

Welcome to tobacco country

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We might think we're big in mining, synthetic fuels, cellphones or banking, but our biggest listed company on the JSE soon will be in tobacco.

British American Tobacco (BAT) will dwarf all other South African behemoths by market capitalisation when it sets up a secondary listing on the JSE later in the year. Its capitalisation is expected to be R560-billion compared to current market leaders BHP Billiton (R550-billion) and Anglo American (R543-billion). BAT will be almost twice the size of South African giant Sasol, which is capitalised at about R250-billion.

Tobacco will hold the top spot on the JSE even though South Africa is an insignificant player in tobacco production. The country produced just 10 000 tons of tobacco compared to market leader China's 2,64-million tons. China produces 36% of the world total; South Africa less than 1%.

But South Africa is nonetheless a big player in the tobacco industry thanks to the role the Rupert family played. Remgro and Richemont, Rupert-associated companies, are restructuring by unbundling their interests, meaning that shareholders will now directly hold their BAT shares rather than indirectly.

Since South African institutions are significant holders of these shares, BAT has agreed to a secondary listing on the JSE. BAT is understood to control about 80% of the cigarette market in South Africa. Its brands include Rothmans, Dunhill, Benson & Hedges, Peter Stuyvesant, Lucky Strike, Pall Mall and Kent.

BAT is the number three player worldwide, with 17% of the global market share. China National Tobacco holds the top spot with about 40% of the global market.

BAT is listing in South Africa following the complex restructuring of Remgro and Richemont (or Compagnie Financière Richemont SA), two of the biggest shareholders in BAT, which was announced last Friday.

Together the companies own about 30% of BAT through a Luxembourg-based holding company called R&R Holdings.

"With the restructuring of the companies, a large portion of BAT's shareholders will be South African institutions and investors," said **Evan Blecher**, researcher for health economics at the University of Cape Town.

"It's not that BAT operations in South Africa are very large in comparison to their global operations, which is commonly a reason for secondary listings, but rather that many shareholders are South African institutions," he says.

Remgro chief executive Thys Visser said the reasons why Remgro and Richemont requested that BAT make a secondary listing in Johannesburg was to comply with South African exchange control regulations and to provide shareholders with the opportunity of holding and trading their shares in South Africa.

About 90% of Remgro's shareholders are South African, he said, and as such this move is to "benefit shareholders by offering them the opportunity to trade their BAT shares in South Africa". Remgro will be distributing 90% of its BAT shares directly to shareholders.

Because of changes in Luxembourg tax regulations, the holding company structure is no longer advantageous to shareholders. With its dissolution Richemont and Remgro will rid themselves of their tobacco interests.

BAT said in a statement to the Mail & Guardian: "We always said we would seek a secondary listing on the Johannesburg Stock Exchange if asked to do so by Richemont and Remgro. This is where the majority of their shareholders are based and can therefore benefit from a local listing of our shares."

Blecher said that the restructuring and planned listing has been in the pipeline since the Rembrandt group, Remgro's forerunner, consolidated its tobacco interest through Rothmans International in the late 1990s.

Aside from the obvious forex benefits, the proposed BAT listing will offer investors more choice, said **Blecher**. They have direct access to BAT shares rather than going through the Remgro R&R Holdings structure.

Blecher also pointed out that investors with ethical qualms about tobacco can now own shares in Remgro and Richemont without indirectly buying into BAT.

The outlook for the tobacco industry is a mixed one, said **Blecher**, who has been monitoring changes in the regulation of tobacco products in South Africa.

Tobacco production has fallen, but this has been because of a general decline in agricultural production in recent years, he said.

"South African tobacco farmers have not been able to compete with global competition from countries such as Malawi and Zambia, whose product is cheaper," he said.

But with the tax instituted on cigarettes, cigarette companies have been able to increase their margins dramatically, said **Blecher**.

Francois van der Merwe, chairperson of the Tobacco Institute of South Africa, put the tax contribution of cigarette sales, through VAT and excise duties, at just more than R8-billion in 2007. This puts the total amount spent by South Africans on cigarettes at about R16-billion.

But while two-thirds of the increase in the retail price can be laid at the taxman's door, a third of it is due to the industry increasing their margins, said **Blecher**.

The World Health Organisation reported earlier this year that cigarette taxes in South African were increased by 250% during the 1990s to just less than 50% of the retail price. It said that cigarette "consumption fell by 5% to 7% for every 10% increase in the price of cigarettes".

Blecher said that while consumption of cigarettes has levelled off, "cigarette production has not fallen as dramatically. Cigarette companies are exporting and their production is about 50% higher than their sales."

Blecher said that although cigarette consumption is declining in the developed world, multinationals such as BAT, Japan Tobacco International and United States-based Phillip Morris have moved towards developing markets. Here smoking prevalence is low, but as per capita incomes grow tobacco giants can and will grow their markets.

"BAT has the biggest footprint in Africa, which will make it attractive to investors," said **Blecher**.

Interestingly enough, while developed countries have placed innumerable restrictions on the advertising, sales and smoking of cigarettes, they still remain highly lucrative businesses.

Blecher said that the few "die-hard" smokers in these countries are "milked" for all they are worth by tobacco companies consistently ramping up their margins.

BAT still remains a solid, well-performing investment for investors, he said.

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