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Session 3: Investment for the future

Only one thing might matter more than what is happening now—what’s happening next. The future of our industry was such a popular subject that some attendees were forced to stand and listen to the panel discussion from the hallway. Moderated by Erik Bloomquist, a global tobacco industry investment analyst, the big question for panelists was: Could tobacco investments continue to be profitable even when faced with constant volume declines?

Tobacco has been a titan for investors. Things have changed in those meetings surrounding investing, however. It used to be that regulation and litigation were mandatory subjects, but those questions aren’t coming up anymore, according to one panelist. She said that investors know the challenges facing the tobacco industry are manageable; moreover, tobacco is not the only consumer-industry product in a constant volume decline. Packaged foods, carbonated soft drinks and mainstream beer are just a few of the products facing the same issue.

Tobacco is different though. Tobacco has been facing volume declines for extended periods of time and has learned how to adapt. Investors are confident in tobacco’s return on investment, where the future of other consumer industries experiencing volume declines is a relative unknown. Daily consumption for smokers was essentially unchanged throughout 2015. It doesn’t seem like smokers are going to change their consumer habits anytime soon, according to panelists. Another advantage tobacco has is that smokers are willing to move toward premium brands when they have extra dollars in their pockets, as recent low gas prices in the U.S. have shown. Consumers aren’t generally upgrading their soft drink purchases.

Globally, the cigarette market varies. Some areas, such as Asia, are growing, while other markets, such as Russia, are in decline. But overall, there are plenty of opportunities for tobacco investments. Taxation and legislation do make an impact. However, looking at a market like Australia, the first to institute plain packaging, tobacco volume hasn’t seen any dramatic declines. This leaves plenty of hope for investments in markets looking to adopt plain packaging. Tobacco, as an investment, continues to be quite profitable around the globe.

Reduced-risk products may be in the future for tobacco, but not in the near term. The vapor industry is growing, and consolidation has helped the tobacco companies involved in the industry increase their market share, but tobacco is not in danger of being overtaken by vapor products anytime soon. Tobacco companies will continue to innovate and wade their way through the new regulatory environment in vapor. Their role will continue to grow. Vapor is, after all, a relatively new industry.

Another possible future for tobacco is a bit more controversial. Legal cannabis, especially in the U.S., where multiple states currently have some form of legal marijuana, could become another major investment opportunity for large tobacco companies. Currently, according to one panelist, the marijuana market in the U.S. is valued at more than \$30 billion (one attendee stated he believed this number was very conservative). The legal market is currently worth about \$6 billion.

One catalyst for growth in the cannabis market will be elections. Three U.S. states passed recreational marijuana initiatives on their ballots. The industry is estimated to be valued at more than \$50 billion by 2026. This is a huge investment opportunity, especially if federal deregulation

happened, one analyst noted, adding that large tobacco companies could have a 20 percent share of the legal cannabis market by 2036. "That would double top-line growth for the industry," she said. "Tobacco companies are also well-versed in taxation and working in a heavily regulated environment."

In closing, tobacco remains a strong investment. Regulation and taxation, combined with volume declines, will only have minimal effects in the short term. It will be at least 10 years before they truly make any impact, according to one panelist. However, everyone could agree new and emerging market opportunities will keep the industry highly profitable into the future. Bloomquist said it best: "Tobacco companies will continue to innovate."