



SMOKINGATE

- [ABOUT](#)
- [CONTACT US](#)
 - [PRESS CONTACT FORM](#)

THE MARLBORO CARTEL

BY SMOKINGATE ON NOVEMBER 30, 2011 · IN THE CARTEL · WWW.SMOKINGATE.COM

Reviled by many as a “merchant of death,” Philip Morris International, the world’s leading tobacco company, is a darling of investors who love its cash-generating, profit-making, stock-appreciating potential. Above all, investors love PMI’s unique “pricing power,” the key driver of its earnings.

This love affair may be drawing to a bitter end. An industry insider who has revealed an international cartel operated by the world’s largest tobacco companies claims that PMI’s astonishing profit-making machine is powered by illegal price-fixing. PMI’s customers are paying inflated prices for their *Marlboros*; PMI’s public shareholders, fooled by the “pricing power” myth, are paying inflated prices for their stock; and PMI’s senior management are laughing all the way to the bank in their Ferraris.

This is the first in a series of explosive revelations about the multinational tobacco industry and its leader PMI that will be published on this site. Welcome to SmokinGate.

“I’ve had two General Counsel who told me: ‘I had a discussion with the SMT [Senior Management Team] and I can assure you there will be no more price-fixing – it’s fixed, it’s taken care of.’ Two – two! We’ll see if the third one takes care of it.”

– PMI Deputy General Counsel, June 2011

“If you [Max] think we know right today that this is a per se violation and we’ve got to fix it, then all you’re giving the business is something that they would say, ‘the law then is created by people who are on drugs, because they don’t understand.’ . . . My job is to figure out how the business can continue, not how the business hits hard roadblocks and kind of crashes because the law is there.”

– PMI General Counsel (“the third one”), July 2011

Meet **Max**, a former employee of Philip Morris International’s Swiss-based operations center who has revealed the existence of a price-fixing cartel in the international tobacco industry.

Adam from SmokinGate.com: Max, you claim that PMI, the leading international tobacco company, operates a price-fixing cartel with its direct competitors. And it sounds from these quotes above that this cartel may have been around for a while and is still on-going. This could mean a major antitrust investigation if the U.S., European or other national authorities decide to take up this case, right?

Max: That is true. Price-fixing is a hardcore antitrust violation enforced by criminal sanctions and monetary penalties, which could be astronomical. In the European Union, to take some recent examples, the so-called Car Glass cartel was fined \$1.7 billion; the Candle Wax cartel, \$940 million. The European Commission may impose fines up to 10% of the violator’s global turnover; considering the size of net revenues of the tobacco companies involved, the *Marlboro* cartel may potentially face record-breaking penalties.

Adam: So how do the tobacco manufacturers fix prices?

Max: The scheme works like this: Competitor A makes a confidential announcement to the trade (tobacco wholesalers, distributors, big retail chains) about the timing and the size of its intended future price increases; the trade forwards this announcement to Competitors B, C, and D, who then respond with their own announcements of intended future prices, which the trade forwards back to Competitor A. After some such back-and-forth, the Competitors arrive at the same price increase, which they all subsequently implement. Schemes like this are regarded and prosecuted as cartels, no different in principle from competitors’ meeting in a room and agreeing to fix prices directly. Here is the whole scheme in three sentences:

“We make announcements to one another and we ‘agree’ on a price – that is a problem. . . . I find this behavior very hard to justify under the law. . . . This is why we have always been very nervous about it.”

– PMI Deputy General Counsel, June 2011

Max: Keep in mind that there are only four big multinational tobacco manufacturers – PMI, British American Tobacco (BAT), Imperial Tobacco Limited (ITL) and Japan Tobacco International (JTI) – and price collusion is always easier to accomplish in an oligopoly.

Adam: Can you give us a concrete example to demonstrate this scheme in action?

Max: Here is what happened in Germany earlier this year: In March, PMI announced in confidential communication to the trade its intention to increase prices by 20 Euro cents as of April 15; PMI then received from the trade its competitors’ future price lists with the matching 20 Euro cents price increases, but to take place on May 1. PMI then recalled its prior announcement and issued a new one, with the price increase also effective May 1:

All major competitors (BAT, BAT, JTI) have now announced their new cigarette and OTP pricing for May 1, 2011. PMG had announced new cigarette prices for April 15, 2011 (see Highlights March 4, 2011) and has now recalled this announcement. PMG will also increase cigarette prices as of May 1, 2011 and is currently evaluating its OTP pricing options.

BAT – New retail prices for cigarettes and OTP as of May 2011

BAT's retail prices for cigarettes will be raised by €0.20 per standard pack.

