



cutting through complexity

Project SUN

A study of the illicit cigarette market in the European Union

2013 Results

Presenting today: Helen Young, Associate Director, KPMG Strategy Group



Helen Young

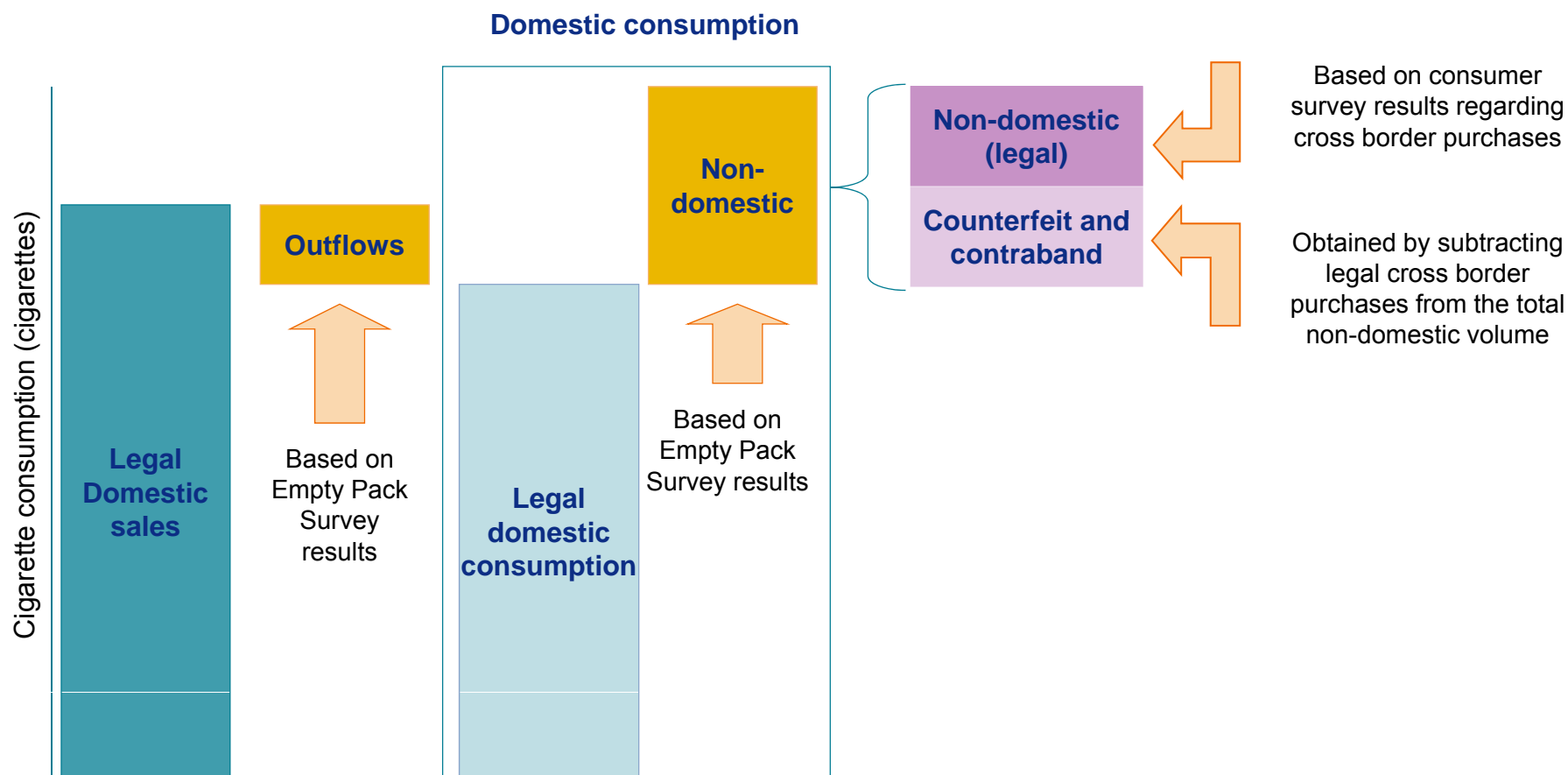
Associate Director, KPMG Strategy Group,
London UK

- Helen Young is an Associate Director in KPMG's Strategy Group with over thirteen years experience in consumer goods, retail and industrial markets
- Helen is focussed on anti-illicit trade services and has been leading the delivery of Project SUN since 2012, a multi year project assessing the size, evolution and flows of illicit tobacco across all of the EU member states
- She has also led a similar study assessing the illicit tobacco trade in the Latin American region
- In addition, Helen has extensive strategy consulting and transactions experience

The Project SUN methodology

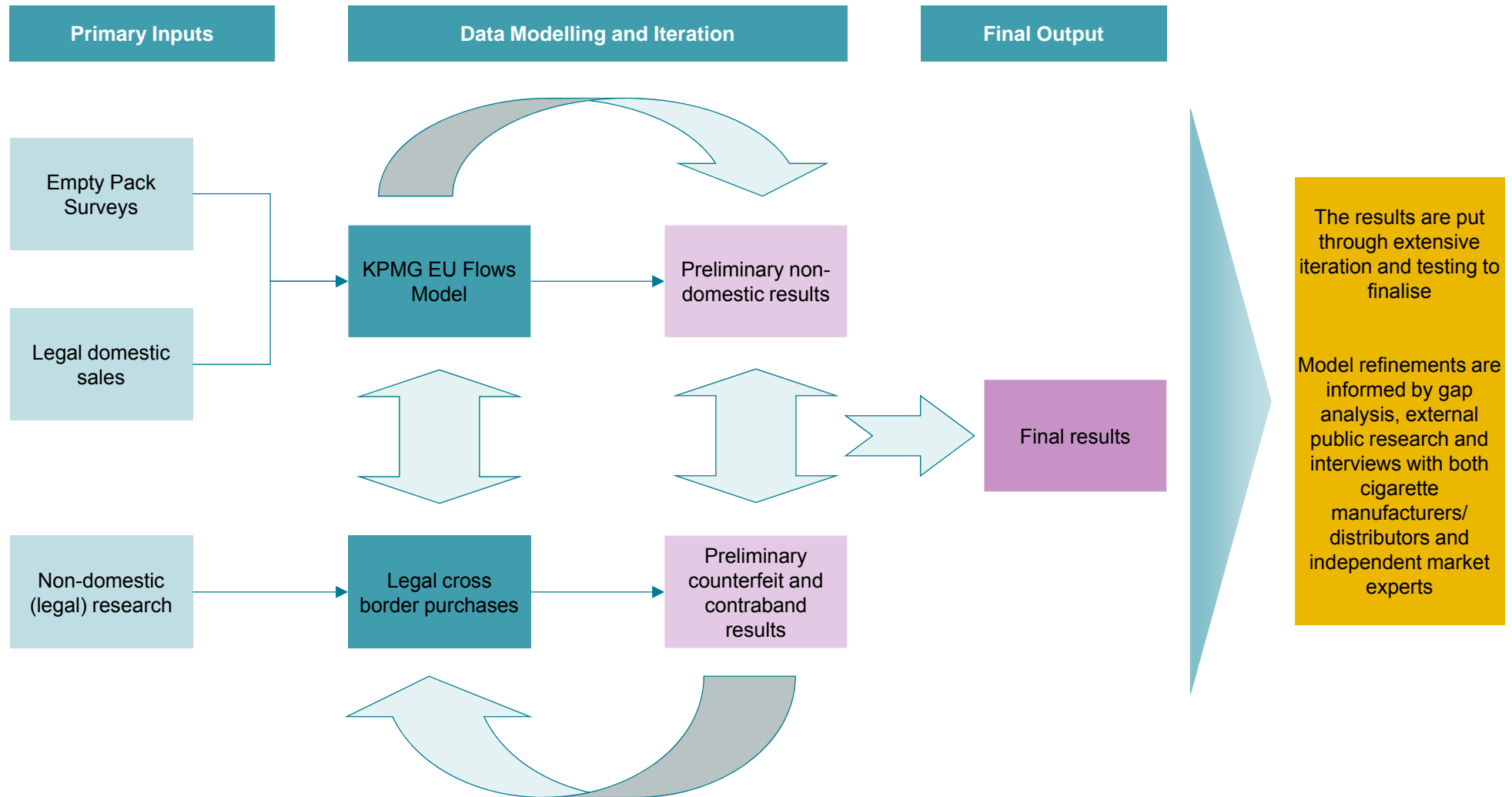
Pan industry approach	<ul style="list-style-type: none"> ■ In 2013, Project SUN (previously Project STAR) was commissioned jointly by the four major tobacco manufacturers. The input and provision of data sources from all four major cigarette manufacturers has provided KPMG with access to a much wider set of data sources, allowing for greater refinement of results
Objective evidence sourced from LDS and EPS results are input to the bespoke KPMG EU Flows Model	<ul style="list-style-type: none"> ■ The KPMG EU Flows Model is a dynamic, iterative model that is based on legal domestic sales (LDS) and Empty Pack Survey (EPS) results and is used to estimate overall manufactured cigarette volumes ■ The KPMG EU Flows model has been developed by KPMG to specifically measure inflows and outflows of cigarettes between EU countries. It is an iterative data driven model that uses LDS and EPS results to estimate the volume of non-domestic outflows and inflows to and from each EU Member State
EPS results provide a robust indication of the incidence of nondomestic and counterfeit packs by country of origin	<ul style="list-style-type: none"> ■ EPS is the only market research method that relies purely on physical evidence, avoiding the variability of consumer bias found in interview-based methods ■ The EPSs are conducted by independent market research agencies on a consistent basis across all the EU markets, allowing for direct comparison of data and the identification of inflows and outflows between all of the countries analysed ■ Over 500,000 packs were collected in 2013 as part of this research
Primary market research, combined with tourism & travel trends and pricing changes, is used to estimate legal non-domestic cigarette purchases	<ul style="list-style-type: none"> ■ The key objective of the market research programme undertaken by independent market research agencies is to estimate genuine, legal non-domestic tobacco purchases (including cross border shopping) in each market ■ ND(L) data used in the analysis in the 2013 Project SUN Report is based upon approximately 160,000 full interviews and over 14,000 net respondents. ■ Primary research is critical to deliver robust results as no other sources of sufficient detail and accuracy are available for legal cross border shopping ■ In addition to the research programme, ND(L) data has been adjusted by KPMG to reflect inbound visitor inflows and relative price changes

