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**BRITISH AMERICAN TOBACCO UGANDA LIMITED (BATU)  
RESEARCH NOTE**

**No 1 .04**

**The Company History**

- BATU is a subsidiary of British American Tobacco (Investment) Limited UK. The company came into existence in 1927 when commercial varieties of tobacco were first introduced into Uganda. Hoima was the first district to grow tobacco leaf that year.
- Tobacco is now a key cash crop and is grown in the districts of Arua, Gulu, Kitgum, Apac, Lira, Hoima, Masindi, Kibaale, Kiboga, Mubende and Rukungiri.
- In 1928, the company built its first cigarette factory in East Africa at Jinja.
- In 1972, BATU was nationalised pursuant to the Properties and Business (Acquisitions) Decree No 32 of 1972 as a result of former President Idi Amin's political and economic policies.
- The company was spilt up into three parts: Uganda National Tobacco Company, Produce Marketing Board and Smallholders Tobacco Project, an arm of the Ministry of Co-operatives and Marketing.
- In 1976, the Government of Uganda (GoU) decided to restructure its parastatal organisations, resulting in the formation of the National Tobacco Corporation (NTC) in 1978.
- In 1982, British American Tobacco Uganda Limited applied to GoU under the Expropriated Properties Act 1982 for restitution of its assets.
- In July 1984, B.A.T Uganda 1984 Limited was formed as a joint venture with British American Tobacco (Investments) Limited, a U.K company owning 70% of the shares and GoU, 30%.
- In April 1998, B.A.T Uganda 1984 Limited changed its name to British American Tobacco Uganda Limited (BATU).
- In July 1998, BATU adopted the new British American Tobacco universal uniform and corporate identity and then became known as British American Tobacco Uganda.
- In May 2000, a resolution to convert the company to a Public Limited Company was successfully filed with Registrar of Companies thus laying ground to the eventual Initial Public Offering (IPO).

**The Business**

- BATU is the leading tobacco growing and processing company in Uganda.
- The main revenue drive brands are Sportsman, Embassy and Rex.
- To control the quality of tobacco, the company manages tobacco growing and sale of leaf as a secondary business through an extension farming system that contracts over 50,000 farmers to grow tobacco leaf in the West Nile, Bunyoro, Mubende, North Kigezi and Middle North.
- The Company has access, at an annual fee, to technical expertise of the parent company, BAT (Investments) Limited, in areas such as marketing, management training and development, production, leaf processing and consultancy services.

**FINANCIAL RATIOS**

	2002	2003	2004F
Earnings per Share	97.40	64.10	70.50
Dividend per Share	140.00	60.00	70.00
Price Earnings Ratio	12.32	18.40	16.10
Dividend Yield %	11.67	5.08	6.17
Net Asset Value per Share	440.00	424.00	403.00
Share Price	1200	1180	1135

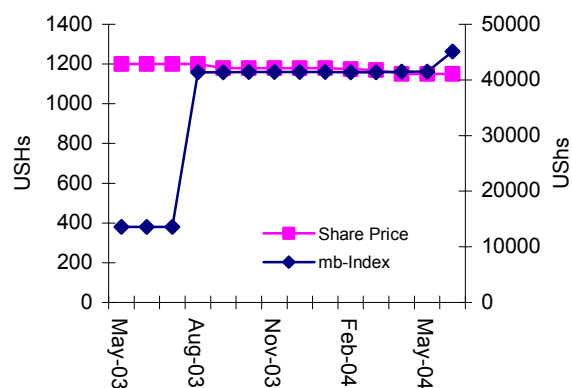
Source: : mbea Research Department

Note: Past performance is not necessarily an indicator of future performance

**Listing**

- The BATU IPO took place from 28<sup>th</sup> June 2000 to 9<sup>th</sup> August 2000.
- Listing took place on the Uganda Securities Exchange (USE) on 3<sup>rd</sup> October 2000 and BATU became the first Agricultural/Industrial stock to be quoted on the USE.
- The IPO shares offered to the public were 4,907,984 at an Offer price of US\$ 1,000. Opening price on the first day of trading was US\$ 1,195 (195% rise), Closing price was US\$ 1,205 (20.5% rise).
- Authorised Ordinary shares are 64,000,000. Issued and fully paid shares are 49,080,000 with a nominal value of US\$ 1.25 each.
- BATU shareholding is now held by British American Tobacco (Investments) Limited (70%), Precis (1790) BV (20%), Public [traded on the Stock Exchange] (10%).
- The offer was oversubscribed by 5%.