Cigarettes	Soft OTP per pack 2011	Chg. vs. 2010	Retail prices per pack					
			€	Price strike	€	To strike	To GORE	% Chg.
BAT (Max. Retail)	12.8	+0.8						
Paradise	8.8	+0.1						
Paradise SF-OTC	8.5	+0.1	5.00	25	5.00	20	5.80	+4.0
Paradise KS-OTC	9.8	+0.1	4.20	23	5.00	19	5.15	+4.1
Paradise Max-OTC	9.4	+0.1	4.00	26	5.00	20	5.15	+3.2
Paradise SF-VP	9.8	+0.2	5.00	23	5.00	20	5.80	+4.0
Paradise Soft-OTC	9.2	+0.0	4.20	20	4.80	16	5.00	+4.0
Paradise Max-Joe-OTC	9.2	+0.2	5.00	20	5.00	20	5.80	+3.4
Paradise Red 100-OTC	9.1	+0.0	4.80	20	4.80	19	5.25	+4.0
Paradise M.F. Soft-OTC	9.1	+0.0	4.70	20	4.80	18	5.60	+4.0
Lucky Strike	4.8	+0.8						
Lucky Strike KS-OTC	9.8	+0.0	4.00	20	5.00	18	5.55	+4.0
Lucky Strike SF-VP	9.0	+0.0	5.00	21	5.00	20	5.80	–
Lucky Strike SF-OTC	9.0	+0.7	5.00	26	5.00	24	5.15	+4.3
Lucky Strike Max-OTC	9.8	+0.2	5.00	20	7.00	26	6.50	+3.0
Lucky Strike Soft-OTC	9.0	+0.1	4.80	20	4.70	18	5.40	+4.0
Lucky Strike R.F. OTC	9.0	+0.0	4.70	20	4.90	18	5.60	+4.0
PMI	4.0	+0.2						
PMI KS-OTC	9.0	+0.1	4.70	20	5.00	18	5.60	+4.0
PMI Classic (Short SF-OTC)	8.7	+0.0	5.00	24	5.00	20	5.80	+4.0
PMI Classic (Short KS-VP)	9.2	+0.0	5.00	20	5.00	20	5.80	–
PMI Classic (Short SG-OTC)	9.1	+0.0	4.80	20	5.00	18	5.80	+4.0
Camel	9.8	+0.5						
Camel (Soft KS-OTC)	9.4	+0.0	4.70	20	4.90	18	5.60	+4.0
Camel (Soft SF-OTC)	9.2	+0.0	5.00	24	5.00	20	5.80	+4.0
Camel (Soft Extra 100-OTC)	9.1	+0.0	4.90	20	5.10	18	5.90	+4.1
Camel (Soft KS-VP)	9.0	+0.0	5.00	20	5.00	20	5.80	–
Prince	9.0	+0.1						
Prince KS-OTC	9.2	+0.0	4.70	20	4.90	18	5.80	+4.0
Prince (Soft KS-OTC)	9.2	+0.0	5.00	24	5.00	20	5.80	+4.0
Prince (Soft KS-VP)	9.0	+0.0	5.00	20	5.00	20	5.80	–
Vogue	9.4	+0.1						
Vogue Super (Soft-OTC)	9.2	+0.0	5.00	20	5.00	18	5.80	+4.0
Vogue (Soft KS-OTC)	9.2	+0.1	5.00	20	5.00	18	5.80	–
Doublet	9.0	+0.8						
Doublet International (Soft Long-OTC)	9.2	+0.0	5.00	20	5.00	20	5.80	+3.8
Doublet KS-OTC	9.1	+0.0	5.00	20	5.00	18	5.80	–
Other	9.0	+0.0						

*PMI monthly exchange rate March 2011: € 0.73 = USD 1

- Report of March 4, 2011: “PMG [Philip Morris Germany] plans to implement the price increase as of April 15. . . . Competitors’ price moves during the transition period might make PMG price adjustments necessary”;
- Report of April 1, 2011: “All major competitors (IMT, BAT, JTI) have now announced their new cigarette and OTP [other tobacco products] pricing for May 1, 2011. PMG had announced new cigarette prices for April 15, 2011, and has now recalled this announcement. PMG will also increase cigarette prices as of May 1, 2011 and is currently evaluating its OTP pricing options”;
- Report of April 15, 2011: “After the price announcements of IMT, BAT, JTI and Poeschl for OTP, PMG has announced increased prices for fine cut and cigarillos, which will become effective as of May 1, 2011.”

Max: As you see, the competitors have managed to coordinate the size and the timing of their price increases through the exchange of their intended future prices via the trade.

Adam: Was that an isolated occurrence?

Max: No, that incident was clearly part of a historical pattern. Let’s take a look at Germany in 2010: PMI revised its intended future price increases already announced to the trade in order to meet the future price increases subsequently announced by its competitors:

- Report of May 21, 2010: “As a reaction to the current market situation PMG decided to adjust prices of selected brands in the low price segment as of June 2010. PMG had announced an increase in prices for their Low price offers as of mid May 2010, while key competitors kept Big Pack prices for their main Low price offers at €5.00/23 Cigarettes (e.g., *JPS*, *Pall Mall*) and increased Low price Soft Packs only by €0.10 to €4.20/19 Cigarettes. PMG will now adjust prices for the following products: [Big Packs and Soft Packs]. . . . [Price increase] initially announced for mid May 2010 does not come into force — [revised prices] now announced for June 2010 [€5.00/23; €4.20/19, matching those announced by the competitors].”
- Report of May 21, 2010: “After the price announcements of BAT and Imperial for OTP, PMG will increase prices for Fine Cut and Cigarillos as of July 2010.”

Adam: And before that?

Max: The same thing happened in Germany in 2009 as well: in April of that year, PMI announced, in a confidential communication to the trade, that it intended to raise prices by €0.20. PMI then received from the trade its competitors' future price lists which followed PMI's proposed price increases for cigarettes, but for a number of brands in the "other tobacco products" segment (such as fine cut tobacco and cigarillos) the competitors did not intend to raise prices. PMI then backtracked on its announced price increases for the competing OTP brands and reissued another price list, reflecting prices in line with those announced by its competitors:

- Report of April 17, 2009: "PMG announced price increase of Cigarette products as of June 2009. . . . There has not been any announcement yet of new price lists by competition since our announcement";
- Report of May 1, 2009: "Following PMG's earlier price announcement, all major competitors have now communicated their new price lists. Overall, competition has followed PMG's €0.20/pack price increase";
- Report of May 1, 2009: "PMG announced price increase of OTP [Other Tobacco Products] products as of end June 2009. . . . BAT announced price increase of OTP products. However, the price for *Pall Mall Stix Tabac*, the leading brand in the Traditional Fine Cut segment, was unchanged. Furthermore, the prices of the *Pall Mall 25g* pouches as well as the *Pall Mall XL Filter Cigarillos* also remain currently unchanged";
- Report of May 15, 2009: "Imperial changes OTP price list. According to Imperial's communication to the trade yesterday, the prices of several products will not be increased. . . . PMG is currently re-evaluating their announced OTP price increase";
- Report of June 5, 2009: "Following latest competitive price moves, PMG has issued a new price list which replaces the one announced beginning of May."

