

British American Tobacco Australia
166 William Street
Woolloomooloo
Sydney NSW 2011

Wednesday 12 March 2014

**British American Tobacco Australia and Imperial Tobacco Australia
Meeting**

In attendance:
For the Chantler review:

Sir Cyril Chantler and Tabitha Jay

For British American Tobacco Australia:

Kasia Witon-Wanstall and Mark Connell

For Imperial Tobacco Australia:

Gary Dickson, Andrew Gregson and Rachel Elliott

(1.10 pm)

Wednesday 12 March 2014

MARK CONNELL: How would you like to proceed?

SIR CYRIL CHANTLER: I'm here to listen to you guys, basically. I am a bit further forward than when I met the industry in London, but I really want to have your views. Coming to Australia was an important part of the review, for obvious reasons. I haven't finally decided what my conclusion is, but obviously I am nearer to it. To begin with, you tell me and Tabitha what you want us to hear and we'll listen very carefully, then we have one or two things we'd like to ask you. We don't have a structure like we had before. Have you seen the transcript?

MARK CONNELL: We've seen transcripts.

GARY DICKSON: Yes.

SIR CYRIL CHANTLER: If there is anything there that you need to draw to my attention, it is fine, but I do not think there is any point going over all of that again, unless you want to.

MARK CONNELL: And we've assumed that since then we've had plain packaging here for 12 months and, therefore, facts and figures about what has happened in that 12-month period is going to be of most importance to what you guys are after.

TABITHA JAY: Can I interrupt? Although everyone has their names in front of them, forgive me, I am not sure who is from which company.

MARK CONNELL: I am Mark Connell. I am the Head of Corporate and Regulatory Affairs for BAT Australia.

KASIA WITON-WANSTALL: I am Kasia Witon-Wanstall. I am Business Insights Manager for British American Tobacco.

GARY DICKSON: I am Gary Dickson, Regulatory Affairs Manager for Imperial Tobacco Australia.

ANDREW GREGSON: I am Andrew Gregson. I am Head of Corporate Affairs with Imperial Tobacco Australia, and have been in the role for a grand total of five weeks, so anything you need to know, I'm your guy.

TABITHA JAY: What was your previous role? Was it related?

ANDREW GREGSON: Agriculture. I was looking for something less controversial, so tobacco.

RACHEL ELLIOTT: I am Rachel Elliott. I am the Public Affairs Manager at Imperial Tobacco Australia.

SIR CYRIL CHANTLER: Philip Morris, as in London, didn't want to join us because they are not represented and Japan Tobacco don't have much of a market share.

MARK CONNELL: They've got one brand.

GARY DICKSON: We actually sell their products for Imperial Australia. We have an arrangement.

SIR CYRIL CHANTLER: I see. Thank you.

MARK CONNELL: I'm not sure how you want to proceed. We have prepared statements.

SIR CYRIL CHANTLER: Why don't you start.

MARK CONNELL: That might be a good way to get the conversation going. Are you happy for me to go, Andrew?

ANDREW GREGSON: Absolutely.

MARK CONNELL: First of all, on behalf of British American Tobacco Australia, we want to thank you very much for taking the time to meet with us here in Sydney. In particular, for undertaking the due diligence and robust investigation into the evidence base for, and possible consequences of, plain packaging to be presented to the Secretary of State for Health. Such an approach wasn't taken in Australia prior to the introduction of plain packaging a couple of years ago, and we believe that if there had been a regulatory impact study that we may not have seen the implementation of the policy here in Australia.

We welcome the opportunity to provide you with some insights into the impact that the introduction of plain packaging has had in Australia and note that you have a specific interest in data demonstrating real impacts.

SIR CYRIL CHANTLER: Can I just interrupt you? I am sorry for this, but I should have mentioned it. My terms of reference, which you have all read, are clear but they are limited to the public health impact of standardised or plain packaging, either

positive or negative, with particular interest for young people, so that some of the other issues, such as commercial or legal issues, aren't part of my terms of reference, except to the extent that they are intimately connected to my terms of reference which, I am sure, before the end of the meeting we will be talking about.

MARK CONNELL: Sure.

SIR CYRIL CHANTLER: Thank you.

MARK CONNELL: Will I continue?

SIR CYRIL CHANTLER: Yes.

MARK CONNELL: We will endeavour to provide you and your team with as much information as you require within the legal constraints, competition law and your terms of reference. The first point that BAT Australia would like to make quite clear is that all of the data available since the introduction of plain packaging demonstrates that this policy has not had its intended effect, nor does it indicate that it may do so in the future.

