

Impact Of Illicit Cigarettes On Philip Morris In Asia



Great Speculations

Buys, holds, and hopes

Opinions expressed by Forbes Contributors are their own.

Opinions expressed by Forbes Contributors are their own.



[Trefis Team, Contributor](#)

Illicit cigarettes represents a threat to tobacco companies and tax authorities by subverting the regulation of sales and consumption of cigarettes. This thwarts the attempts made by governments to increase their revenue from taxation and achieve the public health objective of reducing the ill effects of cigarette smoking. As we have written earlier, all forms of illicit cigarettes other than smuggled original cigarettes impact the revenue of tobacco companies such as [Philip Morris International](#) adversely (See [Excise Taxes, Illegal Cigarettes And Altria: The Case Of Massachusetts](#)).

In this article we analyze the impact of illicit cigarettes on Philip Morris' Asia Division, **which contributes ~36% of the stocks value per our analysis. This is more than any other division, even though in terms of EBITDA margins, Asia trails the European Union, the largest market by revenue before excise taxes. The cigarette market (in terms of number of units sold) in Europe however is forecast**

to decline at an alarming rate and drop by almost 20% by 2021. Asia on the other hand is expected to show a small but steady growth rate of a little less than 1% CAGR in the same period. This makes Asia the largest component of Philip Morris in our discounted cash flow model, and hence makes any threat to its revenue potential in this region a matter of serious impact.

[See Our Complete Analysis For Philip Morris International](#)

Insights From Philip Morris Sponsored Study

International Tax and Investment Center and Oxford Economics were contracted by Philip Morris to study the illegal cigarette market in 14 Asia Pacific region countries. They are the 10 ASEAN member countries, Australia, Hong Kong, Pakistan, and Taiwan. The study found that while people in these countries smoked ~760 billion cigarettes in 2013, **10.9% of these were illicit**. In countries excluding Laos, Cambodia and Myanmar, the number of illicit cigarettes increased over 20% year on year. The major contributor to this increase was Philippines which **tripled its illicit cigarette consumption** in one year.

Types Of Illicit Cigarettes

The study under consideration has classified the illicit cigarettes consumed in Asian countries under four heads. Counterfeits, which constitute ~3% of illicit cigarettes and have been defined by the researchers as cigarettes that are illegally manufactured and sold without permission of the trademark rights holder. Contrabands are cigarettes bought legally in low excise tax countries and smuggled to high excise tax countries to be sold below the tax-inclusive market price of these products. They constitute 13% of the illicit cigarettes consumed in Asia in 2013. Domestic illicit cigarettes are manufactured and sold in the same country without paying the excise taxes. These constitute 40% of the illicit cigarettes consumed in Asia in 2013. Cigarettes that cannot be identified as legal or falling into any of the three categories above are classified as *unspecified*, and constitute 44% of illicit cigarettes which seems too large a chunk to be uncertain about.

Aspersions Cast On The Study

Industry independent research **suggests** that estimates of illicit cigarettes from industry sponsored research may be biased towards

the higher side. This is because the tobacco industry has vested interests in overstating the illicit tobacco problem. The first of these is the need to leverage the dependency of illicit cigarettes on high excise taxes as an argument against high excise taxes on cigarettes. Secondly, the existence of counterfeits are blamed on plain packaging laws, and cited as a reason for repealing these. Thirdly, since the regulator does not hold Philip Morris responsible for illicit variants other than contrabands, there exists the motive for these to be overstated.

<http://www.forbes.com/sites/greatspeculations/2014/11/14/impact-of-illicit-cigarettes-on-philip-morris-in-asia/>