

GTNF 2015

Bologna, Sep. 15–17

Breakout session summary

Session 8 - Investment: A view from the financial industry

In their near-term and long-term outlook on the tobacco industry, the financial analysts representing the panel of this GTNF session were unanimously positive, arguing that U.S. tobacco companies were able to generate strong pricing and cost savings, with high single-digit or low double-digit growth rates. Pricing is expected to help offset declining smoking prevalence. While reduced-risk products (RRPs) raised lots of uncertainties, they were judged in the end as being a good thing rather than a bad thing for the industry.

The panelists said reasonable regulation and pricing power were keys to the industry's sustainability. With regard to smoking behavior, they claimed, the impact of tobacco control had been fairly minimal. As one of the negative factors influencing the sector, panelists named taxation, which drives up prices of tobacco products and touches upon the price sensibility of consumers. Likewise, illicit trade of tobacco continues to be a steady and increasing risk, estimated to account for 10 percent of global tobacco consumption.

The spread of plain packaging was ruled out as a big risk factor: Market research in Australia, the first country to introduce generic packaging of tobacco products at the end of 2012, showed that consumer behavior hadn't changed much since then. As one panelist pointed out, smokers who have already smoked will continue to smoke and don't care about the packaging. Panelists criticized the fact that plain-packaging advocates had been dishonest about the impact of the measure in their lobbying efforts.

In fact, the market share of entrenched players could actually benefit from plain packaging, since the legislation cemented existing market shares. What could be witnessed in Australia, though, was a downtrading to cheaper brands, and the question was raised by the panel what will happen in the United Kingdom (which will also implement plain packaging) if an extraordinarily high-level tax meets plain packaging—i.e., if the benefit of a non-generic pack will be removed. Nevertheless, analysts remained confident that, as a consequence of legal action taken against plain packaging, the legislation could be reversed in some markets.

With the Reynolds-Lorillard merger completed in June 2015, panelists expected only limited future consolidation in the U.S. On the global level, Imperial Tobacco Group was named as a potential takeover candidate. Such a move would reduce the four tobacco giants to three and enable British American Tobacco, for example, to surpass world market leader Philip Morris International. According to the panelists, Japan Tobacco was seeking expansion, too. Apart from that, local companies could become acquisition targets. And of course there is always the question about the Chinese state monopoly. With regard to merger and acquisition activity of tobacco companies in the vapor industry, panelists noted some saturation. Now that Japan Tobacco has taken over Logic, each of the leading cigarette makers has an asset in this market.

Panelists also examined the potential of vapor devices versus RRP. According to studies, 45 percent of vapers have never smoked a combustible cigarette; vapor products are especially attractive to younger people who are open to new technologies. However, vapor devices account for a sales volume of around \$3 billion in the U.S., whereas the market for combustible cigarettes stands around \$80 billion to \$85 billion. Tobacco companies, panelists agreed, have no choice but to develop RRP, although they might never replicate the “real experience” of a combustible cigarette, just like Diet Coke does not taste the same as traditional Coca-Cola. While most panelists forecast great opportunities for heat-not-burn products, one participant was cautious, arguing that vaping had got a head start and people were by now clear about what vaping is but did not know what heat-not-burn products are, with the industry not being united on this issue.

In this context, the panel discussed taxation and regulatory approaches to e-cigarettes. At the time of the GTNF, excise taxes were already levied to vapor products in two U.S. states (Minnesota and North Carolina) and several countries (South Korea, Portugal and Italy). As one panelist stated, “Excise taxes are addictive.” In the first half of 2015, 22 U.S. states had introduced bills that would assess an excise tax on e-cigarettes and nicotine liquid solutions used in e-cigarettes—eight of them failed and 15 bills are still pending. Panelists concurred that the most sensible measure to determine e-cigarette taxation was their level of relative risk. With that, governments might be able to recoup some of their revenue lost as consumption of combustible cigarettes declines.