In the year since its introduction, we have seen the long-term trends of decline in key tobacco industry metrics slow or even halt for the first time in 10 years. The volume of tobacco sold in Australia, that is the number of cigarettes, including roll-your-own tobacco equivalent to a tobacco stick or cigarette, had been declining at an average of 4.1 per cent each year prior to the introduction of plain packaging and, in 2013, that rate of decline halted entirely with the volumes actually up 0.3 per cent. So the volumes actually went up on the year before. These volumes do not include, of course, the rise of illicit tobacco that we will talk about later. At the same time, smoking incidence - the number of people smoking tobacco in Australia - had been also declining at an average steady rate of around 3.3 per cent each year for the four years prior to plain packaging. In 2013, that rate of decline slowed to less than half of that rate to around 1.4 per cent decline.

The third issue is what we call average daily consumptions, the number of cigarettes smoked on a daily basis on average. They had also been declining at a rate of 1.9 per cent each year four years prior to plain packaging, but in 2013 that rate of decline slowed to a decline of 1.4 per cent.

SIR CYRIL CHANTLER: Where is this data sourced from?

MARK CONNELL: The majority of this data is the Roy Morgan research. It is national sales research.

KASIA WITON-WANSTALL: Can I add to that? Our volume comes from the exchange of total industry sales that all the manufacturers provide, so it is an industry view in terms of volume. It is not what is scanned, but the total industry sales that comes from all the manufacturers. For smoking incidence we use a company called Roy Morgan, which is an established research company. They interview 35,000 people a year. We have been using them for more than a decade in terms of measuring the incidence of smokers. It is a big national survey; as I said, 35,000 a year, on average.

The average daily consumption is a measure that we gather through our internal consumer survey. We survey 6,000 smokers a year. It is your typical research that measures consumption patterns. It is a global methodology that British American Tobacco uses. The first sources are widely available. They are syndicated sources, so the Government and all the other parties can access the numbers. The third source is a British American Tobacco survey.

SIR CYRIL CHANTLER: The chief executive of Imperial - you will have seen it in the transcript in London - Alison Cooper, in her half yearly report for six months up to the summer of 2013 remarked that the market had declined by 2 to 3 per cent since plain packaging came in; not as bad as we thought it might be. She went on to say that, for Imperial, the results had been partially mitigated by the fact that they had increased their share of the market. I cannot quite reconcile what you've just told me with that information.

RACHEL ELLIOTT: The expectation of going into plain packaging was that illicit trade would spike. Illicit trade has spiked. The presumption was that it could spike to a higher figure than it actually did. The comment was more to the point that illicit trade has spiked. We thought it could be potentially worse than it is. Illicit trade is not quite as bad as we expected, but it is still bad.

SIR CYRIL CHANTLER: I imagine you have read what she actually said, because it is online.

RACHEL ELLIOTT: Mmm.

SIR CYRIL CHANTLER: She said, "We've seen the market decline roughly 2% to 3%, so maybe not as bad as we might have anticipated." I understand the argument that in terms of prevalence that has not been affected because illicit has gone up.

RACHEL ELLIOTT: That was the argument, yes.

SIR CYRIL CHANTLER: And that is what your company in London tells me.

RACHEL ELLIOTT: Illicit figures.

SIR CYRIL CHANTLER: Nonetheless, the market as far as is Imperial is concerned, illicit manufactured product has fallen between 2 and 3 per cent since plain packaging came in. Has BAT seen the same change?

KASIA WITON-WANSTALL: I think I would need a clarification from ITA, when we talk about market decline, is it the market of scanned volume, is it the market of EOS volume because those numbers will differ. What also happens with the behaviour of the tobacco market is that you usually have a higher sales volume at the beginning of the year because of the Christmas impact and you have got a buy-up before your typical price increase in February, then it stabilises throughout the year.

SIR CYRIL CHANTLER: Yes, but that is not what she is saying.

KASIA WITON-WANSTALL: But your yearly number could probably be a lot lower than when you announce the figures --

SIR CYRIL CHANTLER: Do we have that information for the whole year now from Imperial?

KASIA WITON-WANSTALL: Yes.

GARY DICKSON: You will see an industry figure very shortly. We have not split it up individually. We can provide that at another point in time.

SIR CYRIL CHANTLER: It would be in the company report, wouldn't it, to shareholders?