Project SUN uses legal domestic sales, Empty Pack Survey results and consumer research to quantify the volume of C&C cigarettes consumed in the EU



KPMG has developed and refined its methodology for estimating counterfeit and contraband incidence across the 28 EU markets since 2006

Our approach integrates multiple sources with custom-built analytical tools



Executive summary

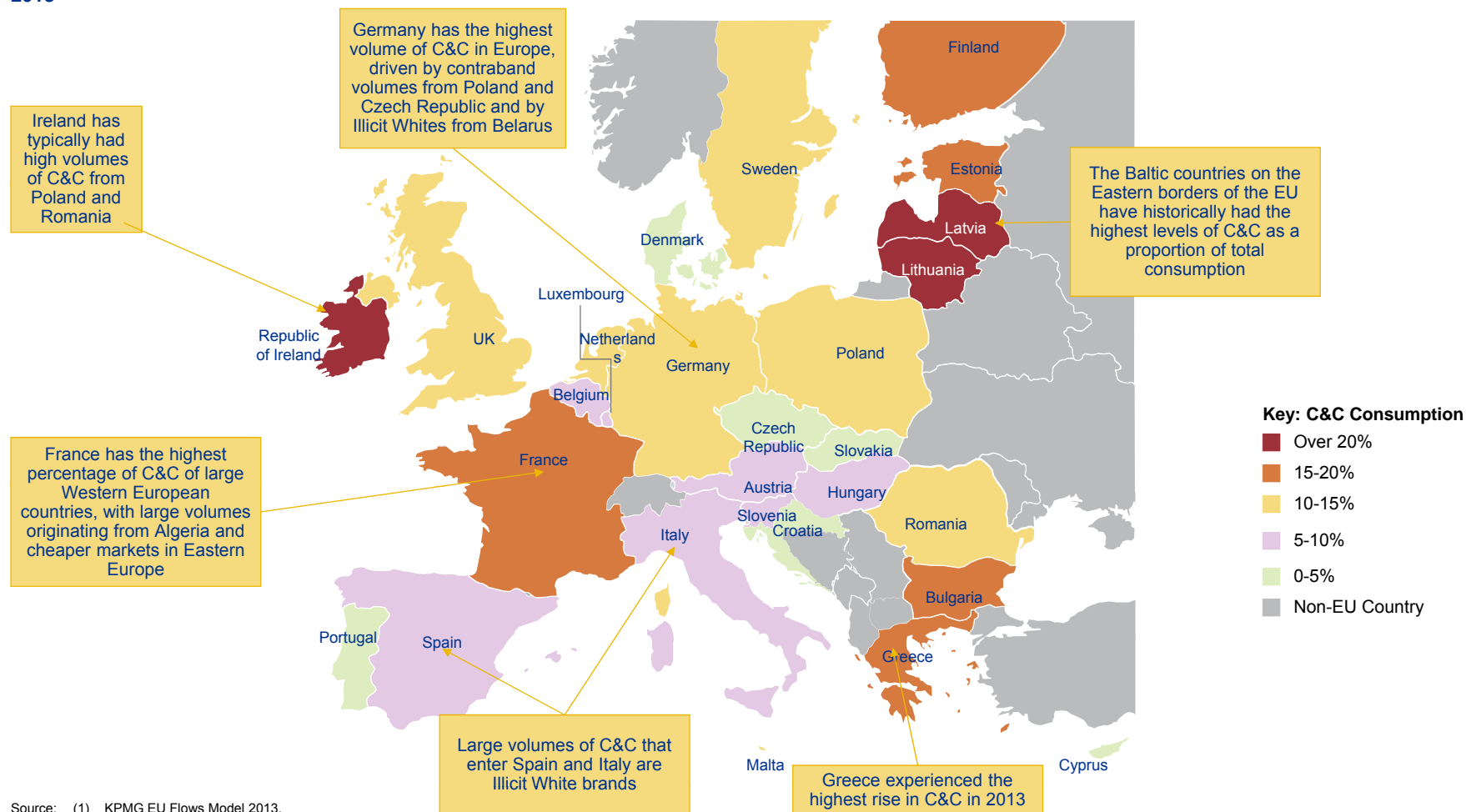
Project SUN 2013 headlines

Counterfeit and contraband volumes declined as a percentage of overall consumption in 2013	<ul style="list-style-type: none"> ■ Overall volumes of counterfeit and contraband (C&C) consumption declined from 65.7 billion cigarettes to 58.6 billion cigarettes. The C&C share of overall consumption fell from 11.1% to 10.5%. If these cigarettes had been sold legally in the countries where they were identified, the tax revenue would have been worth approximately €10.9 billion. ■ The C&C decline reflects a reduction of 3.9 billion cigarettes in the UK and 3.6 billion cigarettes in Italy, whilst in most countries, consumption of C&C products remained broadly static. ■ Greece experienced the highest increase in the overall volume of C&C product consumed at 26%, resulting in C&C volumes rising to over 17% of overall consumption.
Consumption of Illicit Whites brands grew from 17.1 billion to 19.6 billion cigarettes in 2013, 33% of overall C&C consumption	<ul style="list-style-type: none"> ■ Illicit Whites brands were identified in every EU country (except Luxembourg), many with unspecified or Duty Free labelling. The majority of Illicit Whites brands are manufactured by six manufacturers and distributed across Europe through sophisticated criminal supply chains. ■ The largest source of Illicit Whites was Belarus, where a large volume of brands were manufactured by the Grodno Tobacco Company.
Overall consumption of legally manufactured cigarettes in the EU declined by 7%	<ul style="list-style-type: none"> ■ Legal domestic consumption, the most significant proportion of total consumption in all markets, declined by 7.5%. Legal domestic sales may have been impacted by both the economic environment within Europe and price rises. Unemployment rose in 21 of the 28 EU countries, whilst in over half the EU countries prices increased by more than 5%. In some countries there is evidence of consumers switching to other tobacco products (OTP).
Levels of EU contraband consumption (excluding Illicit Whites) declined significantly, in the main being replaced by non-domestic legal (ND(L)) purchases	<ul style="list-style-type: none"> ■ Border sales between cheaper and more expensively priced markets grew by 12.0% in 2013. In many areas with high volumes of border sales, prices in cheaper markets increased at a greater level than in more expensive markets, resulting in a lower price gap. ■ Countries with large populations close to the border with cheaper markets had the highest volume of non-domestic legal consumption. These countries included the Netherlands, Austria, France and Germany.

European market overview

There are significant hotspots of C&C consumption across the European Union

Counterfeit and contraband consumption as a percentage of overall consumption
2013⁽¹⁾

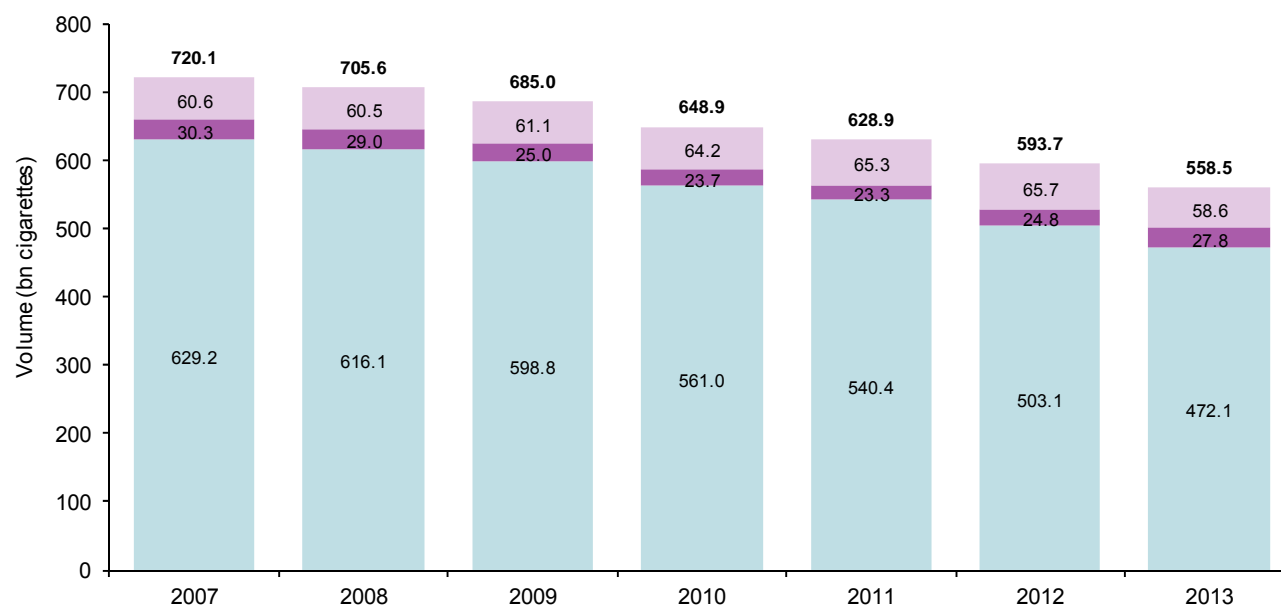


Source: (1) KPMG EU Flows Model 2013.

European market overview

Overall consumption declined by 7% in 2013. For the first time since the start of the study, C&C decreased by 11% in volume terms

Total cigarette consumption within the EU by type 2007-2013^{(1)(a)(b)}



CAGR (%)	2007-2013	2012-2013
Counterfeit and contraband	(0.5)%	(10.6)%
Non-domestic legal	(1.4)%	12.0%
Legal domestic consumption	(4.9)%	(7.5)%
Total	(4.3)%	(7.0)%

Note: (a) The percentages above have been calculated without the inclusion of Croatia, however the overall volumes for 2013 include Croatia for the first time. Without Croatia total consumption would have been 551.5 billion, C&C 58.3 billion, ND(L) 27.7 billion and legal domestic consumption 465.6 billion.

