# Reynolds may give British American Tobacco second wind

By Fifi Peters

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British American Tobacco's sizeable stake in the enlarged Reynolds American group promises to deliver increased returns for the world's second-largest cigarette maker, which on Wednesday posted slower first-half sales amid declining cigarette volumes.

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The maker of the Dunhill, Kent and Peter Stuyvesant brands finalised a $4.7bn investment in Reynolds American last month to maintain its 42% stake in the company following the latter's recent acquisition of Lorillard. "We remain committed to leading in next-generation products and made good progress on the development and rollout of our portfolio. Our e-cigarette brand, Vype, continues to perform well in the UK," CEO Nicandro Durante said on Wednesday.

Reynolds American, which owns the Camel brand, paid $25bn for Lorillard, the third-largest US cigarette maker, last month. This week Reynolds American said first-half sales rose to $2.4bn, an increase of 11% year on year.

Standard Bank analyst Sumil Seeraj said the company had predicted full-year sales would rise 11%-17%, boding well for British American Tobacco in future. "The (increased) income from British American Tobacco's associate company is expected to have a positive effect on earnings in the second half," he said.

Apart from the Reynolds deal, the cigarette maker, which has a primary listing in London and a secondary listing on the JSE, will receive increased income, albeit on a smaller scale, should its 550m bid for Europe's TDR pass regulatory scrutiny. TDR is the leading independent cigarette manufacturer in central Europe with a market leading position in Croatia.

## Shrinking global cigarette sales consolidates sector

"This is a small acquisition in British American Tobacco's life but it's a necessary one," said Seeraj, citing shrinking global cigarette sales that have led to an acceleration in consolidation in the sector as companies seek to protect margins.

British American Tobacco is also in talks with minority shareholders of its Brazilian subsidiary, Souza Cruz, to acquire the 24% stake in the company that it does not already own and to delist the company from the stock exchange in Sao Paulo.

Both transactions are expected to be completed during the third quarter of this year.

## Impact of current currency

Although the group's sales in constant currency declined 6% year on year during the first half, sales in current currency terms increased 2.4% to £6.96bn (R136bn) as higher cigarette prices offset unfavourable exchange rate effects.

The British pound strengthened significantly against emerging market currencies such as the rand, the Russian rouble and the Brazilian real, where the company has operations.

British American Tobacco sold 322-billion cigarettes during the period, down 2.9% from the first half of last year but better than the industry's decline of 3.5%. The group said its cigarette sales were hurt by increased taxes in Russia, Australia and South Korea, which resulted in higher product pricing.

Margins were held flat at 39.2% in reported currency for the six months, which Kagiso Asset Management investment analyst Dirk van Vlaanderen said "is a good result given the significant transactional currency drag where a significant portion of product costs are denominated in US dollars, but revenues are denominated in (now much weaker) local currencies".

Currency headwinds in the second half were expected to intensify but management was confident of delivering "good" earnings growth, in constant currency terms, and planned to improve operating margins. "We believe this confidence stems from a better pricing environment expected in the second half, further cost savings and the inclusion of additional earnings from Reynolds American," Mr van Vlaanderen said.

The shares leapt 3.27% to close at R718.50 on the JSE on Wednesday.

*Source: Business Day*