GARY DICKSON: I am not sure they get broken down that far.

SIR CYRIL CHANTLER: This is her report to shareholders.

GARY DICKSON: I can tell you that our share and volume has grown in that period, and we will talk about industry figures in a moment.

TABITHA JAY: You said it's "scanned" data.

KASIA WITON-WANSTALL: Correct.

TABITHA JAY: Is that sales to customers in the hand, or is that --

KASIA WITON-WANSTALL: Correct.

TABITHA JAY: -- out of the factory?

KASIA WITON-WANSTALL: Yes, so what we are providing you as a growth of 0.3 is our sales as manufacturers to the retailers.

TABITHA JAY: So it might mean there's more in wholesale now?

KASIA WITON-WANSTALL: It could be. So then the scanned numbers is what the consumers are buying. It goes through the scanner of every retailer. There is always a little bit of a discrepancy because there is a little bit of stock holding, depending on which time of the year you are at. As an industry, the best view of the industry volume is when you have numbers from all three manufacturers that go to one company called InfoView, and then they give us the volume. We've done this as an industry for decades. We have always used the same company and the same numbers for decades in terms of measuring what is the change to volume. You will see that in one of the documents that you will take with you. We've given you a volume change going back to 1994 so you can see how --

TABITHA JAY: That is all out-of-the-factory numbers?

KASIA WITON-WANSTALL: Correct. There is always relativity. They behave in similar ways. The gap between them is similar, although it is not always the exact number.

TABITHA JAY: Do you have the customer numbers as well?

KASIA WITON-WANSTALL: We don't have that as an industry, because as three different manufacturers we work with different companies. We work with Nielsen, PMI and ITA work with a company called Aztec. We buy different channels, so not everyone buys data from every available channel, because it is a costly

exercise. So we don't know exactly what each of us from a competitive point of view measures with scanned because it depends what - there are a lot of channels. This is a market of six complex channels.

TABITHA JAY: When they come out of the factory and get scanned, or whatever it is called, are they sold to someone at that point, or what actually happens? What triggers it?

KASIA WITON-WANSTALL: It is a report that we get on a weekly and monthly basis. This is our industry view of the total volume.

GARY DICKSON: What happens is that at a certain point in time at the end of the month, we all pass our sales information to a company called InfoView. They take the data and aggregate it into industry information. We pass our information on and we get a file back with information from all three companies contained in it. We pass it on to Aztec or Neilsen, who then break it down in the way we look at it from our business point of view.

TABITHA JAY: It means that you have sold it to the wholesaler? That's what it's measuring?

GARY DICKSON: It could be wholesalers or it could be individual stores. Again it depends on our supply chains.

TABITHA JAY: But you no longer own it. That's the moment at which the data point is triggered?

GARY DICKSON: Yes. The scanned data which you were referring to before is bought from customers, so we might buy scanned data from Woolworths or Coles to see what they are selling to their customers directly. It is a different process altogether.

TABITHA JAY: I see.

SIR CYRIL CHANTLER: I still have the problem that volumes have not fallen. Indeed, the rate it falls stopped and volume has gone up. What I have learned from Imperial, and I don't know about BAT - as I said, no doubt you will have that information - also, in the KPMG report on illicit, they said that legal domestic sales in Australia of manufactured and loose tobacco have fallen in 2013. It is in kilograms, 15.3 to 15.1.

GARY DICKSON: Yes. It is a different source. The KPMG report uses a database called Euromonitor, which is an external source used

for that report. As part of that process to get to where they get to, they use industry exchange of sales [EOS] to validate, if you like. That is their checkpoint. It is a different data source altogether.

SIR CYRIL CHANTLER: How do you reconcile them?

KASIA WITON-WANSTALL: The only thing I would like to point out is that this data point is only until the middle of 2013. What has happened in 2013, if you remember, we had another big ad hoc increase from 1 December of 12.5 per cent. What you tend to do and the business or the industry does at the time, the retailers want to get as much stock as possible at a slightly lower price. This is a typical fluctuation through every year. We always have a heavy beginning and heavy end of year before Christmas. Even though at July 2013 you see that drop 15.3 to 15.1, I am pretty sure that when we get the latest report, which will have a full year number, that will not happen, because --

SIR CYRIL CHANTLER: You have not got that yet?

KASIA WITON-WANSTALL: No, I haven't got those numbers.

GARY DICKSON: It is currently in progress and we are reviewing it.