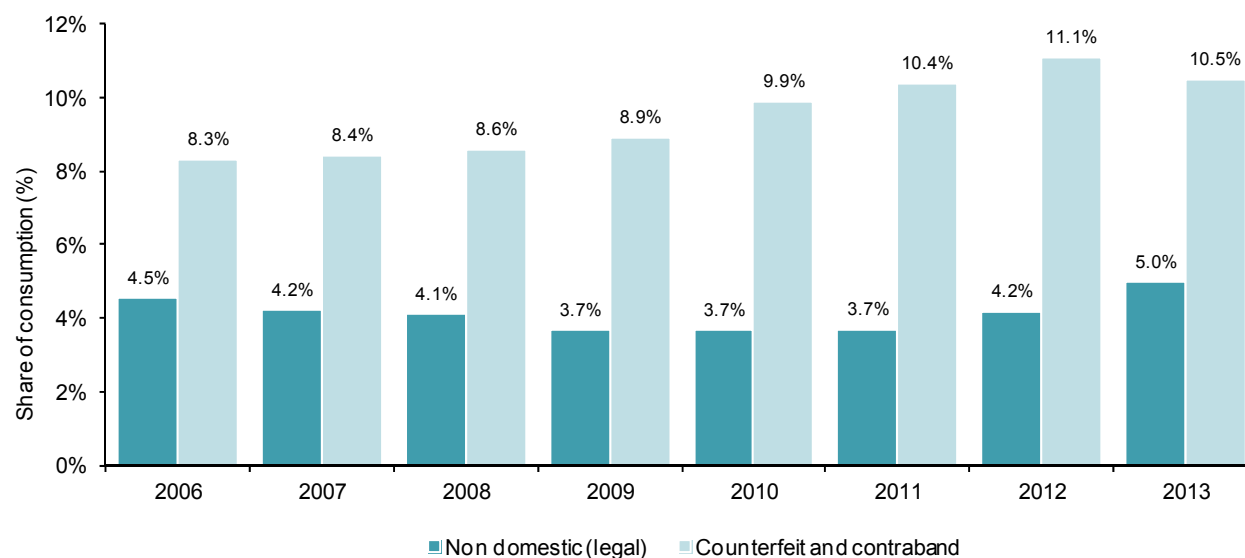
(b) The availability of data from all manufacturers for the first time in 2013 has allowed for additional refinement of results in some countries. The net impact of this is to allocate an additional 1 billion to ND(L) from C&C. Without these refinements C&C would be 59.6 billion and ND(L) 26.8 billion.

Source: (1) KPMG EU Flows Model 2007 – 2013.

European market overview

After years of growth, C&C declined as a share of total consumption in 2013, while ND(L) continued to grow

ND(L) and C&C share of total consumption 2006-2013^{(1)(a)(b)}



ND(L) and C&C volumes (bn cigarettes)								
	2006	2007	2008	2009	2010	2011	2012	2013
ND(L) volume	31.0	30.3	29.0	25.0	23.7	23.3	24.8	27.8
C&C volume	56.8	60.6	60.5	31.1	64.2	65.3	65.7	58.6

Note: (a) As previously noted, the availability of additional data sources has had a net impact of 1 billion sticks in favour of ND(L). Had this not been available, the overall C&C volume would have been 10.75% of total consumption and ND(L) 4.85%.

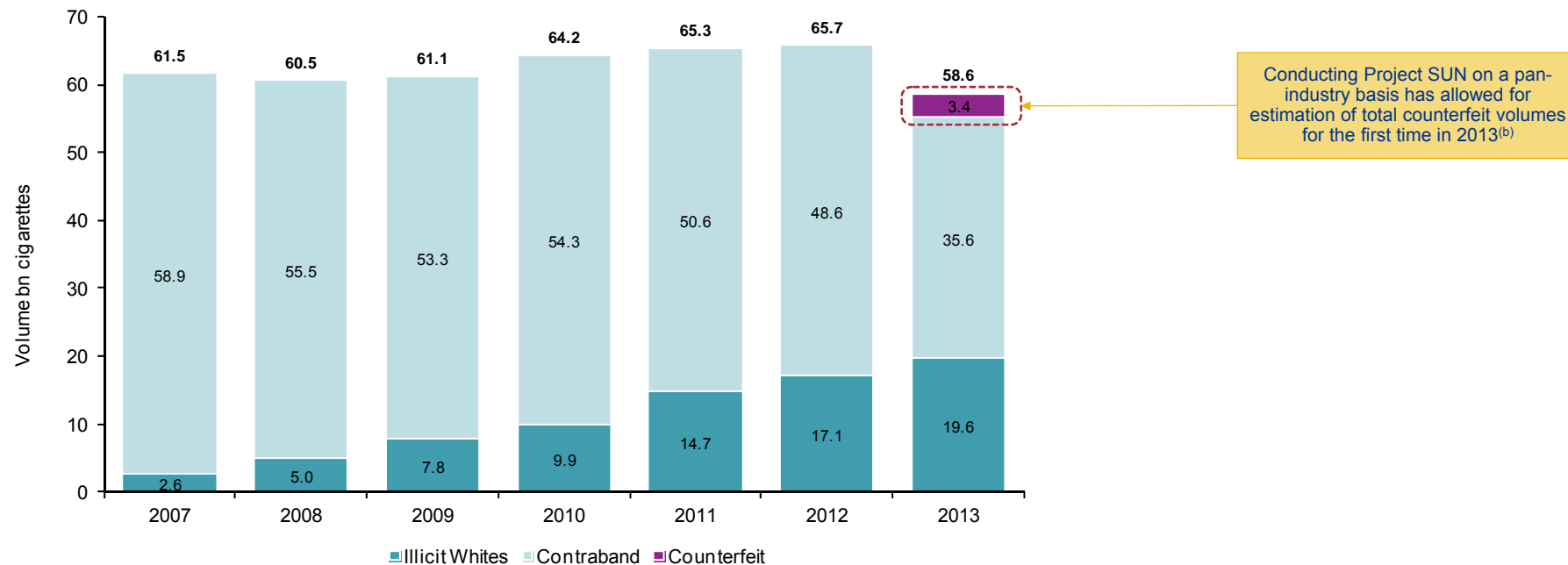
(b) 2006 calculation does not include Bulgaria and Romania.

Source: (1) KPMG EU Flows Model calculations 2006 – 2013.

European market overview

Illicit Whites grew to 33% of overall C&C consumption in 2013

Counterfeit and contraband consumption by type 2007-2013^{(1)(a)(b)}



Note: (a) Overall decline in C&C includes the effect of availability of additional data sources as stated previously.

(b) The Counterfeit volume reflects Counterfeit data from BAT, Imperial Tobacco, JTI and PMI, but does not include data from other manufacturers.

Source: (1) KPMG EU Flows Model 2007 – 2013.

European market overview

Hungary, Slovenia and Croatia had the highest price increases in the EU in 2013 in order to comply with the minimum EU tax rate

Country price comparison WAP, pack of 20 (€)			
Country	End of 2012	End of 2013	Price change
Serbia	1.52	1.79	16.2%
Hungary	2.66	3.00	13.0%
Russia	1.16	1.31	12.7%
Slovenia	2.95	3.27	10.8%
Croatia	2.46	2.70	10.0%
Ukraine	0.80	0.88	9.9%
Albania	1.27	1.39	9.1%
Bosnia	1.57	1.71	9.1%
Finland	4.50	4.89	8.7%
Canary Islands	1.68	1.83	8.6%
UK	7.52	8.15	8.5%
Latvia	2.40	2.60	8.3%
Estonia	2.62	2.82	7.6%
Greece	3.28	3.50	6.8%
Spain	4.03	4.30	6.7%
France	6.10	6.50	6.6%
Romania	2.64	2.81	6.5%
Lithuania	2.25	2.38	5.8%
Austria	3.95	4.18	5.7%

Country price comparison WAP, pack of 20 (€)			
Country	End of 2012	End of 2013	Price change
Slovakia	2.72	2.87	5.7%
Poland	2.65	2.80	5.5%
Switzerland	6.00	6.33	5.5%
Ireland	8.47	8.92	5.3%
Netherlands	5.03	5.29	5.1%
Cyprus	3.91	4.08	4.3%
Czech Republic	2.76	2.88	4.2%
Macedonia	1.24	1.29	3.8%
Germany	4.88	5.02	2.8%
Luxembourg	3.84	3.95	2.8%
Belgium	4.77	4.88	2.3%
Denmark	5.26	5.33	1.3%
Portugal	3.85	3.90	1.3%
Bulgaria	2.36	2.38	0.9%
Italy	4.56	4.58	0.4%
Malta	4.14	4.07	-1.6%
Sweden	6.02	5.91	-1.8%
Belarus	0.66	0.64	-3.5%
Norway	12.14	11.66	-3.9%

Key

■ EU Countries highlighted

Note (a) Manufacturer estimates used for countries not included in the EU Tax Tables