Adam: Indeed, the pattern is becoming quite apparent. And before that?

Max: Going further back in time, we find the same scheme, but even more brazenly executed:

“To answer one specific question, whether this is a new issue in Germany – the answer is no, it is not. Four or five years ago a corporate affairs executive in Germany called me in a dither over this very issue. Because they would actually have it a little more blatant than this – in which there was an industry journal and people would publish their announcements in this newspaper, and then the next day the other people would publish their announcement in the newspaper and it was back-and-forth – actually in the industry journal. And he got very nervous about this, sensible guy. So this is not new and we from time to time try to grapple with it but . . . we run up against the reality of the way this market works. And the fact that also . . . it would be a massive change in behavior.”

– PMI Deputy General Counsel, July 2011

Adam: Sounds like this may have been going on for many years. And how widespread is this practice?

Max: I have discovered similar instances of such price collusion in other regions where PMI does business, and PMI does business everywhere in the world except the U.S. I suspect that this is the *modus operandi* of the international tobacco industry:

“In Germany this is not because there is a lawyer asleep at the wheel. That is not the issue. The issue is – it’s endemic, it’s endemic.”

– PMI Deputy General Counsel, June 2011

“In terms of price lists, this is not a practice that has been developed in the last four years – this has been like this for many years.”

– PMI Vice President, June 2011

Adam: Can you give us examples from other countries?

Max: In the Netherlands, in the beginning of 2011, PMI and Imperial had intended to increase their prices by 40/50 Euro cents, but then BAT announced its future prices that were 20 Euro cents below. Both PMI and Imperial then revised their announced prices to match those by BAT, raising them by 20/30 only:

- Report of January 21, 2011: “We learned from the trade that ITN has announced new prices applicable as of March 1, 2011. Below you can find an overview of the price points according to each price segment [premium brands from €4.80 to €5.20; low-priced brands from €4.20 to €4.70]”;
- Report of February 4, 2011: “PM Benelux communicated the below 2011 cigarette prices to the trade [premium from €4.80 to €5.20; low from €4.20 to €4.70]. This would generate a favorable impact of approx. +€4.5 mio”;
- Report of February 4, 2011: “We learned from the trade that BAT has announced new cigarette prices applicable as of March 1, 2011: [premium from €4.80 to €5.00; low from €4.20 to €4.50]. . . . Pall Mall increases by €0.30/19s only This price is €0.20 below the announced prices from PM Benelux and Imperial Tobacco. PM Benelux is currently reviewing its pricing plans”;
- Report of March 18, 2011: “Due to recent market developments and in order to remain competitive, PM Benelux has communicated their revised prices to the trade. These prices differ from previously announced prices (*Marlboro* KS 19s from €4.80 to €5.00 vs. €5.20, *L&M* KS 19s from €4.20 to €4.50 vs. €4.70). The new price plan is expected to generate a negative financial impact of US\$ -18 mio”;
- Report of March 18, 2011: “We learned from the trade that Imperial Tobacco has announced revised prices applicable as of March 1, 2011. The prices differ from those communicated earlier: [premium from €4.80 to €5.00 vs. €5.20, low from €4.20 to €4.50 vs. €4.70]”

Adam: This is the same pattern that we saw in Germany.

Max: Exactly. And this pattern repeats itself in other countries around the world as well (in the EU, Latin America, Eastern Europe, Asia), but I don't want to put your readers into a coma with all these details.

Adam: Who at PMI knew about all this?

Max: The whole senior management team. These reports are distributed weekly to PMI's Chairman and CEO, COO, CFO, Chief Compliance Officer, General Counsel and Regional Presidents. In fact,

at least four General Counsel of the Company knew about price-fixing and did not stop it — the three mentioned by Deputy General Counsel in the opening quote, and the Deputy himself who was PMI's General Counsel in 2008.

Adam: Max, what are the implications of these revelations?

Max: I think this is quite an extraordinary case. PMI, a Fortune 500 corporation, the most profitable tobacco company in the world and the fourth most profitable consumer goods company, has been operating a long-running and world-wide price-fixing cartel, in full view of its senior management that has allowed price-fixing to continue despite being told several times that it was illegal. I think this may turn into a very major antitrust case.

But I think this matter may have broader and even more significant implications for the industry than just an antitrust case — because of the unique character of the tobacco business.

Adam: What is so unique about it (other than that its products are dangerous and addictive)?

Max: What is unique about it is the amazing “pricing power” of the industry, allowing it to keep raising prices and stay profitable even in the markets where people smoke less and less:

The screenshot shows the Euromonitor International website. At the top left is the logo with the text "EUROMONITOR INTERNATIONAL". To the right is a search bar and navigation links: "Home | Contact Us | Shopping". Below the logo is a horizontal menu with six items: "ABOUT US" (Learn about Euromonitor and our methodology), "PRODUCTS" (Database subscriptions, reports and books), "CONSULTING" (Research tailored to your business needs), "BLOG" (Articles, podcasts, videocasts and webinars), "PRESS" (Media contact centre and news), and "MY PA" (Get all research). Below the menu is a banner image of tobacco with the word "Tobacco" in large white text. Underneath the banner is a breadcrumb trail: "You are here: Home * Solutions * Industries * Tobacco". To the right of the breadcrumb are social media icons for Twitter, Facebook, LinkedIn, and YouTube. Below the banner is a section titled "GLOBAL BRIEFING" with the main headline "Pricing Power – Still Driving Tobacco Industry Profits" and the date "Nov 2010". To the right of this section is a blue button that says "Request more information".