SIR CYRIL CHANTLER: Can I ask you, so I am clear, there was a 12.5 per cent tax hike in December 2012, was it?

KASIA WITON-WANSTALL: December 2013.

SIR CYRIL CHANTLER: December 2013?

GARY DICKSON: Correct.

SIR CYRIL CHANTLER: Then how did that affect - you said December '12 just now.

KASIA WITON-WANSTALL: Sorry, I meant December '13.

SIR CYRIL CHANTLER: How could have that have had an effect on these 2013 figures?

KASIA WITON-WANSTALL: Because your November sales in preparation for the 1 December change --

SIR CYRIL CHANTLER: But the tax didn't go up in December 2012?

GARY DICKSON: No, it did.

SIR CYRIL CHANTLER: It did or --

GARY DICKSON: It did, yes. On 1 December there was a change.

TABITHA JAY: December '13.

KASIA WITON-WANSTALL: '13.

GARY DICKSON: '13.

SIR CYRIL CHANTLER: Not December '12, which is when plain packaging came in?

GARY DICKSON: Yes. So on 1 December 2013 the first of the 12.5 per cent excise hikes went through.

TABITHA JAY: Which would encourage people, you are arguing, to have bought extra in November?

KASIA WITON-WANSTALL: Correct.

GARY DICKSON: Typically, yes.

KASIA WITON-WANSTALL: Yes, and that is how the retailers always try to prepare --

SIR CYRIL CHANTLER: That is in November '12, but the tax didn't go up until December '13.

ANDREW GREGSON: No, that is November '13 you are talking about. There was a draw forward of purchase in advance of an excise spike.

TABITHA JAY: Into November '13?

KASIA WITON-WANSTALL: Therefore, a full 2013 number --

SIR CYRIL CHANTLER: That is not relevant to these figures.

RACHEL ELLIOTT: You are talking about the year before that?

SIR CYRIL CHANTLER: The figures are there for the first six months of '13 before the tax hike.

KASIA WITON-WANSTALL: Correct, and you see a drop because the

second half of the year has had very good sales for all the manufacturers. When you then look at the full year number, there is no decline in sales or volume.

SIR CYRIL CHANTLER: In these figures do you take account of the change in the size of - it does not affect prevalence, I know that, but do you take account of the size of the population, which is rising so far as I can see, by over 1 per cent per year?

KASIA WITON-WANSTALL: We've looked at the numbers, and we've looked if there is an absolute change. So when you look at the prevalence, it goes with the population, so you are not building --

SIR CYRIL CHANTLER: I know about prevalence, but in terms of volumes, you might think that it would be appropriate to correct it. Observed or expecting, which is the sort of scientific way I would look at it, in relation to variables such as the increase in the size of the population, particularly immigrant population, given it is the policy to increase the size of the population in Australia. And I may add that the population that comes into Australia - I don't know but you may know - probably has a higher prevalence of smoking because Australia has a low prevalence of smoking. Do you correct your figures for that?

KASIA WITON-WANSTALL: We do. I will have to come back to you, because we did look at it and it wasn't a correlation --

SIR CYRIL CHANTLER: The figures you have just mentioned to me have not been so correct?

KASIA WITON-WANSTALL: Which figures?

SIR CYRIL CHANTLER: The volume figures I was told just now.

KASIA WITON-WANSTALL: I am only saying that those figures that we've seen from KPMG stopped in the middle of the year. Therefore, a full year number corrects them in the sense that there was a strong second half of 2013.

GARY DICKSON: KPMG uses a different data source to the source that we were talking about earlier on.

SIR CYRIL CHANTLER: Yes.

GARY DICKSON: They then take our industry information and use that to upweight it to an appropriate level.

SIR CYRIL CHANTLER: It is slightly difficult for me, the amateur, if you like, coming into this to understand how different data sources are used in different ways.

GARY DICKSON: Yes.

KASIA WITON-WANSTALL: Correct.

SIR CYRIL CHANTLER: It does seem to me that the data source that comes from you guys in terms of what your company reports to the shareholders must be pretty accurate.

GARY DICKSON: Yes.

ANDREW GREGSON: That would largely be the InfoView data that drives that.

GARY DICKSON: Yes.

ANDREW GREGSON: And our InfoView data is telling us that in 2013, as compared to 2012, legal tobacco sales are up 59 million sticks.

SIR CYRIL CHANTLER: Imperial?

ANDREW GREGSON: Yes.

GARY DICKSON: No, that is industry figures.