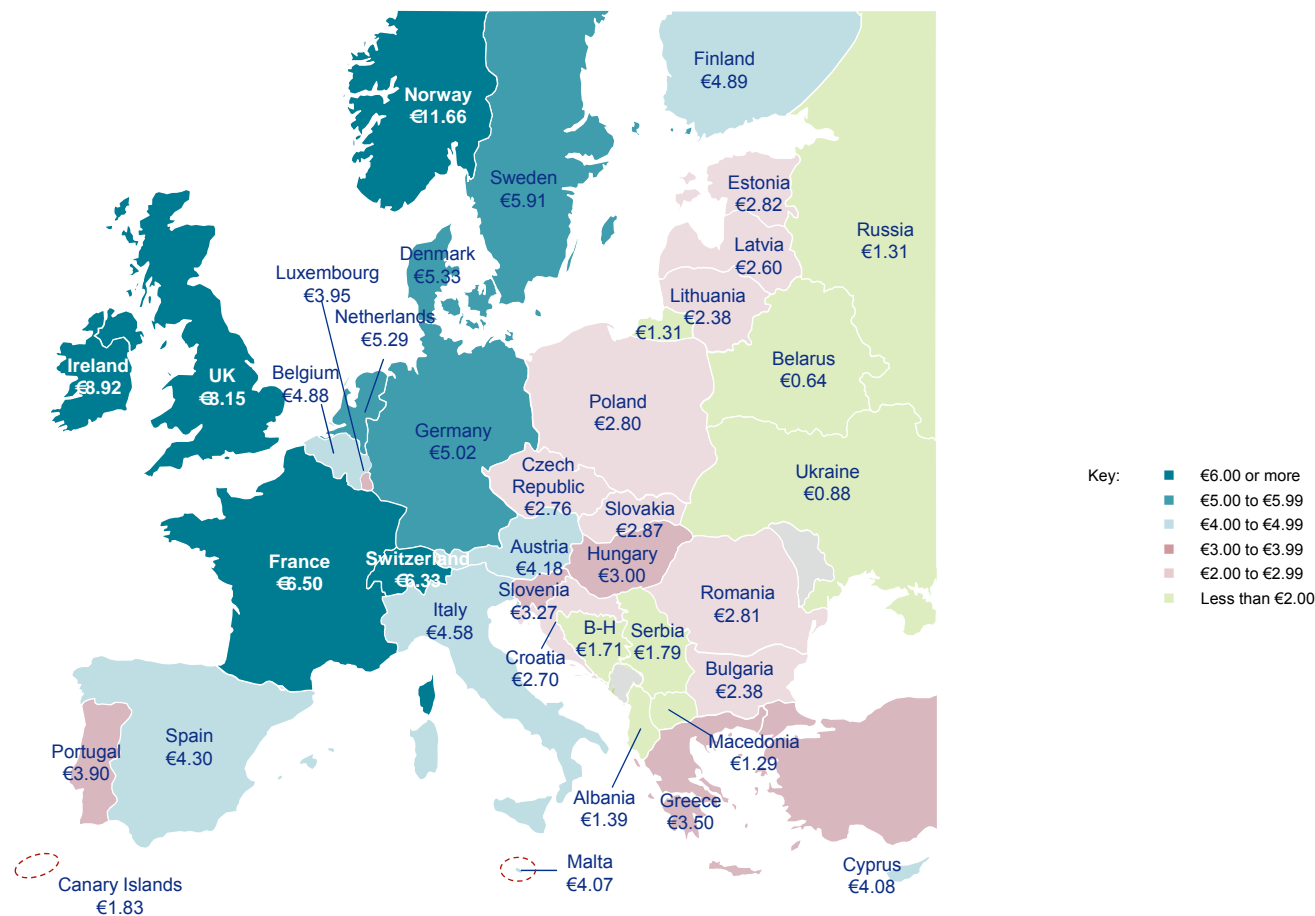
(b) EU countries highlighted

Source: (1) EU Tax Tables

European market overview

Price gaps have narrowed between EU countries; however, prices in non-EU countries on the Eastern border remain up to 13 times lower than the EU

Map denotes weighted average prices for a pack of 20 cigarettes
End of 2013⁽¹⁾



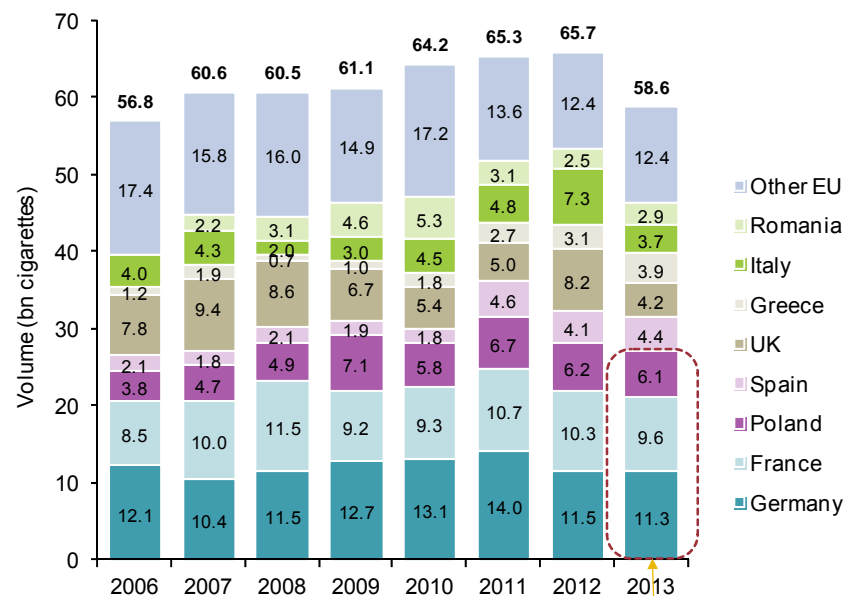
Note (a) Manufacturer estimates used for countries not included in the EU Tax Tables

Source: (1) EU Tax Tables

European market overview

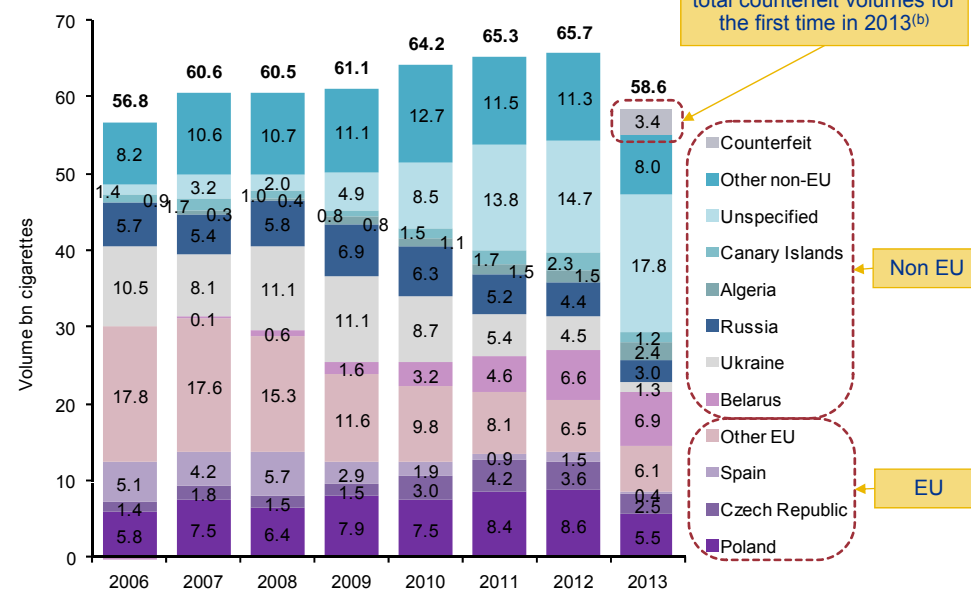
The key C&C consumption markets of Germany, France and Poland were stable. Declines in Italy and UK were offset by an increase in Spain and Greece. The main source country to increase was Belarus

C&C volume by destination country
2006-2013⁽¹⁾



Almost half of C&C manufactured cigarettes are consumed within three countries in Europe

C&C volume by source country
2006-2013⁽¹⁾



Conducting Project SUN on a pan-industry basis has allowed for estimation of total counterfeit volumes for the first time in 2013^(b)

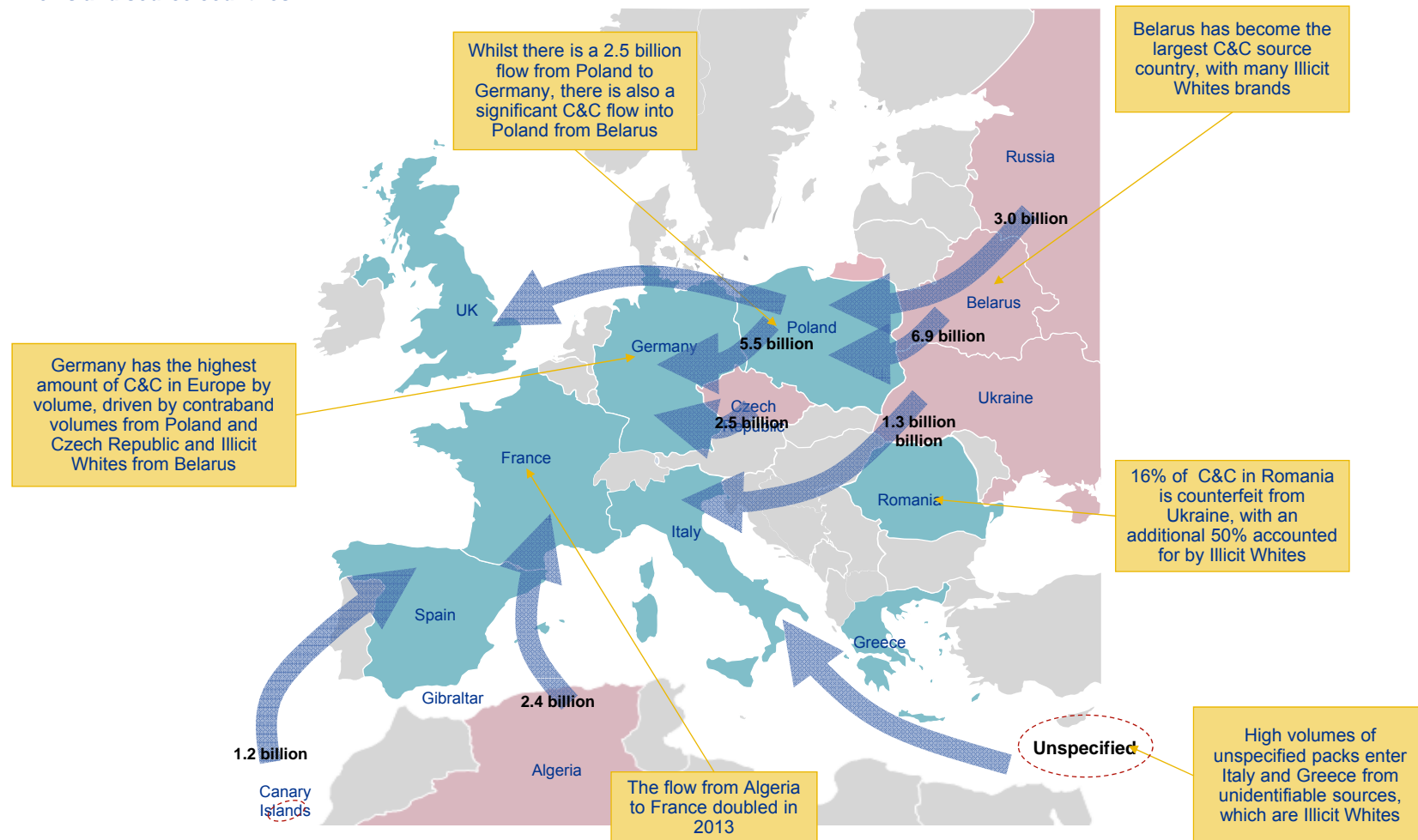
The growth in "unspecified" as a source of C&C is the result of greater volumes being sold with no tax stamps and as Illicit Whites

Source: (1) KPMG EU Flows Model 2007 – 2013.