“Pricing power – the ability of the tobacco industry to sustain price rises and profitability in the face of volume falls – is integral to the financial structure of the tobacco industry.” Euromonitor International, November 2010

CREDIT SUISSE

Products and services | Careers | About

About Us

Who We Are | Media | Investor Relations | Corporate Governance | Corporate Responsibility | Sponsorship | In Focus

Home » About Us » In Focus » Economy » Sectors & Companies

Sectors & Companies

Tobacco Industry Set to Grow In Emerging Markets

Olivier P. Müller, Research Analyst Consumer Staples

03.02.2011

While the tobacco industry is set to grow in emerging markets in coming years, driven by population growth and increasing disposable income, cigarette volumes are expected to contract in developed countries as a result of tightening regulations.

Recent monetary easing and indications from various central banks indicate that the low interest rate environment is likely to continue for another 1-2 years. This is likely to force investors to seek alternative sources of cash yield. With unique defensive characteristics including robust earnings growth, high profitability and therefore strong operating cash flows, tobacco companies pay high and secure dividends and run share repurchase programs.

Emerging Market Exposure of Global Tobacco Companies

Growing Cigarette Volumes in Emerging Markets

Increased health consciousness and tightening regulations, such as public smoking bans and taxation in many countries, are the main limiting factors of cigarette volume growth in developed countries. The quantity sold in developed countries is therefore likely to contract by around 2 percent per annum over the next five years. In emerging markets, in contrast, sustained positive volume growth of 1 percent per annum is expected, driven by faster population growth and increasing disposable income for discretionary consumption, which supports the penetration of branded products. Cigarette companies with the highest emerging market exposure are therefore best positioned. While profitability looks below average in these regions at present, volume leverage should further boost margins over the longer-term.

Tobacco Companies' Market Share Globally Excluding China (2011E)

Strong Pricing Power Drives Revenue Growth

The tobacco industry benefits from a unique pricing power in comparison to other consumer goods industries for a number of reasons. First, the global tobacco market is highly concentrated. Beyond the closed Chinese market, which in 2011 accounts for 40 percent of worldwide volumes, the global tobacco market is dominated by the five largest tobacco companies, Altria, Imperial Tobacco, British American Tobacco, Japan Tobacco and Philip Morris International.

“The tobacco industry benefits from a unique pricing power in comparison to other consumer goods industries.” CreditSuisse, September 2011

Global: Tobacco

The time is right: Now it's EMs' turn to drive cash; BAT up to Buy

Long-term growth from emerging markets

Despite accounting for 80% of global cigarette consumption, emerging markets (EMs) share only 50% of the global category profit pool. As income levels rise across these markets, we expect the global industry profit pool to triple from US\$63 bn in 2008 to US\$183 bn by 2030.

Over 50% volume exposure to EMs

Within our global coverage of tobacco, at 78%, BAT has the highest group volume exposure to EMs. PMI sell 68% of its cigarettes in EMs while JT and Imperial Tobacco follow with exposures of 57% and 59% respectively.

Top returns at attractive valuations

We expect global tobacco stocks to offer the highest total shareholder returns versus other consumer staples subsectors in 2010-11 at an annual average of 18% versus the staples average of 15.6% while trading at an average P/E discount of c.20%.

BAT up to Buy; and we are still buyers of IMT, PMI and JT

We upgrade BAT to Buy (from Neutral). Our 12-month price target of 2940p implies 31% upside and the stock is currently on the GS SUSTAIN watch list (which comprises candidates for potential future inclusion in the Focus List). We reiterate our Buy ratings on Imperial Tobacco (12m price target of 2450p; 30% upside), PMI (12m price target US\$57; 22% upside) and JT (12m price target ¥450,000; 66% upside). JT is also on the Pan-Asia Conviction List. We also update our estimates for BAT and Imperial Tobacco to account for latest FX spot rates.

Risks remain, but return trade-off is attractive

Valuations suggest markets remain concerned about regulatory risks and sluggish global volume growth. We believe pricing power is the most important growth driver for manufacturers' future profits. Illicit trade, in our view, remains the biggest threat, but this is an area where government and manufacturer interests are aligned. We do not share market concerns that fewer consolidation opportunities will limit growth; we expect the sector's mid-teens total shareholder returns to be sustainable.

ACTION

OUR GLOBAL LARGE-CAP TOBACCO UNIVERSE:

Company	Rating	Financial Upside / (downside)
Altria Group, Inc.	Neutral	12%
British American Tobacco	Buy	21%
Imperial Tobacco	Buy	30%
Japan Tobacco	Buy	46%
Lorillard Inc.	Buy	32%
Philip Morris International Inc.	Buy	22%
Reynolds American Inc.	Sell	2%
Japan Tobacco	is also on the Pan-Asia Conviction List.	

Source: Goldman Sachs Research estimates.

COVERAGE VIEWS:

Europe - APC & Tobacco: Attractive
 America - Tobacco: Neutral
 Japan - Consumer Products: Neutral

RELATED RESEARCH:

Europe: Consumer Products: Food & APC: Emerging market growth to drive steep change in returns; published today.