ANDREW GREGSON: Sorry, that is industry figures.

SIR CYRIL CHANTLER: So if Imperial is down by 2 to 3 per cent and the chief executive says that the market share has increased --

KASIA WITON-WANSTALL: We think it might be easier for you to have this table so you have got all the exact numbers. This is back to InfoView, our industry exchange of sales, going back to 2009. You can see the growth. This is four years, so every year is a full year. So it is a full 2013 number. This is total industry, all manufacturers, and the growth.

TABITHA JAY: This is out of the factory rather than sold to the consumers?

KASIA WITON-WANSTALL: Correct.

MARK CONNELL: I am not sure if the figures that Ms Cooper is quoting

are figures that are specifically related to Imperial.

ANDREW GREGSON: Our sales?

SIR CYRIL CHANTLER: Specifically Imperial.

MARK CONNELL: Or industry as a whole.

SIR CYRIL CHANTLER: They are specifically Imperial. But she goes on, saying that their share of the market is growing. It must be at the expense of either Philip Morris or British American Tobacco, unless they have also fallen.

GARY DICKSON: Do you want to comment on that?

KASIA WITON-WANSTALL: I can comment, and we've got to make it very clear that every manufacturer might have a slightly different measurement, but from our point of view the one manufacturer that has gained share in 2013 has been ITA and according to our measures, it is 2.1. PMI and BAT have lost share, 1 per cent for --

SIR CYRIL CHANTLER: They have lost share?

KASIA WITON-WANSTALL: Yes, 1 per cent for BAT, according to our measurements, and 0.9 to PMI, and 2.1 share gain for ITA. That is from scanned.

SIR CYRIL CHANTLER: Thank you.

TABITHA JAY: This is scanned.

GARY DICKSON: That is exchange of sales, Tabitha.

KASIA WITON-WANSTALL: We've done due diligence to make sure that we really have every source clearly marked and it is important that we emphasise that.

SIR CYRIL CHANTLER: Thank you very much. Back to you.

MARK CONNELL: Thank you. I was referring to the volume figures of the average daily consumption and the incidence figures before. Following on from that, it is our view that these figures, in isolation, certainly do suggest that plain packaging is not achieving any of the stated objectives, but when combined with the fact that the illegal tobacco sector in Australia has increased, it could be argued if you have got an increase, of

course, in volumes and an increase in the percentage of illegal tobacco being bought and consumed here that you have actually got more people smoking in 2013 than you did the year before, which is the opposite of what the policy was intending to do. It is, of course, extremely difficult to clearly attribute changes in the market exclusively to plain packaging, but these factors are the best available indicators of real change in the first year following the introduction of plain packaging.

Since the introduction of plain packaging, the Government and tobacco control agencies have run large-scale education campaigns. The measure of tobacco excise indexation has changed. The Government has announced a series of significant ad hoc excise increases and the make-up of the illegal tobacco industry has significantly changed. Because of their decision to introduce plain packaging in Australia without any evidence base or regulatory impact assessment, the Australian Government is now required to carry out post-implementation review of the plain packaging policy. We expect that the Department of Health will begin this in December 2014 and report back around six months later. This obviously falls outside your timings in terms of your recommendation to Government, but obviously we think it is prudent to suggest --

SIR CYRIL CHANTLER: As a matter of fact, I am not recommending to Government what their policy should be; that is not my task. It is way, way above my pay grade. I am restricted to whether it is likely to have an impact on public health and, if so, what that might be, positive or negative.

MARK CONNELL: I am getting to the end here. The other piece of evidence not currently to hand that I believe may be of interest to the review is the upcoming KPMG report on the illicit tobacco market in Australia. We are aware that you met with KPMG in the UK and that they have briefed you on the report that was released in October last year. The next report will be available from 28 March 2014 and will contain a full year of data following the introduction of plain packaging. Obviously we would like to provide you with a copy of that report when it becomes available. For your awareness, all indications are that the trend of an increase in illegal tobacco has continued since the introduction of plain packaging, which we will obviously talk about later, and that's it. Thank you for the opportunity and we look forward to assisting in any way we can.

SIR CYRIL CHANTLER: Thank you. Am I allowed a copy of that?

MARK CONNELL: Absolutely.

SIR CYRIL CHANTLER: Thank you very much.

ANDREW GREGSON: Are you happy for us to commence?

SIR CYRIL CHANTLER: Yes, indeed.