European market overview

A greater proportion of counterfeit and contraband now originates from unspecified sources along with Belarus, Russia and North African countries

Major C&C inflows and source countries 2013⁽¹⁾

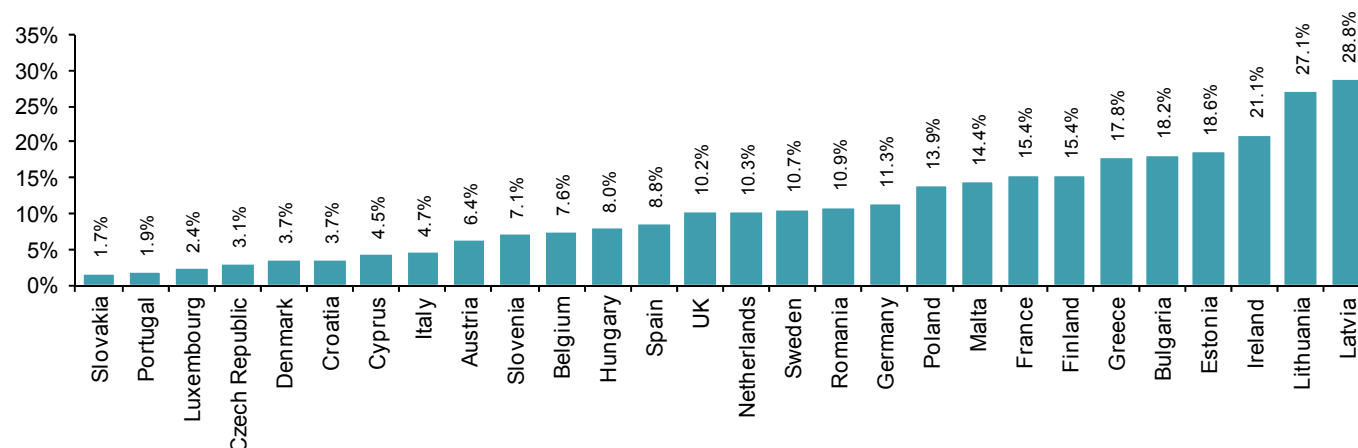


Source: (1) KPMG EU Flows Model 2013.

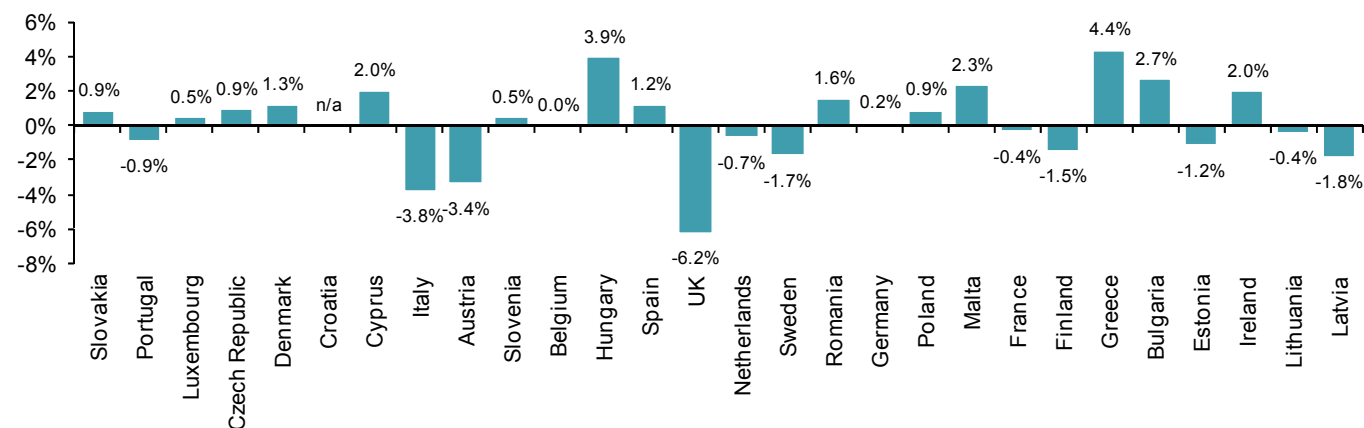
European market overview

11 of the 28 EU markets experienced a decline in illicit cigarette consumption as a percentage of overall consumption in 2013

C&C consumption incidence by country 2013⁽¹⁾



Percentage point change in C&C consumption incidence by country 2012 vs. 2013⁽¹⁾

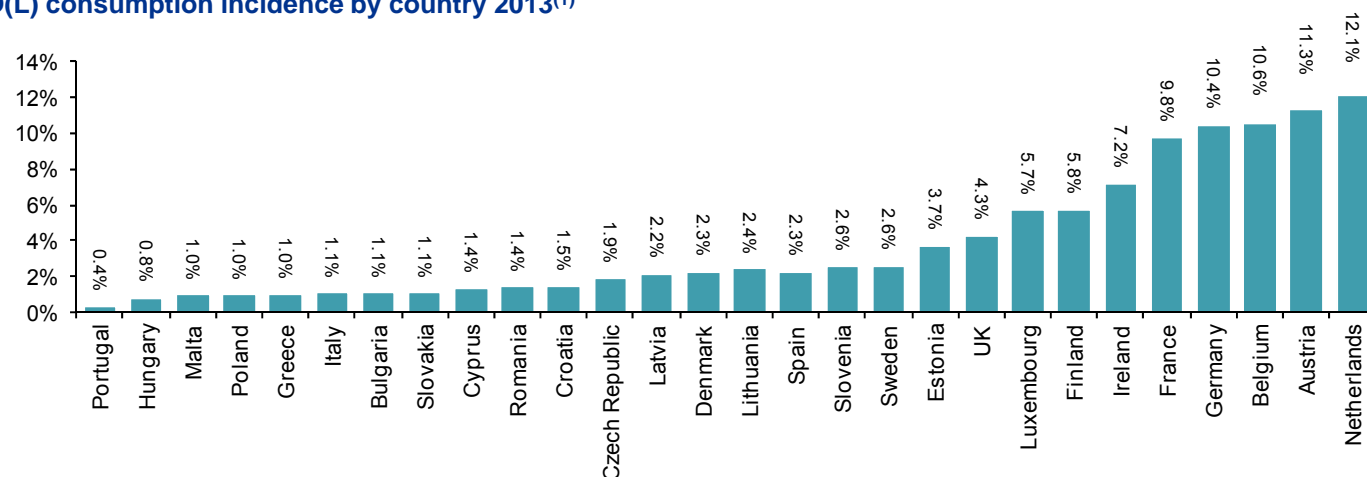


Source: (1) KPMG EU Flows Model 2007 – 2013.

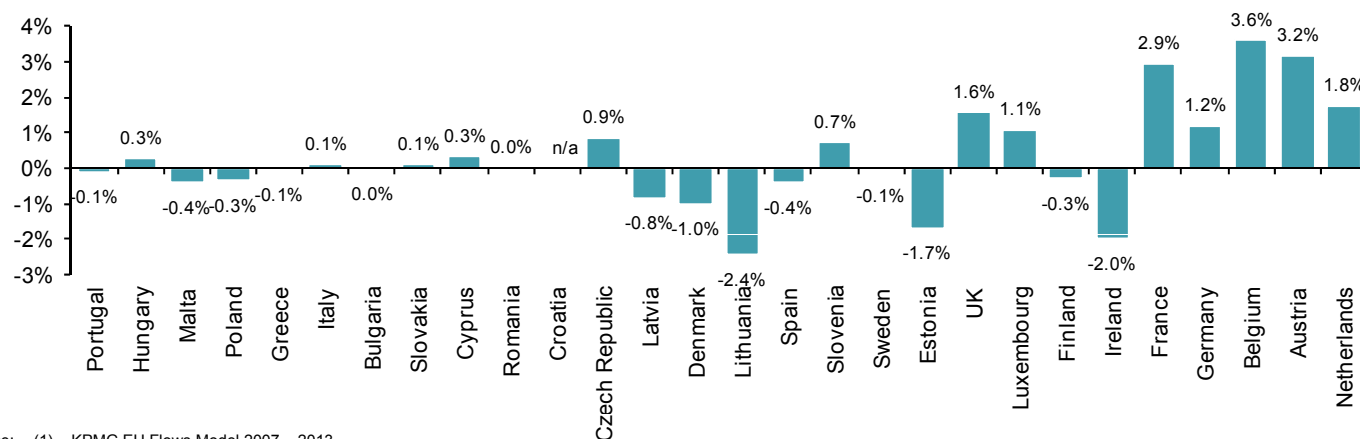
European market overview

Key ND(L) flows were from Poland and Czech Republic to neighbouring western European countries