EUROPE CONSUMER STAPLES RESEARCH TEAM:

Fabrizio Cazzol (Tobacco & Food Ingredients)
 +44 (0) 7552-3722

Alexis Colombo (Food manufacturers)
 +44 (0) 7552-3629

Noelle Edwards (BPC & non-branded consumer)
 +44 (0) 7552-3710

Lucy Baldwin (Team Marketing Analyst)
 +44 (0) 7552-5908

Fabrizio Cazzol
 +44 (0) 7552-3722 fabrizio.cazzol@gs.com Goldman Sachs International

Judy E. Hong
 0121 9030490 judy.hong@gs.com Goldman Sachs & Co.

Katsunori Tanaka
 +81 (0)6637-9073 katsunori.tanaka@gs.com Goldman Sachs Japan Co., Ltd.

Tyler Walling
 0121 924 6646 tyler.walling@gs.com Goldman Sachs & Co.

The Goldman Sachs Group, Inc. does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision. For Reg AC certification, see the end of the text. Other important disclosures follow the Reg AC certification, or go to www.gs.com/research/hedge.html. Analysts employed by non-US entities are not registered/qualified as research analysts with FINRA in the U.S.

"We believe pricing power is the most important growth driver for manufacturers' future profits . . . and the key driver to long-term growth in earnings and returns for the tobacco sector. . . . The key risk to the industry is unexpected deterioration in pricing power." Goldman Sachs, July 2010

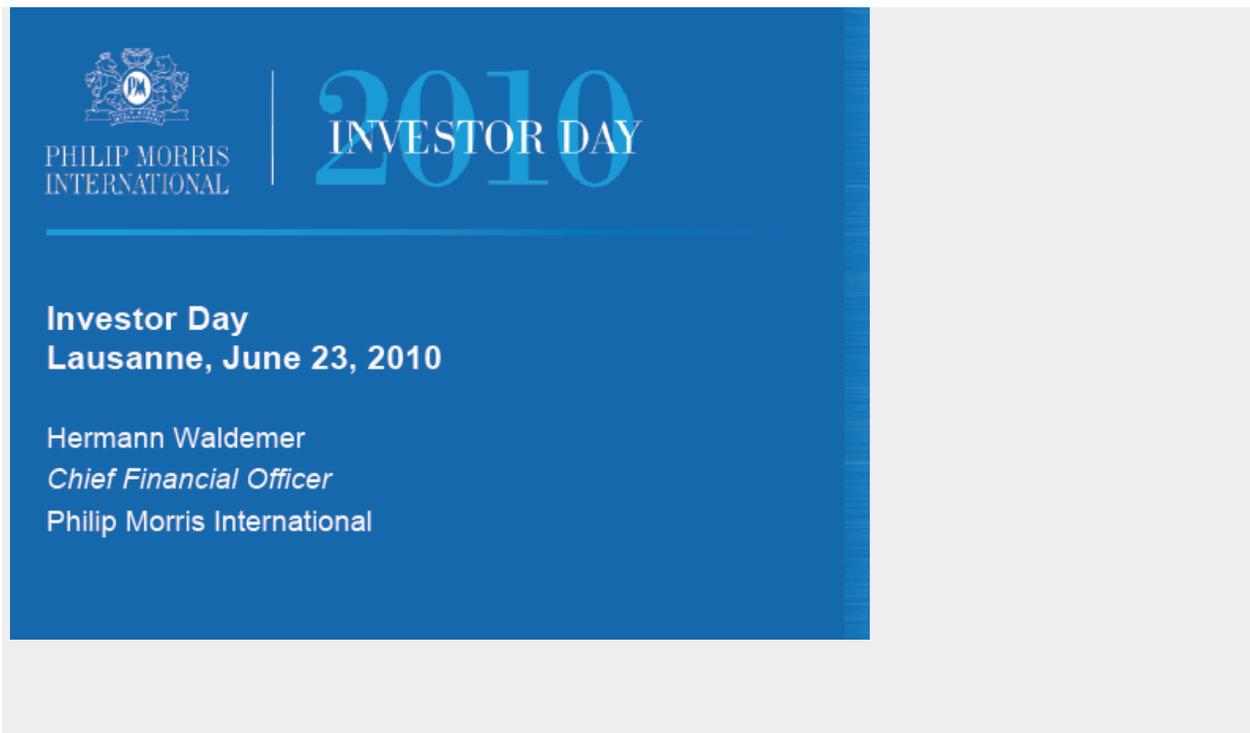
Adam: Well, tobacco companies have this unique pricing power because cigarettes are addictive and consumers are loyal to their brands, everyone knows that.

Max: These are indeed the commonly accepted explanations. But I have a different theory: the industry's pricing power and profitability critically depend on price collusion among the tobacco

manufacturers; this pricing power and profitability are likely to deteriorate without price collusion, and neither the smokers' addiction nor their brand loyalty will be able to stop that deterioration.

Adam: Is there any proof of this theory?