**BATU Share Price vs mb-Index  
May 2003 - June 2004**



Source: : mbea Research Department

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## Production

- Tobacco leaf is collected from farmers and bought through a grade price system at leaf centres upcountry before being transported to Kampala for processing at its Green Leaf Threshing (GLT) plant located in Kampala's Industrial area. BATU is also planning to move to bigger premises in the outskirts of Kampala within two years.
- There are 3 tobacco types distinguished by the method of curing, namely: Flue Cured Tobacco, Dark Fire Cured Tobacco and Burley (air cured) Tobacco.
- Main process involves conditioning, threshing, classifying and redrying before packing for export or transportation to the factory in Jinja. The process results in a yield of about 85%.
- Tobacco for domestic consumption is packed in hessian bales from farmers and transported to Jinja in cartons of 200 kgs each of various tobacco leaf and stem where it is stored for 12 months before going into the cigarette manufacturing process.
- Cigarettes are produced from the different blends of the various tobacco types.
- Approximately 22,000 tonnes of tobacco were handled in 2002 and there are plans to increase capacity by 54%.

### Cigarettes produced

- In 2002, the total number produced in the country (estimated to evaluate competition) was 1330.1 million sticks. BATU produced 1055 million sticks, compared to 1035 million (2001) and 1277 million (2000).
- In terms of numbers, Safari cigarette was the best selling brand at 587 million sticks and continues to be the best selling brand in the BATU brand portfolio.

### Exports

- Around 13,000 tonnes of excess tobacco leaf was trucked to Thika in Kenya for processing. The export tobacco is transported to the port of Mombasa for export. Tobacco leaf for exports is mainly sold locally to Universal Leaf Tobacco Company, who in turn exports leaf to Japan, Europe and Egypt. Cigarettes are not exported but are consumed locally. However BATU does have capacity to produce cigarettes on contract manufacture basis.

### Distribution and Marketing

There are 17 distributors, 5 Stockists, 1300 wholesalers and 21,000 retailers.

### The Competition

- The company presently (for its own estimates) commands around an 87.4% share of the market finished product with Leaf Tobacco & Commodities [formerly by Mastermind Tobacco Uganda Limited] claiming 11.9% and others 0.7%.
- Market share has also notably decreased from 92.90% in 1999, meaning that the competition has made gains. Even with smuggling being contained of late, this decrease in market share is still substantial.

### Litigation

- TEAN vs. BATU – Product labelling suit filed by environmental activists. TEAN had filed a suite alleging that BATU has failed to warn consumers

adequately about the danger of smoking and exposure to tobacco smoke. TEAN requested the court to author health warnings and order BATU to place the warning on its product packets and marketing. The case has since been dismissed by the court.

- More court appearances by BATU instigated by customer lawsuits etc and possible "financial damage" cannot be ruled out in future.

### Corporate Responsibility Social (CRS) Program

- Launched in 2000, the CRS is an ambitious but positive effort to facilitate a series of stakeholder dialogues conducted by BATU for its employees, farmers, partners and critics. It is intended to improve the company's image with the public as a responsible company and is really a process of listening and responding to its stakeholders.
- This year, 2003, the program was kicked off in Hoima and was attended by farmers' representatives from the tobacco growing districts of Masindi, Arua and Hoima. Local government officials from Hoima also attended.
- The dialogue focussed on BATU's relationship with farmers and its contribution to the local economies where tobacco is grown.
- On the cigarette warning label issue, the company has said it is in the process of changing the current warning label on cigarette packs from "Smoking can be dangerous to your health" to "**Smoking is dangerous to your health**" promised in the last dialogue in 2002.