ND(L) consumption incidence by country 2013⁽¹⁾



Percentage point change in ND(L) consumption incidence by country 2013⁽¹⁾

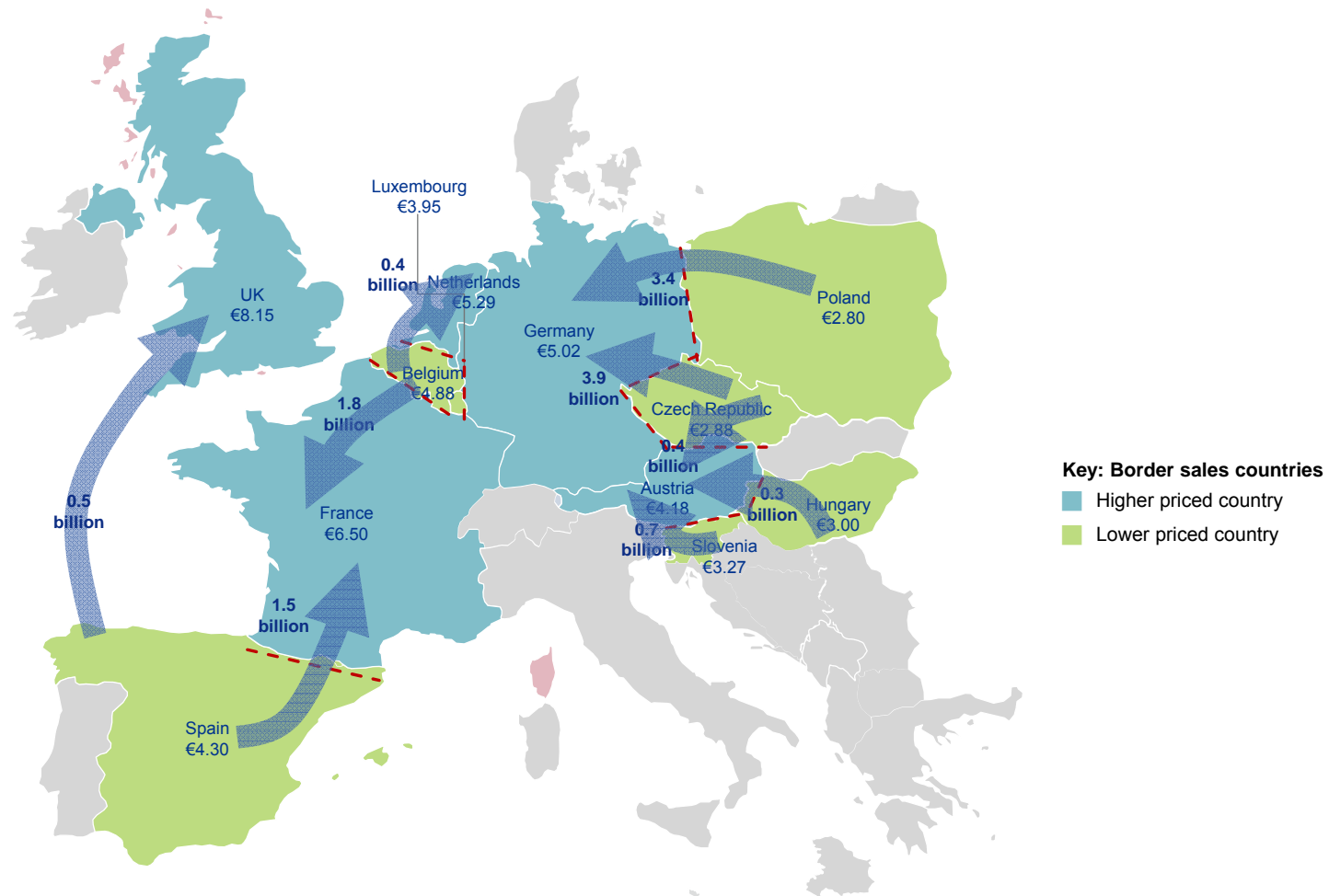


Source: (1) KPMG EU Flows Model 2007 – 2013.

European market overview

Non-domestic legal consumption increased as a result of greater border sales between markets with large price differentials

Major border sales points⁽¹⁾

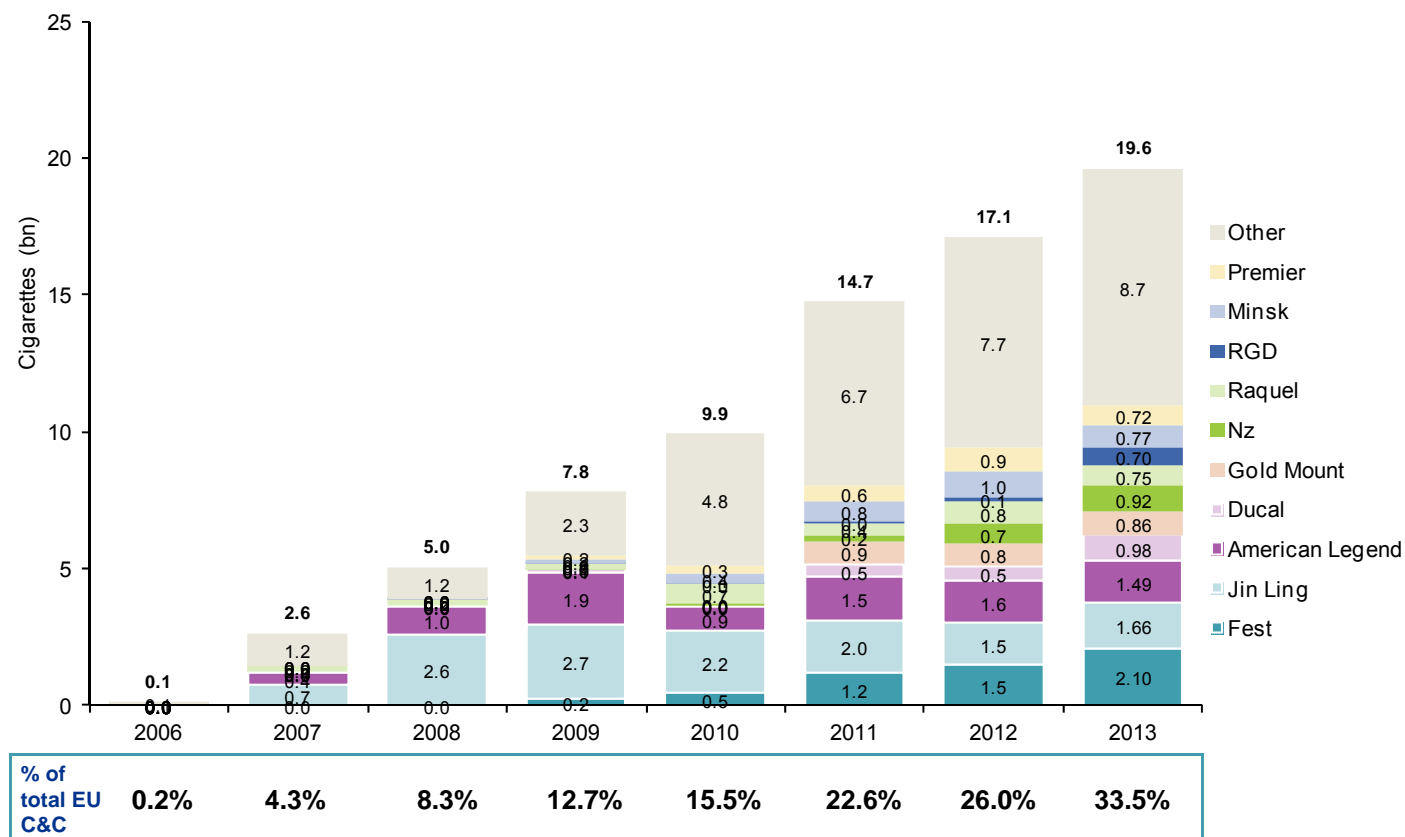


Source: (1) KPMG analysis of Non-domestic legal research

Illicit Whites

Total consumption of Illicit Whites increased by 22% in 2013, representing 33% of total C&C volumes in the EU. The largest Illicit Whites brand is Fest, which increased its volumes by 44%

**Consumption of Illicit Whites brands
2006-2013^{(1)(a)}**



Top Illicit Whites brand growth	
Brand	2012-13%
Fest	44%
Jin Ling	8%
American Legend	(5)%
Ducal	81%
Gold Mount	5%
NZ	32%
Raquel	(11)%
RGD	541%
Minsk	(21)%
Premier	(17)%

CAGR (%)	2007-13	2012-13
Illicit Whites	40%	15%

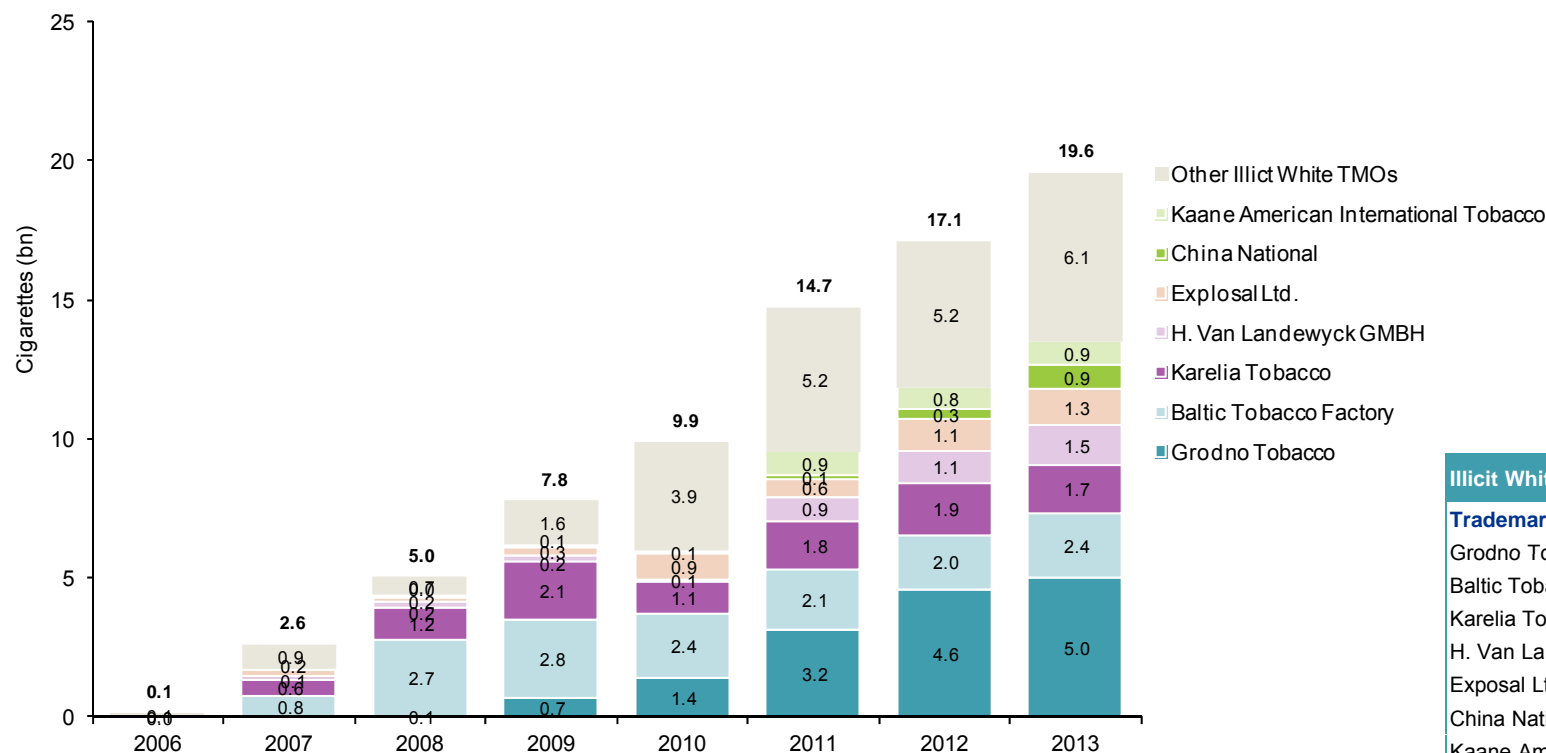
Note: (a) Our definition of Illicit Whites has been updated in 2013 to the ITIC definition (shown in the Glossary). We have updated our Illicit Whites analysis from prior years in reflection of this and have applied this definition consistently over the period shown, resulting in some updates to Illicit White volumes from prior years.

Source: (1) KPMG analysis based on Empty Pack Surveys, legal domestic sales and non-domestic (legal) research.

