



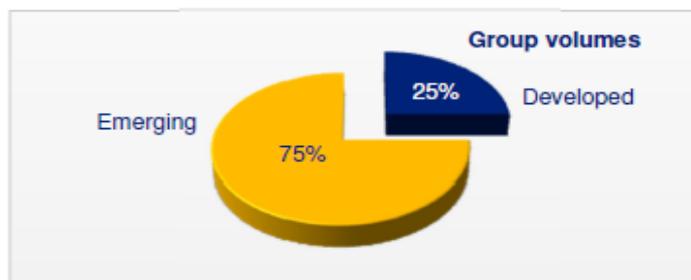
GOING BAT-TY

I recently attended a seminar organised by the wealth management division of NCB stockbrokers. At this seminar three representatives of major financial organisations gave presentations on individual funds available to clients of NCB.

One of the presentations was given by Morgan Stanley Asset Management and there was one particular aspect of the presentation that motivated me to write this opinion piece.

The presenter was talking about some of the investments that had worked for them in recent years when she mentioned that their tobacco company investments had done fantastically well. In particular she wanted to highlight the great performance of British American Tobacco (BATs). In an attempt at humour she said that they had recently been saying in their office that British American Tobacco should be renamed Brazilian Asian Tobacco because they were now growing so rapidly in those markets. The thing that struck me at the time was the delight with which she told this story. She was happy because they had made fantastic returns but my reaction was one of sadness. I was sad because this meant that people in Brazil and Asia were being “taken in” by the marketing machines of the tobacco companies and would end up with cancer or other smoking related illnesses. The government health warning says: “Smoking Kills” but that won’t stop Morgan Stanley from making money!

Here is a chart from a recent BATs investor presentation showing volumes of cigarette sold by geography and it suggests that a name change to Brazil Asia Tobacco might not be a joke!



I think of myself as being lucky to have hated cigarettes in my teenage years and to have the personality that enabled me to avoid peer pressure but unfortunately it appears that large numbers of people in Brazil and Asia are succumbing to the smoking habit.

Given my concerns about the health implications of smoking I have always felt that it is one of the few sectors to avoid completely. I have never owned a tobacco company and I have never even looked at them as a potential investment. However lots of investors appear to have no problem investing in the sector. Morgan Stanley Investment Management had over 20% of that particular fund invested in BATs, Imperial Tobacco and Philip Morris International.

I was recently listening to a speech given at the Ben Graham Centre for Value Investing at the University of Western Ontario by Value Investor Tom Russo (http://www.bengrahaminvesting.ca/Resources/Video_Presentations/Guest_Speakers/2012/Russo_2012.htm) when I realised that he too was a major investor in the same tobacco companies. In his speech he did not mention tobacco stocks (even though 22% of his fund was invested in the sector) and he spent his time talking about Nestle, Berkshire Hathaway and Pernod Ricard but in the question and answer section a student asked about his thinking on the long term prospects for tobacco in developed markets. He answered by saying that he assumed in the long run that revenues would decline to zero but there was enough money to be made between now and then so that in his opinion these were still good investments. Nobody even questioned the ethics of the situation so it appears that I am out on my own in feeling this way.

I mentioned my concerns to my friends at the Value Investment Institute (www.valueinstitute.org) just to see their reaction and it was interesting to hear the various responses. The most challenging response was in relation to the ethical issues involved in companies they know I own. In other words I was challenged on how I could own shares in companies that make alcohol and components for the nuclear power industry. (Some companies I own might even make components for military applications). I responded by saying that drinking in moderation might be beneficial to health but smoking can never be of similar benefit.

I also said that my gut tells me that it is much harder to be a moderate smoker than to be a moderate drinker because of my observations while watching a number of my friends struggling to give up smoking. (I don't have scientific research to back up this intuitive claim so I might be completely wrong)

Having thought some more about the issue I have to accept that each person has to make up their own mind. I try to weigh up the positives and negatives of things. I can see some positives in alcohol drunk in moderation (I enjoy a glass of wine), I can see some benefits in nuclear power and I can see the need for military equipment but I just cannot see any positives to tobacco and that is why I remain reluctant to try to make money in the sector and as the following chart shows there has been a lot of money made:



Maybe I am being hypocritical but I am going to continue to avoid tobacco companies in the hope that BATs share price will be like Bertie Aherne's career- a major collapse- then instead of renaming BATs as Brazilian Asian Tobacco we could rename it Bertie Ahern Tossler. (My attempt at bad taste humour!)