### GoU measures to curb smuggling

- Tax Stamps - Introduced on cigarettes packs meant for sale in Uganda. The Uganda Revenue Authority (URA) also banned the sale of unstamped cigarettes. It also destroyed cigarettes impounded from smugglers.
- Minimum Specific Tax - Was introduced in July 2002 as a move aimed at reducing dumping of cheap cigarettes in the country.
- All imports of cigarettes are considered to have cost at least US\$ 25,000 per packet. This means that cigarette packs that actually cost US\$ 10,000 attract the same tax as those that cost US\$ 25,000.

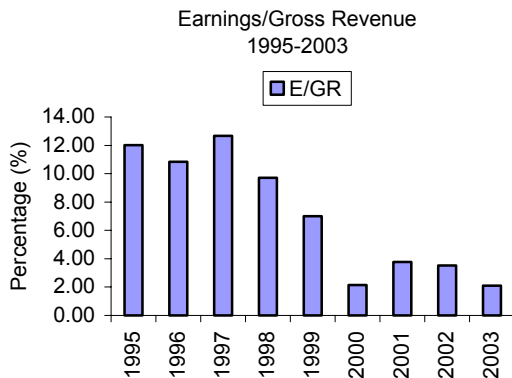
### 2003 Performance Review

- Growth in Gross Earnings increased marginally by 9.52% to US\$ 148.95 billion from US\$ 136.00 billion in 2002.
- The increase was largely attributable to increased tobacco leaf production. **Gains were however largely offset by a corresponding rise** in Cost of Sales of 8.24%.
- No Interim Dividends were declared and for the first time dividends payout has been lower than earnings. Earlier in 2002, the **dividend payout had exceeded earnings** for four years in a row since 1999. Retained earnings, which had also experienced a steady drain every year since 1998 registered an upward movement of 1.88% (see 2003 financials).
- However, for the second successive year, the all important **Current Ratio** (Current Assets/Current liabilities) has dropped below 1.00 to stand at 0.94. (2002 = 0.98). **Net Current liability was US\$ 6.7 billion. (2002 = US\$ 5.2 billion)**. This is due to seasonality/cycle of cash flows, which inevitably

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implies higher borrowings at December month ends, which happens to be the end year balance sheet date.

- Bank borrowing also reached very high proportions after amassing an increase of US\$ 8.9 billion in 2003 to stand at US\$ 38 billion from 29 billion in 2002. An increase of 31 %.
- BATU will inevitably have to deal with accompanied higher financial costs. Predictably we do not rule out a further increase in borrowings in 2004 to meet working capital requirements, expansion plans etc.



Source: BATU Annual Reports

Note: Past performance is not necessarily an indicator of future performance

- Historically, BATU's annual percentage growth in Gross Revenue (GR) has hovered around 8-10% with the exception of 2002, which posted a record US\$ 130 billion, an impressive 31% rise over 2001.
- **The company has unfortunately been unable to translate such gains into reasonable bottomline growth.** A glance at BATU historicals show that whereas GR increased from US\$ 68.77 billion in 1995 to US\$ 148.95 billion in 2003, an increase of almost 120%, Net Earnings decreased from US\$ 8.26 billion to US\$ 3.15 billion, a 62% decline within the same period.
- **Retained earnings have also dwindled considerably** from a high of US\$ 19.00 billion in 1998 to US\$ 10.90 billion in 2003, thus raising further concerns that the company has not been building adequately on reserves. In 2003, a marginal increase US\$ 200 million in the coffers reflecting a 1.90 % increase to US\$ 10.90 billion may signal a shift to growing reserves.