Illicit Whites

Grodno Tobacco remained the largest Illicit Whites trademark owner in 2013 whilst Baltic Tobacco increased volumes by 19%

Consumption of Illicit Whites brands by trademark owner 2006-2013^{(1)(a)}



Illicit Whites trademark owner growth	
Trademark owner	2012-13%
Grodno Tobacco	9%
Baltic Tobacco Factory	19%
Karelia Tobacco	(9)%
H. Van Landewyck GMBH	27%
Explosal Ltd	12%
China National	161%
Kaane American International Tobacco	5%

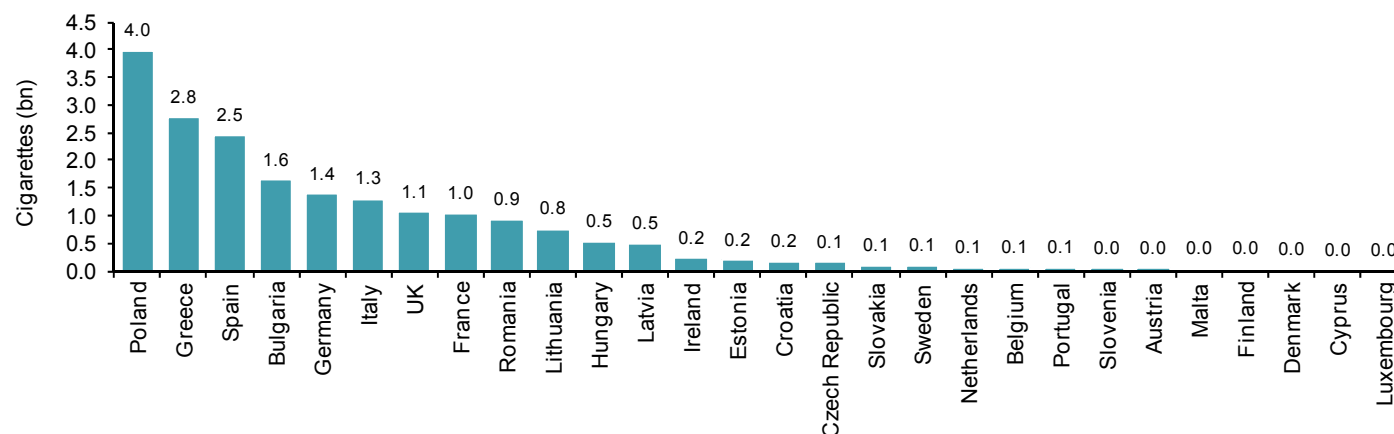
Note: (a) Our definition of Illicit Whites has been updated in 2013 to the ITIC definition (shown in the Glossary). We have updated our Illicit Whites analysis from prior years in reflection of this and have applied this definition consistently over the period shown, resulting in some updates to Illicit White volumes from prior years.

Source: (1) KPMG analysis based on Empty Pack Surveys, legal domestic sales and non-domestic (legal) research.

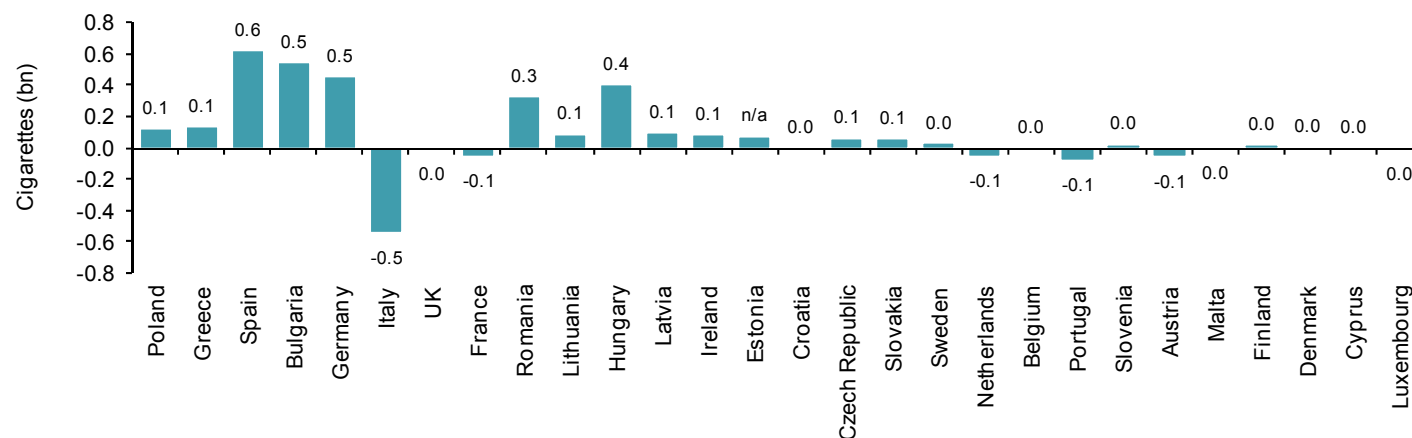
Illicit Whites

Poland had the highest level of Illicit Whites consumption in 2013. 15 out of 28 EU markets experienced a growth in Illicit Whites consumption in 2013

Illicit Whites consumption by country 2013^{(1)(a)}



Volume change in Illicit Whites consumption by country 2012 vs. 2013^{(1)(a)}



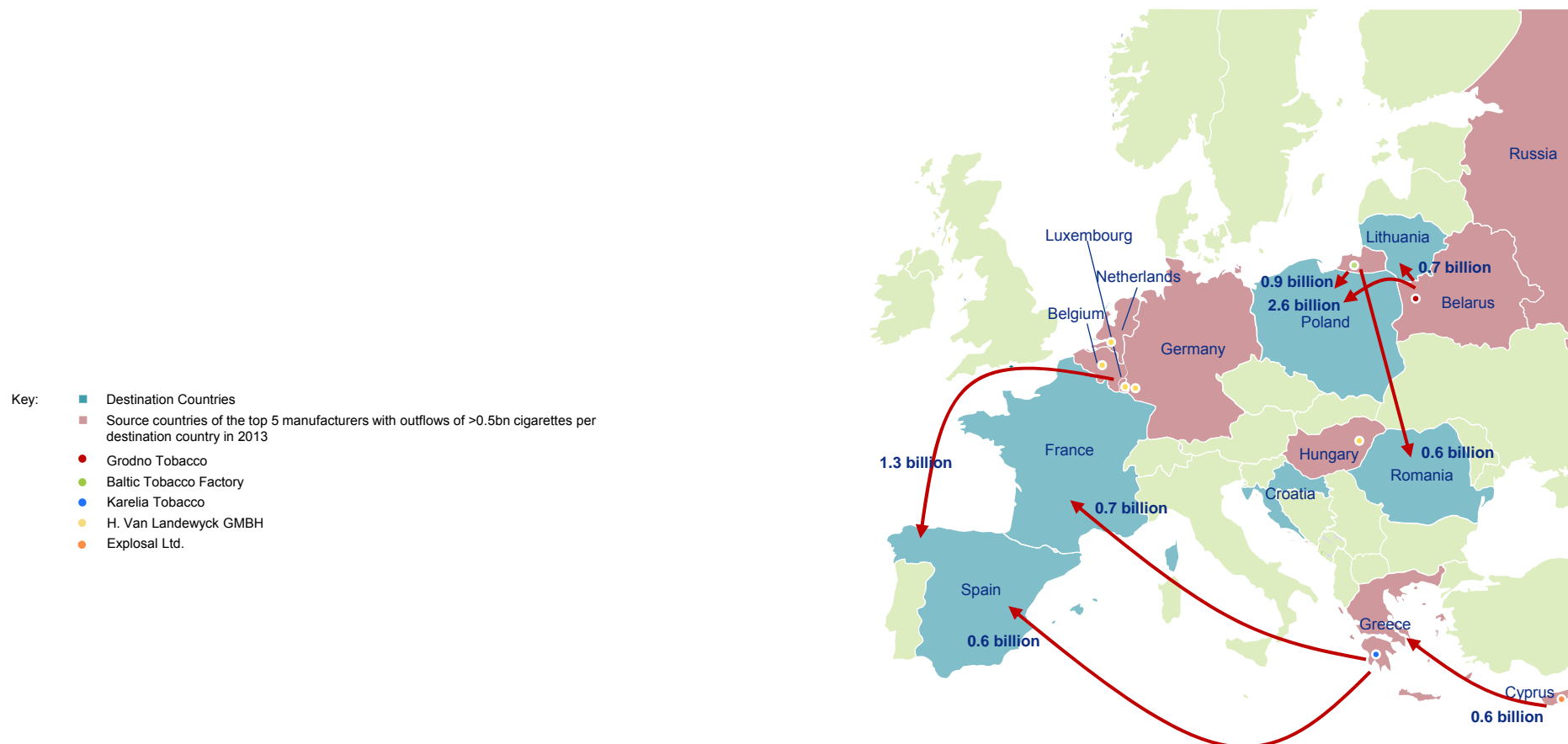
Note: (a) Our definition of Illicit Whites has been updated in 2013 to the ITIC definition (shown in the Glossary). We have updated our Illicit Whites analysis from prior years in reflection of this and have applied this definition consistently over the period shown, resulting in some updates to Illicit White volumes from prior years.

Source: (1) KPMG analysis based on Empty Pack Surveys, legal domestic sales and non-domestic (legal) research.