Max: Ultimately, the proof will be in the pudding: we'll have to see what happens with the industry's pricing power and profitability in the future once its price-fixing cartel is dismantled. But there is a real-life example that can offer us a glimpse of what that future may look like. First, let's see what PMI has been saying about its pricing power in its recent public statements:



"Pricing has played a central role in our ability to meet, or surpass, all our financial currency neutral growth targets in 2008, 2009, and again during the first quarter this year." PMI CFO, June 2010



PHILIP MORRIS INTERNATIONAL

**Annual Meeting of Stockholders
New York
May 11, 2011**

Louis C. Camilleri
Chairman and Chief Executive Officer
Philip Morris International

“Pricing has been the key driver of our increased profitability, adding a cumulative \$4.9 billion over the three year period.” PMI CEO, May 2011



PHILIP MORRIS INTERNATIONAL

**2010 Full-Year and Fourth-Quarter
Results**

February 10, 2011

2011 Business Outlook



- Reasonable excise tax increases, except Mexico
- High unemployment continuing to impact industry volumes and mix
- Recent events in North Africa likely to impact our performance there, but hope this will be a temporary phenomenon
- Organic volume performance expected to be in line with 2010
- Anticipate a solid market share performance
- Pricing will continue to be the key driver of profitability growth
- Some continued pressure on costs
- \$250 million pretax target for cost savings in 2011
- Forecast strong cash flow performance
- \$5 billion in share repurchases anticipated in 2011

↓
2011: another solid year of growth expected for PMI

28



PHILIP MORRIS INTERNATIONAL

2011 First-Quarter Earnings Results

April 21, 2011

1

Pricing Assumptions



- Continued economic difficulties and consumer affordability issues in certain markets, such as Greece, Spain and Ukraine
- Reaction to competitive price moves, such as selective tax absorption, brand repositioning, discounting and delays in the implementation of tax-driven price increases
- Pricing will nevertheless remain the key driver of PMI profitability growth and our 2011 pricing variance is expected to surpass the level achieved last year



PHILIP MORRIS INTERNATIONAL

2011 Second-Quarter Earnings Results

July 21, 2011

Summary



- Very strong second-quarter results
- Adjusted diluted EPS growth of 21.0%, excluding currency
- Outlook is promising, with strong market share and business momentum
- Pricing remains the key driver of profitability, with Spain a special case
- Very limited input cost pressures and we expect to exceed our \$250 million annual productivity target
- 2011 reported diluted EPS guidance raised by another 15 cents to a range of \$4.70-\$4.80
- We continue to use our growing cash flow to generously reward our shareholders

Source: PMI Financials

28

Max: You can see from the Q2 earnings release that in the summer of 2011, Spain suddenly became an exception to PMI's pricing power. And not just PMI – it looks like this “unexpected deterioration of pricing power” affected the whole tobacco industry in Spain that summer, as they launched into a brief but vicious price war with each other. The market leader in Spain, Imperial Tobacco, was the hardest hit, but all the other competitors — PMI, BAT and JTI — suffered as well:

Spanish cigarette price war burns £100m hole in Imperial profits

Cash-strapped Spanish smokers have cut back – sparking fierce price competition among manufacturers

Julia Kollewe

guardian.co.uk, Monday 13 June 2011 20.49 BST

[Article history](#)

Imperial Tobacco is facing a £100m profits hit as a result of a cigarette price war, tax increases and a [smoking ban](#) in [Spain](#).

Imperial, which is the world's fourth-largest tobacco company and the market leader in Spain, warned on Monday that a slump in cigarette purchases by cash-strapped smokers had led to a fierce price war in the country.

27 July 2011

HALF-YEARLY REPORT TO 30 JUNE 2011

SUMMARY

Six Months Results - unaudited	2011	2010	Change
Revenue	£7,438m	£7,298m	+2%
Profit from operations	£2,691m	£2,271m	+18%
Adjusted profit from operations	£2,760m	£2,460m	+12%
Basic earnings per share	94.5p	76.9p	+23%
Adjusted diluted earnings per share	96.1p	87.1p	+10%
Interim dividend per share	38.1p	33.2p	+15%

- The Group's organic revenue at constant rates of exchange grew by 7 per cent with continued good pricing momentum. Reported Group revenue was up 2 per cent.
- Adjusted Group profit from operations increased by 12 per cent. All the regions contributed to this good profit result. The reported profit from operations was 18 per cent higher at £2,691 million. The adjusting items are explained on pages 23 to 24.
- Group volumes were 344 billion, down 1 per cent as the overall market share of the Group increased and industry volume decline moderated.
- The four Global Drive Brands achieved good overall volume growth of 11 per cent. Dunhill was up 1 per cent, Kent 16 per cent, Lucky Strike 8 per cent and Pall Mall grew by 14 per cent.
- Adjusted diluted earnings per share rose by 10 per cent, principally as a result of the growth in profit from operations, reduced by a higher tax charge. Basic earnings per share were up 23 per cent at 94.5p (2010: 76.9p).
- The Board has declared an interim dividend of 38.1p, a 15 per cent increase on last year, to be paid on 28 September 2011.
- 13 million shares were bought back at a cost of £335 million.

"In Spain . . . profit deteriorated following the price war."



JAPAN TOBACCO INC.
2-1, Toranomon 2-chome, Minato-ku
Tokyo 105-8422 JAPAN
Phone:03-3382-3111

FOR IMMEDIATE RELEASE

Tokyo, July 28, 2011

JTI accelerates revenue and GFB growth
Market share increases in most key markets
Japan Tobacco International (JTI) business results for
April-June and January-June 2011

Highlights

April-June 2011

- Core net sales excluding tax¹ increased by 13.8%, driven by pricing and GFB² shipment volume growth.
- At constant rates of exchange, core net sales excluding tax grew by 6.0% and core net sales excluding tax per thousand cigarettes³ increased by 6.2% to US\$24.9.
- GFB shipment volume grew 4.0% driven by Russia, the Middle East and Italy.

January-June 2011

- Core net sales excluding tax increased by 9.3%, driven by pricing and GFB shipment volume growth.
- At constant rates of exchange, core net sales excluding tax grew by 6.2% and core net sales excluding tax per thousand cigarettes increased by 6.1% to US\$25.7.
- GFB shipment volume grew 3.2% driven by Russia, Turkey and Italy.

