	1,581	1,581	1,581
PBT	18,078	21,219	24,571	27,476	31,376	33,562	36,675
Tax	-7,444	-8,660	-9,984	-10,472	-12,864	-13,761	-15,037
Net earnings	10,634	12,559	14,586	17,004	18,512	19,802	21,638
EPS	56.8	67.1	77.9	90.8	98.8	105.7	115.5

Source : Company Annual Reports and First Capital Research Estimates

Appendix II: Statement of Financial Position

Balance Sheet (LKR Mn)	2015	2016	2017	2018	2019E	2020E	2021E
As at 31st December							
Assets							
Non Current Assets							
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
Investments in subsidiaries	0	0	0	0	0	0	0
Net surplus assets on retirement benefit plan	531	652	673	276	276	276	276
Receivables	138	142	126	122	122	122	122
Total Non Current Assets	2,742	3,064	3,057	3,480	3,821	4,144	4,448
Current Assets							
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	2,550	2,758	2,984
Assets held for sale		0	0	0	0	0	0
Cash & cash equivalents	11,378	15,050	17,424	20,153	21,559	23,126	24,672
Total Current Assets	15,930	19,490	21,760	24,729	26,765	28,757	30,763
Total Assets	18,672	22,555	24,817	28,209	30,586	32,901	35,212
Equity and Liabilities							
Equity							
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	4,412	5,402	6,484
Total equity	2,885	3,485	4,570	5,359	6,285	7,275	8,357
Non - Current Liabilities							
Unfunded retirement benefit obligations		1	1	1	1	1	1
Deferred tax	408	447	507	563	563	563	563
Total Non - Current Liabilities	408	448	508	563	563	563	563
Current Liabilities							
Trade & other payables	10,374	11,992	12,355	12,638	14,089	15,414	16,643
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
Total Current Liabilities	15,378	18,622	19,739	22,287	23,738	25,063	26,292
Total Liabilities	15,786	19,070	20,247	22,850	24,301	25,626	26,855
Total Equity & Liabilities	18,672	22,555	24,817	28,209	30,586	32,901	35,212
NAVPS	15.4	18.6	24.4	28.6	33.6	38.8	44.6

Source : Company Annual Reports and First Capital Research Estimates

Appendix III: Statement of Cash flow

Cashflow Statement (LKR Mn) Y/E 31st December	2015	2016	2017	2018	2019E	2020E	2021E
Cash Flow from Operating Activities							
Profit before tax	18,078	21,219	24,571	27,476	31,376	33,562	36,675
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
Write off of PPE	0	1	0	0	0	0	0
Provision for consumables	6	9	27	18	0	0	0
Notional interest income	0	0	0	0	0	0	0
Amortisation of employee benefit expenses	0	0	0	0	0	0	0
Actuarial gain on defined benefit obligation	-26	-9	-47	-31	0	0	0
Profit/(Loss) on disposal of PPE	-10	-19	0	0	0	0	0
Operating profit before working capital changes	17,702	20,571	23,283	26,062	30,008	32,212	35,342
Increase/(Decrease) in Inventories	-467	1,465	-526	252	-321	-217	-235
Increase/(Decrease) in Trade & Other Receivables	-75	-1,356	619	-506	-308	-208	-226
Increase/(Decrease) in Trade & Other Payables	3,250	1,618	361	297	1,451	1,326	1,228
Net Change in Working Capital	2,708	1,726	455	43	821	901	767
Operating Activities							
Cash generated from operations	20,410	22,297	23,738	26,105	30,829	33,113	36,109
Interest paid	0	0	0	0	0	0	0
Income taxes paid	-6,638	-8,381	-10,121	-8,778	-12,864	-13,761	-15,037
Gratuity paid	0	0	0	0	0	0	0
Net Cash from Operating Activities	9,962	13,916	13,616	17,777	17,965	19,352	21,072
Investing Activities							
Purchase of PPE	-563	-420	-226	-996	-551	-551	-549
Return on investment subsidiary	0	0	0	0	0	0	0
Proceeds from sale of PPE	12	21	0	0	0	0	0
Interest received	561	823	1,504	1,573	1,581	1,581	1,581
Net Cash from Investing Activities	10	424	1,279	577	1,027	1,027	1,029
Financing Activities							
Dividends paid	-7,596	-10,663	-12,507	-15,623	-17,586	-18,812	-20,556
Unclaimed dividends paid	-7	-4	-15	-2	0	0	0
Net Cash from Financing Activities	-7,603	-10,667	-12,522	-15,625	-17,586	-18,812	-20,556
Net cash during the year	2,368	3,673	2,374	2,729	1,406	1,568	1,545
Net cash at beginning	9,010	11,378	15,050	17,424	20,153	21,559	23,126
Net cash at end	11,378	15,050	17,424	20,153	21,559	23,126	24,672

Source : Company Annual Reports and First Capital Research Estimates

Appendix IV: Top 20 Shareholders

Top 20 shareholders - (% held)	2Q2019	1Q2018	QoQ	2Q2018	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%
SSBT-BMO Investments 11 (Ireland) Public Limited Company	0.7%	0.7%	0.0%	0.7%	0.1%
Northern Trust Company S/A - Fundsmith Emerging Equities Trust PLC	0.6%	0.6%	-	0.6%	-
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%	0.3%	-0.3%	0.4%	-0.4%
SSBT-AL Mehwar Commercial Investments LLC	0.0%	0.3%	-0.3%	0.3%	-0.3%
HSBC INTL NOM LTD-BBH-Mattews Emerging 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%	-
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%	0.0%	0.1%	0.0%
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%	0.0%	0.1%	0.0%
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 Jun 2019: 8.83%

Categorization	Company Category	Buy	Hold	Sell
Grade A	S&P SL20 Companies	13.83%	9.83%	9.83%
Grade B	Rest of the Companies	16.83%	11.83%	11.83%
Grade C	Companies less than LKR 1Bn Market Cap	19.83%	14.83%	14.83%



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BRANCHES

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