#### Outlook for 2004

- A marginal improvement in increased cigarette sales revenues and increased revenues from leaf exports should drive up revenues in 2004F. The impact of positive Government measures on tax stamps enforcement and the minimum specific tax will also help the balance sheet.
- There has been increased agitation by anti smoking lobbyists and with the looming possibility of the Government banning smoking of cigarettes in public places, BATU needs to figure out how it will be able to appease the Government and public and keep its revenues afloat.
- It is our view that future improved bottomline performance will be derived from -

1. Internal cost cutting measures aimed directly at curbing and reducing rising administrative expenses and distribution costs.
2. Stringent enforcement of anti-smuggling measures highlighted earlier. This will be of some temporary comfort to BATU, as the benefits will also accrue to the competition in the long run as a fair level playing field is laid out.
3. Benefits accruing from infrastructural investment especially in increased local processing capacity. This would result in considerable time and transport cost saving since excess leaf is currently processed in Kenya.
4. Future profitability will for the most part now be directly affected by how management handles the issue of the Government and anti smoking lobbyists desire to curb public smoking of cigarettes. To this end, we should witness a serious damage control effort in 2004.

- Shareholders should however be pleased with the **competitive Return on Equity (ROE) levels. In 2003, ROE was 15.12%. Dividend Yield remains attractive and we expect approximately 6.17 % for 2004F.**
- **On the Uganda Securities Exchange**, as at 30 June 2004, BATU is trading at US\$ 1150 which is 2.71 times its 2003 NAV of US\$ 424. **The share is clearly overvalued and given its basic underlying fundamentals it does little to justify the market premium.**
- However, we expect the Share Price to decrease to US\$ 1135 levels by year end on the back of surplus supply with many current shareholders seeking an exit to take advantage of new investment opportunities at the USE. They will also be driven to sell by the uncertainty surrounding the effects of the banning of cigarette smoking and the expected negative impact on revenues.
- Being one of the largest contributors to the Exchequer, with thousands of jobs at stake and in order not to send the wrong signals to foreign investors, we expect the Government will seek to arrive at a mutually acceptable position with BATU on the matter of Public smoking.
- It is also our view that in 2004, BATU's share price will finally be correcting itself after years of trading at an unjustified premium.
- On the basis of the above, we **recommend a HOLD** until the Government declares its official position on Public smoking in the coming days.

**Recommendation: HOLD**

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**BATU Limited**  
**Financial Review**

Balance Sheet	2003	2002	%Change
	UShs.'000	UShs.'000	
<b>ASSETS</b>			
Fixed Assets	33,997,910	32,502,714	4.60
Current Assets	<u>105,055,086</u>	<u>86,605,715</u>	21.30
<b>Total Assets</b>	<b>139,052,996</b>	<b>119,108,429</b>	<b>16.74</b>
<b>EQUITY AND LIABILITIES</b>			
Share Capital	61,350	61,350	
Revaluation reserves	6,889,277	6,889,277	0.00
Retained Earnings	10,909,790	10,708,268	1.88
Proposed Dividend	<u>2,944,800</u>	<u>3,926,400</u>	-25.00
<b>Shareholders Funds</b>	<b>20,805,217</b>	<b>21,585,295</b>	<b>-3.61</b>
<b>Non current Liabilities</b>			
Deferred income taxes	4,639,050	4,273,418	8.56
Prov. for retirement benefit obligations	1,841,654	1,435,610	28.28
	<b>6,480,704</b>	<b>5,709,028</b>	13.52
<b>Current Liabilities</b>			
Trade and other payables	73,589,791	62,606,580	17.54
Borrowing	38,177,284	29,207,526	30.71
	<b>111,767,075</b>	<b>91,814,106</b>	<b>21.73</b>
<b>Total Equity and Liabilities</b>	<b>139,052,996</b>	<b>119,108,429</b>	<b>16.74</b>
<b>Income Statement</b>			
Turnover (Gross)	148,946,870	136,000,546	9.52
Cost of Sales	78,898,059	72,888,748	8.24
Profit before Taxation	6,093,639	7,313,169	-16.68
Taxation	2,947,317	2,532,447	16.38
Profit after Taxation	3,146,322	4,780,722	-34.19

**Sources:**  
**MBEA Market Reports, BATU Company Prospectus**  
**and Annual Reports.**

**“ Remember Share Prices may go up or down”**  
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