Year-on-year market share⁴ continued to grow in most key markets including Turkey, Taiwan, Italy, France and Russia.

January-June results for 2010 and 2011⁵

	2010 Results			2011 Results		
	Jan-Mar	Apr-June	Jan-June	Jan-Mar	Apr-June	Jan-June
Total shipment volume (billions of cigarettes)	94.1	110.7	204.7	94.5 (+0.5%)	110.4 (-0.2%)	204.9 (+0.1%)
GFB shipment volume (billions of cigarettes)	54.6	63.7	118.3	55.8 (+2.1%)	66.2 (+4.0%)	122.0 (+3.2%)
Core net sales, excluding tax (millions of US\$)	2,343	2,571	4,914	2,447 (+4.4%)	2,925 (+13.8%)	5,372 (+9.3%)
Core net sales per thousand						

“Continued industry contraction in Spain.”

Max: The pricing power and profitability clearly deteriorated in Spain during the summer of 2011— but the Spanish smokers were just as addicted and brand-loyal then as they were just before or just after that brief period. This means that addiction and brand loyalty by themselves cannot explain the industry’s pricing power.

Adam: Maybe there were some special conditions in Spain that led to the price war?

Max: That’s what the tobacco companies claimed: PMI attributed it to high unemployment and consumer down-trading; Imperial – to economic woes, a ban on smoking in public places, excise tax increase and “the relative brand positionings in the market,” whatever that means.

Adam: So what’s the problem with these explanations? They all sound quite plausible.

Max: Of course they do, they ought to at least sound plausible. The problem with these explanations is that three months later, when all four tobacco companies together raised their prices in Spain, all these conditions remained in place, so they could not have been the real reason for the pricing power deterioration:

The screenshot shows a Reuters news article from September 21, 2011. The article is titled "UPDATE 2-Imperial Tobacco hurt by Spanish price war" and is written by David Jones. The main text states that Imperial Tobacco, the world's fourth-largest cigarette group, expects sales to rise just 2 percent in the current year after being hurt by a price war in Spain. The article includes a list of bullet points: "Imperial sees annual tobacco revenue up 2 pct", "Annual cigarette volume expected down 2 pct", "Spain results to benefit from recent price increases", "Trading overall in line with group expectations", and "Shares up 1.9 percent in early trade (Adds details, shares)". The article also features a "Related News" section with a link to "UPDATE 5-Japan eyes tax hikes, stake sales for rebuilding".

REUTERS EDITION: U.S. Register | Sign In Search News & Quotes

Home Business Markets World Politics Tech Opinion Breakingviews Money Life & Culture Pictures Video

REUTERS OUR WORLD NOW VIEW SLIDESHOW
New volume in bestselling photography collector's series
An indispensable visual record of our times

ARTICLE

UPDATE 2-Imperial Tobacco hurt by Spanish price war

Recommend Be the first of your friends to recommend this.

Wed Sep 21, 2011 3:32am EDT

- * Imperial sees annual tobacco revenue up 2 pct
- * Annual cigarette volume expected down 2 pct
- * Spain results to benefit from recent price increases
- * Trading overall in line with group expectations
- * Shares up 1.9 percent in early trade (Adds details, shares)

By **David Jones**

LONDON, Sept 21 (Reuters) - Imperial Tobacco Plc, the world's fourth-largest cigarette group, expects sales to rise just 2 percent in the current year after being hurt by a savage price war in Spain, though recent price rises may ease the pain there.

Imperial is market leader in Spain with a near 30 percent share from

NEWS PRO FOR iPad
News and market data for business professionals
CLICK HERE TO DOWNLOAD

Editor's Choice

- Analysis: Fallout from "super committee" failure
- U.S. names Iran a "money laundering concern"
- Lessons from Canada's "basket case" moment
- Euro zone not working: Buffett

Related News

UPDATE 5-Japan eyes tax hikes, stake sales for rebuilding
Fri, Sep 16, 2011

“Imperial raised its cigarette prices in Spain in July and September, alongside price increases by the world’s three biggest players — Philip Morris International, British American Tobacco and Japan Tobacco.”

Tuesday, November 1, 2011 As of 4:49 PM

THE WALL STREET JOURNAL. EUROPE BUSINESS

Europe Edition Home ▾ Today's Paper ▾ Video ▾ Blogs ▾ Emails ▾ Journal Community ▾ Mobile ▾ Tablet

World ▾ Europe ▾ U.K. ▾ U.S. ▾ Business ▾ Markets ▾ Market Data ▾ Tech ▾ Life & Style

Europe's Debt Crisis ▾ Europe Analysis ▾ Irwin Stelzer ▾ Source ▾ Real Time Brussels ▾ Eastern Europe

TOP STORIES IN World

 1 of 12  2 of 12

EUROPE BUSINESS NEWS | NOVEMBER 1, 2011, 10:49 A.M. ET

Imperial Profits Rise

Article | Stock Quotes | Comments

Email Print Save Like +1 0 Tweet 18 A A

 FOR FULL SITE ACCESS **SUBSCRIBE NOW** AND GET 2 WEEKS FREE!

By SIMON ZEKARIA

LONDON—[Imperial Tobacco](#) Group PLC Tuesday posted a rise in full-year profit as revenue was boosted by surging demand in developing markets and price hikes, but cigarette volumes fell.

“We are now at a much more stable situation. Prices are now back at least at the same level or above where they were before this activity began.”