Illicit Whites

Belarus continues to be the largest known source country of Illicit Whites brands, which are mainly manufactured by Grodno Tobacco Company

Source country of Top 5 manufacturers
2013^{(1)(a)(b)}



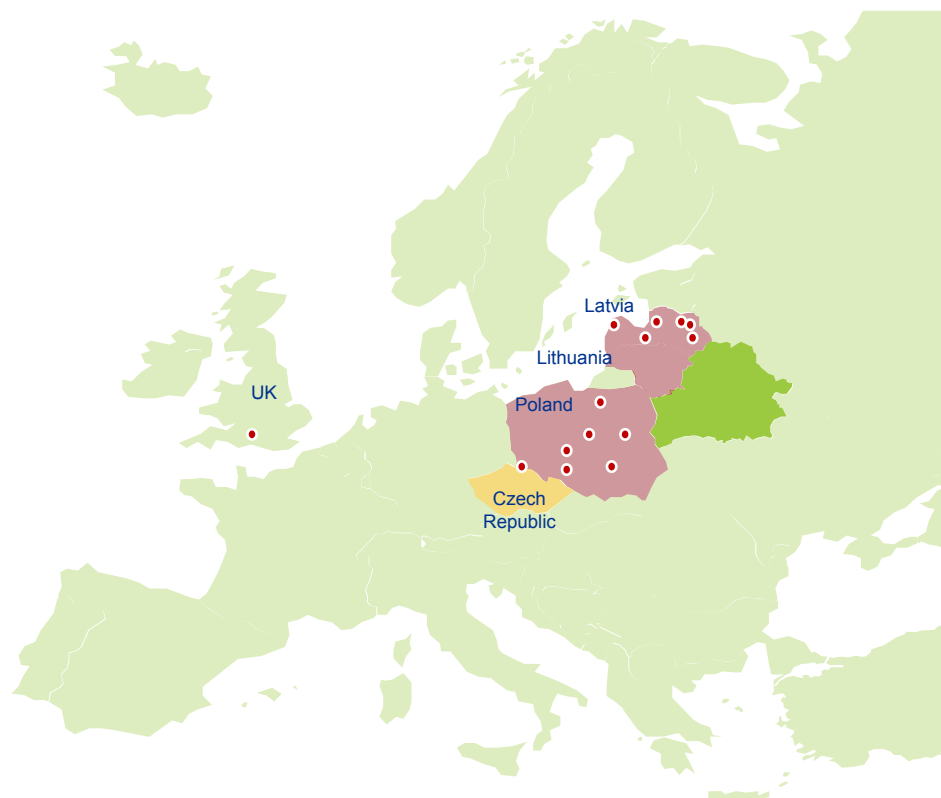
Note: (a) Analysis represents flows for brands of the top 5 manufacturers and from unspecified markets, representing over 60% of total illicit White volumes in 2013

Source: (1) KPMG analysis based on EPS, LDS and ND(L) research

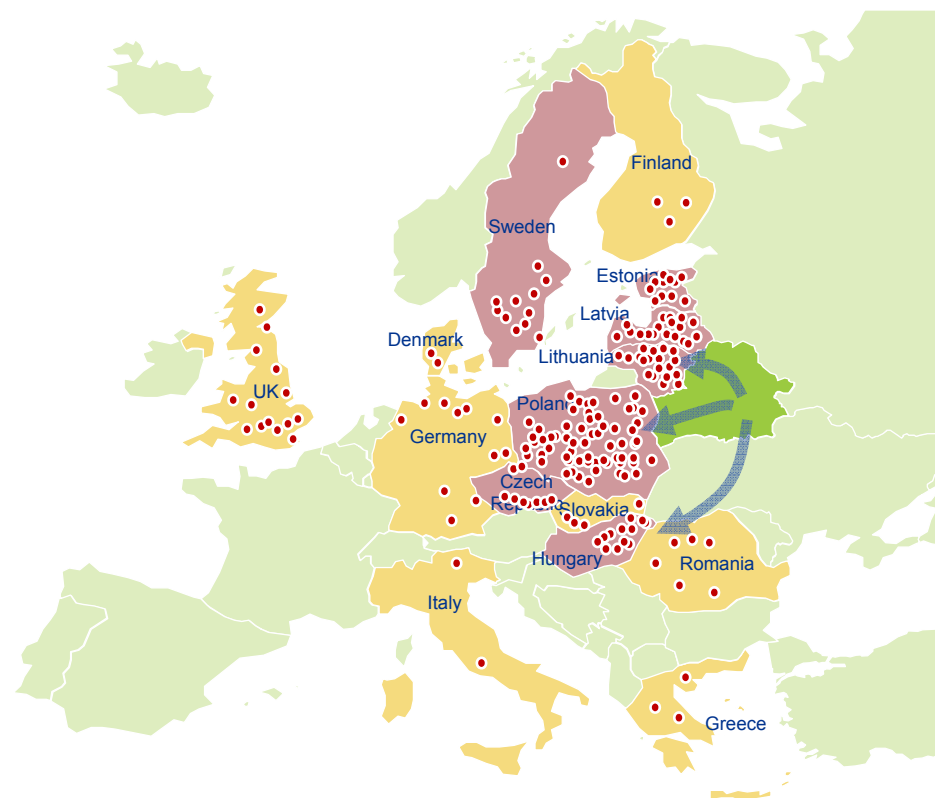
Illicit Whites

While Grodno Tobacco brands were found in 4 countries in 2009, its brands have spread further West, becoming prevalent in 15 countries in 2013

Consumption of Grodno Tobacco brands
2009^{(1)(a)(b)}



Consumption of Grodno Tobacco brands
2013^{(1)(a)(b)}



Key:

- Grodno tobacco brands comprise greater than 0.5% of total consumption
- Grodno tobacco brands comprise between 0.1% and 0.5% of total consumption

Note:

- (a) The analysis covers Illicit Whites brands found in 2009 and in 2013
- (b) The number of dots marked represent the varying levels of consumption in each country
- (c) Grodno brands in the EU consist of Fest, NZ, Minsk, Premier, Queen, Magnat and VIP

Source: (1) KPMG analysis based on Empty Pack Surveys, legal domestic sales and non-domestic (legal) research.

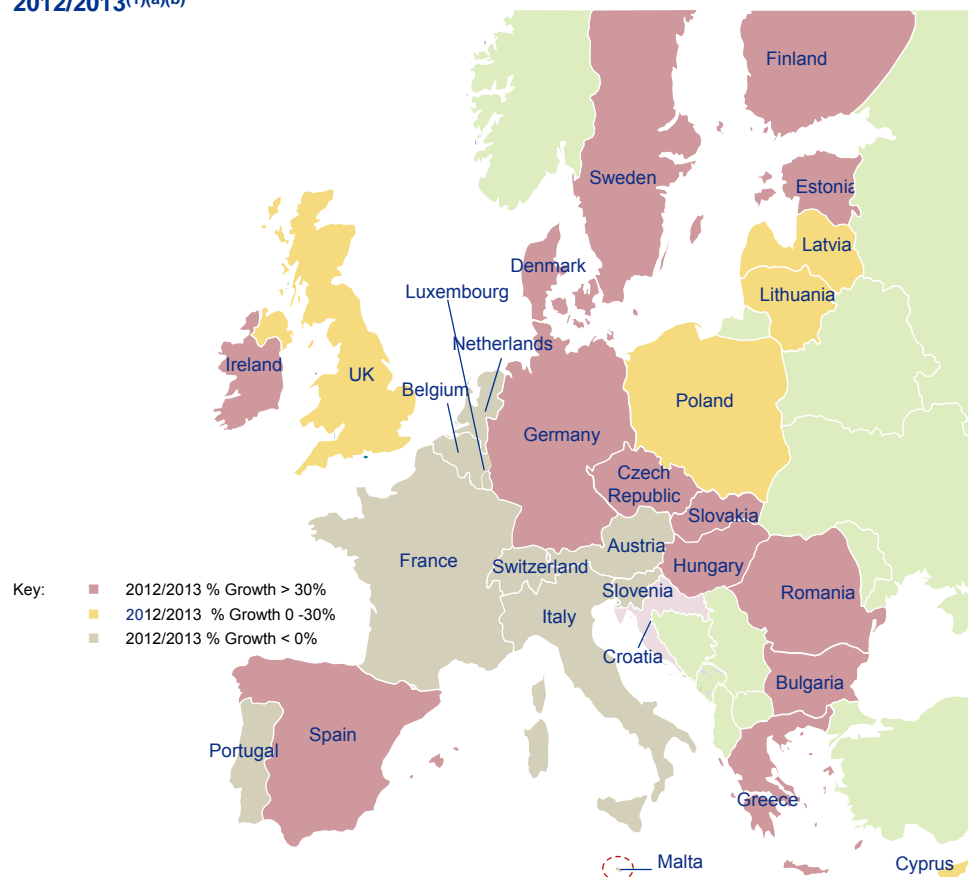
Illicit Whites

Eastern European and Scandinavian countries have seen the fastest growth of Illicit Whites volumes in 2013

Volume and growth of Illicit Whites brands by country

Country	2012	2013	Change 2012-13%	Share of consumption
Hungary	0.12	0.52	>100%	5.8%
Finland	0.01	0.03	>100%	0.6%
Slovakia	0.04	0.10	>100%	1.5%
Slovenia	0.02	0.05	>100%	1.5%
Czech Republic	0.09	0.15	70%	1.1%
Estonia	0.12	0.19	64%	10.3%
Ireland	0.15	0.23	57%	5.0%
Romania	0.60	0.93	54%	3.5%
Bulgaria	1.10	1.64	50%	11.9%
Germany	0.93	1.39	49%	1.4%
Sweden	0.07	0.09	40%	1.5%
Spain	1.83	2.45	34%	4.9%
Latvia	0.40	0.50	24%	21.1%
Denmark	0.02	0.02	19%	0.4%
Cyprus	0.01	0.01	18%	0.6%
Lithuania	0.67	0.76	13%	21.2%
Greece	2.63	2.76	5%	12.2%
Belgium	0.05	0.06	3%	0.5%
Poland	3.87	3.99	3%	9.1%
Croatia	n/a	0.17	n/a	2.5%
UK	1.06	1.06	(1)%	2.5%
France	1.08	1.03	(5)%	1.6%
Malta	0.04	0.04	(5)%	7.7%
Italy	1.84	1.30	(30)%	1.7%
Netherlands	0.12	0.06	(48)%	0.5%
Austria	0.09	0.04	(59)%	0.3%
Portugal	0.13	0.05	(60)%	0.5%
Luxembourg	0.01	0.00	(100)%	0.0%
Total	17.11	19.61	15%	

Change in Illicit Whites consumption
2012/2013^{(1)(a)(b)}



Note: (a) Our definition of Illicit Whites has been updated in 2013 to the ITIC definition (shown in the Glossary). We have updated our Illicit Whites analysis from prior years in reflection of this and have applied this definition consistently over the period shown, resulting in some updates to Illicit White volumes from prior years.
(b) Illicit Whites volumes in Croatia were not identified in 2012, therefore it is not possible to calculate a percentage change year on year; countries where volumes have increased from zero have been coloured red, while countries which remained at zero have been coloured yellow.

Source: (1) KPMG analysis based on Empty Pack Surveys, legal domestic sales and non-domestic (legal) research.



cutting through complexity

© 2014 KPMG LLP, a UK limited liability partnership, is a subsidiary of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative, a Swiss entity. All rights reserved.

The KPMG name, logo and “cutting through complexity” are registered trademarks or trademarks of KPMG International Cooperative (KPMG International).