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Imperial Tobacco

PRESS RELEASE:

SITAB S.A.'s ratings reviewed

WARA has lowered SITAB's long-term rating to BBB from BBB+ following its second assessment. The outlook is revised to 'negative' from 'stable'

WARA's long-term rating on the Ivorian leader of the tobacco industry, a member of the Imperial Tobacco Group, has been downgraded to BBB from BBB+. The outlook has been revised to negative from stable.

Abidjan, 15/01/2018 — **West Africa Rating Agency** (WARA) has downgraded its ratings on Société Ivoirienne des Tabacs (**SITAB S.A.** or **SITAB**). On WARA's regional rating scale, the long-term rating of SITAB is revised to "**BBB**" from "BBB+", in the investment grade category, and its short-term rating is lowered to "**w-4**" from "w-3". SITAB is the leader of the tobacco industry in Ivory Coast and West Africa (excluding Nigeria). The outlook attached to these ratings is now **negative**, while it used to be stable.

Simultaneously, on its international rating scale, WARA has revised SITAB's ratings and outlook to iB/Negative/iw-6 from iB+/Stable/iw-5.

WARA justifies the change in SITAB's ratings and outlook by the fact that the company' market shares have been markedly eroded by imported brands. SITAB's market share dwindled from 60.5% in May 2016 to 46.9% in November 2017. The company has preserved its leading position but competition is gaining ground. Volumes are declining and SITAB is facing the impact of unfavorable changes in regulation, through tougher tax treatments since 2015. New regulations are expected in January 2018, which would further increase the rate of excise duty, meaning further margin compression. The danger for SITAB is to face a strategic stalemate. The company is the only Ivorian player that opted for manufacturing its own cigarettes locally, while its contenders import their products: such situation places SITAB is an unfavorable position, given the recurring tax adjustments that impede locally manufactured products as opposed to imported ones.

Having said that, SITAB can rely on the most powerful cigarette brand in Ivory Coast: Fine is indeed the reference brand of domestic customers, as it controls 45% of the market at the end of November 2017. SITAB's financial position remains very healthy, although some pressure is arising due to the incremental decline of its market share. The operating support provided by the Imperial Tobacco Group is a clear advantage, via brand and technical assistance agreements. On the other hand, SITAB is a "monoline" company relying essentially on price competition: the company's operating profile concentrates on one single line of business, for which price is a key driver of competitiveness, itself dependent on a tax structure that has become unfavorable. The Ivorian market's increasing attractiveness fuels the appetite of importers: the country is growing fast and, since 2015, imported brands benefit from a tax regime that is favorable to them, leading to a fast compression of SITAB's market share. Within Ivory Coast's tobacco industry, tax volatility has become a material source of risk: since 2012, tobacco taxes are neither stable nor satisfactory for all players, creating distortions capable of deeply reshaping the entire sector. In addition, like all other countries in the world, Ivory Coast faces increasing regulatory and sanitary pressure on the tobacco industry. Such constraints lead to declining volumes: the Ivorian market for cigarettes fell by 1.1% in 2016, after a sharp drop of 9% in 2015. Logically, a market facing both regulatory pressure and price hikes attracts more fraudulent imports.

SITAB's ratings do not incorporate any external support factors. Nevertheless, the ratings explicitly account for the continuous assistance and the brand advantage brought to SITAB by its reference shareholder, the Imperial Tobacco Group.

An upgrade of SITAB's ratings would depend on: i) improvements in the macroeconomic environment of the region in general, and that of Ivory Coast in particular, where purchasing power and consumption are growing sharply ; ii) the success of the company's revised commercial and marketing strategy, supposed to compensate, or at least slow down customer's increasing taste for imported cigarettes; iii) the price hierarchy returning to normal, in line with the differences in cigarette quality, either because better quality products are unilaterally repriced upwards (which looks unlikely), or because the tax regime is once again amended in favor of local manufacturers; and iv) an increase in market share.

A downgrade of SITAB's ratings would result from: i) another political, economic or health crisis affecting Ivory Coast; ii) a decline in market shares worse than WARA's expectations, which would in turn mean a material deterioration of its brand capital or a durable weakening of Fine's market position ; iii) regulatory risks quickly materializing, as a result of further sanitary pressure leading to a brutal drop of volumes; or iv) tax pressure worsening, making the market even less predictable and players' medium-term strategies more difficult to define and execute.

With a **negative** outlook, WARA signals that the probability of favorable scenarios is lower to that of unfavorable ones in the medium term, which means in other words that SITAB's ratings carry less chances of an upgrade than risks of a downgrade, under the constraint of Ivory Coast's country ceiling, which WARA currently keeps at 'A'.

The methodology used by WARA to rate SITAB is the credit rating methodology for the industrial and commercial companies, which was published on 15 July 2012 and revised in September 2016, and is available on WARA's website:
www.emergingmarketsratings.com

Information sources used by WARA to perform credit ratings on SITAB are mainly private information collected during discussions with the company's management team in November and December 2017. This information, together with publicly available sources, is considered by WARA as relevant and sufficient for carrying out the credit ratings of SITAB.

Finally, WARA emphasizes that the credit ratings of SITAB were solicited and participating, meaning that the rating process was performed upon a request of the company, and that SITAB's management actively participated in the discussions with WARA's analytical team.

SITAB's long-term, regional-scale rating of "**BBB**" is 1 notch above the minimum credit rating accepted by the CREPMF to issue debt without a guarantee.

The comprehensive credit rating report is available upon request by e-mail at: infos@rating-africa.org

Contact

Lead Analyst

Oumar NDIAYE

+225 22 50 18 44 / +221 33 825 72 22

Email : infos@rating-africa.or