PHILIP MORRIS INTERNATIONAL

2011 Third-Quarter Results

October 20, 2011

Spain



- Very high unemployment driving decline in cigarette industry volume of at least 15% in 2011
- Pricing situation was resolved in September:
 - Marlboro back to previous level of €4.25/pack
 - L&M raised to €3.75/pack



Source: PMI estimates

18

The Telegraph

HOME NEWS SPORT **FINANCE** COMMENT BLOGS CULTURE TRAVEL LIFESTYLE FASHION

Companies Comment Personal Finance Economics Markets Your Business Olympics Business

Banks and Finance Media and Telecoms **Retail** Transport Construction Industry Energy

HOME » FINANCE » NEWS BY SECTOR » **RETAIL AND CONSUMER**

Imperial Tobacco predicts no repeat of 'perfect storm' Spanish price wars as profits edge higher

Imperial Tobacco said it was unlikely to see a repeat of the "perfect storm" that led to revenue-damaging price wars in Spain this year, as it reported annual profits in line with expectations.

By Emily Gosden

1:52PM GMT 01 Nov 2011

[Follow](#) 630 followers

[Comment](#)

Tobacco net revenues were up 2pc but, if the impact of Spain and a change to UK trade buying patterns were excluded, adjusted tobacco net revenues were up 4.5pc, the company said.

Alison Cooper, Imperial Tobacco's chief executive, described the combined effect of Spain's ban on smoking in public places, which came into force in January, increases in excise duty and the

Imperial Tobacco Group

11:10 2011n Nov 22, 2011

Today	Last	Change
2,253.0	+6.00	+0.27%

Share: [Facebook](#) [Email](#) [Print](#)

[Recommend](#)

[Tweet](#) 16

[Share](#) 1

[+1](#) 0

Retail and Consumer

Finance »
News by Sector »
Industry »
Imperial Tobacco Group »
Emily Gosden »

Adam: So what do you think was the real reason for this brief price skirmish?

Max: This BAT's letter to tobacco retailers makes clear that the competitors either failed to agree on prices in Spain that summer or else deviated from their agreement:

BAT France writes to tobaccoconists about price increases in Spain

A Bad Spanish Story

Dear Madam, Sir,

In our newsletter 224 and 225 we informed you of BAT's decision to increase its prices in Spain by 0.10€.

We made it known that we expected competitors do the same.

For BAT France, this act would have rendered Spanish cigarettes less attractive for French adult consumers which would have effectively decreased the level of Spanish sales and reinforced sales in France at our market value, and consequently raised revenues for French tobaccoconists.

More than fancy words, this concrete and voluntary act initiated by BAT seemed a good opportunity for the future and especially for those of you working in the south west of France.

At first, all went well as Imperial Tobacco followed suit and raised their cigarette prices but unfortunately on May 19th, Philip Morris preferred to decrease their price of L&M without touching Marlboro and raised the price of Chesterfield by only 0.05€. Note that the price of L&M was already lowered two years ago.

May 20th, Imperial tobacco reacted to this L&M price decrease and lowered their prices on Ducados & JPS.

May 21st, BAT was also forced to decrease their price.

No change for JTI at the time of printing this Newsletter.

This is how we missed a great opportunity to raise Spanish market value, to reduce the price gap between France and Spain and to favour French tobaccoconists' turnover.

In the future, when certain manufacturers give you a speech about favoring French tobaccoconists you can remind them about this bad Spanish story and they will turn tail.

We will of course keep you informed of the evolution of this project and hope we can find long lasting solutions.

Corporate Affairs Director BAT France

PM France internal translation. Source: French trade

Max: Perhaps by September 2011, these hoped-for "long lasting solutions" were found, allowing all four competitors to raise their prices alongside each other again.

Adam: So what does the Spanish price war show?

Max: I believe the significance of the Spanish episode is this: it shows that the tobacco industry's pricing power and profitability deteriorate precisely in those situations where the companies deviate from their implicit agreement on prices. If price-fixing is eliminated from the tobacco industry

altogether, I would expect the industry's pricing power to disappear along with it, as briefly happened in Spain in the summer of 2011.

Adam: What follows from all this?

Max: I think the consequences for the international tobacco industry could be potentially enormous. For PMI's management, it could mean massive changes in corporate governance and in the way they run their businesses. The Company's owners, its public shareholders, would probably have to undertake a profound reassessment of the business' profitability, correcting for price-fixing both historically and going forward. Regulators would probably inquire whether PMI deceived not only its customers but also its shareholders by making inflated claims about its pricing power without disclosing the underlying price-fixing. At bottom, I believe the end of price-fixing may well lead to "unexpected deterioration in pricing power."

Adam: And then what? Is it really possible that the business "hits hard roadblocks and crashes because the law is there," to quote PMI's General Counsel?

Max: As Yogi Berra wisely said, "It's hard to make predictions, especially about the future." Only time will tell, so let's just wait and see.

Adam: Thank you, Max, we will see certainly wait and see how this develops further.

Please stay tuned for our next episode, and many more to come.

Tagged with: [Cartel](#)

Other sharing options:

2 RESPONSES TO *THE MARLBORO CARTEL*

1. **Philip Morris in Secret Cooperation With a British Health Minister Earl Howe | [smokingate](#) says:**

[December 20, 2011 at 18:20](#)

[...] like the Marlboro Cartel and Price-Fixing Conspiracy stories describe how PMI deceives its customers and investors, our new [...]

LOG IN TO REPLY

2. **Twenty Years of Price-Fixing and Cover-up? | smokingate says:**

[December 9, 2011 at 19:55](#)

[...] Marlboro Cartel story describes the massive, widespread cartel operated by the four multinational tobacco companies [...]