ANDREW GREGSON: First of all, thank you for the opportunity to provide you with some information as part of your task. As I have mentioned, I have been with Imperial for a grand total of five weeks. I think you will find that I am very happy to tell it as it is after the first five weeks and hopefully that is useful to you. Imperial Tobacco Australia is a wholly owned subsidiary of Imperial Tobacco Group PLC, the world's fourth largest international tobacco company. In Australia, ITA has a share of approximately 21 per cent of the total market and approximately 60 per cent of the loose or roll-your-own tobacco market.

SIR CYRIL CHANTLER: Is that the same as fine tobacco?

ANDREW GREGSON: Fine cut.

SIR CYRIL CHANTLER: Yes, fine cut. It is the same?

ANDREW GREGSON: I have noticed that our industry tends to speak in acronyms, so if I do, please feel free to tell me off.

KASIA WITON-WANSTALL: It is the same.

MARK CONNELL: Have you not mastered that yet?

ANDREW GREGSON: Not quite. They gave me 19 pages of it on the first day; I'm getting there.

SIR CYRIL CHANTLER: So 60 per cent is fine cut?

ANDREW GREGSON: Sixty per cent of FCT.

GARY DICKSON: Yes.

ANDREW GREGSON: At a company level, ITA supports the balanced and practical regulation of tobacco products. Whilst we recognise it is the role of governments to provide the general public with clear and consistent messages about the health risks to smokers associated with their smoking, ITA urges the Government to

simultaneously respect the principles of adult choice, freedom of competition, commercial rights of trademark owners and legitimate businesses when so doing.

Plain packaging laws were fully implemented in Australia on 1 December 2013. Whilst it is still early days, ITA has not seen a volume decline and the tobacco market largely continues to perform based on historical trends showing no impact from plain packaging. In Australia, the legal tobacco sales in 2013, when compared to 2012, show an increase of 59 million sticks. Whilst factory-made cigarettes, or FMC, declined by less than 0.1 of 1 per cent per cent, fine-cut tobacco grew by 3.4 per cent. Now, I noticed your question in respect of the data that our global CEO provided to you.

SIR CYRIL CHANTLER: Not to me.

ANDREW GREGSON: Well, to a separate inquiry.

TABITHA JAY: Shareholders.

ANDREW GREGSON: To shareholders, I beg your pardon. I am more than happy to back the data that I have with me today, but we will seek to clarify Ms Cooper's comments and provide the context to you after the meeting today, if that is acceptable to you.

SIR CYRIL CHANTLER: Okay.

ANDREW GREGSON: What is clear, of course, is that in the period since plain packaging was introduced, illicit trade has greatly increased, and allow me to stray off script here for just a moment. I recognise your terms of reference and, in particular, the uptake of smoking and the incidence of youth smoking, and so on, and I would like to make a couple of comments on where the linkage is to illicit trade and what has happened in Australia. The key linkage is the availability of tobacco products and, in particular, the amount of scrutiny given to who that tobacco is being provided. Obviously if it is being provided illicitly in the first instance, those vendors are not particularly concerned about the age or status of people they are selling it to and, as a result, I would suggest that --

SIR CYRIL CHANTLER: Can you explain to me who are the vendors of illicit?

ANDREW GREGSON: Gary is probably best to answer that.

GARY DICKSON: There is a range of avenues that it comes through. We note that tobacconists are about 20 per cent of the illicit market. Behind that, supermarkets, typically independent supermarkets, are 22 per cent, and there is a whole bucket of others, which is 40 per cent. That includes things such as a local market. You might find on a weekend that a truck will pull up at the back, up goes the back of the truck and product will be sold. Asian grocery stores, family and friends are included in that. Tobacconists is probably the most identifiable sector in the market, then supermarkets and then other.

SIR CYRIL CHANTLER: Where do you get that information from?

GARY DICKSON: That came from the KPMG report through the Roy Morgan consumer survey.

RACHEL ELLIOTT: It is readily available. People can readily buy it from the local tobacconist store. All they say is, "What is your cheapest brand? I want the cheapest product", and many people will hand over the illicit product.

SIR CYRIL CHANTLER: Tobacconists are regulated, are they not?

GARY DICKSON: Yes, they are.

KASIA WITON-WANSTALL: Yes.

GARY DICKSON: It varies by State, but the answer is yes.

SIR CYRIL CHANTLER: So are you telling me that regulated tobacconists are the main source of illicit?

GARY DICKSON: They are one of the main sources. There are also independent supermarkets.

SIR CYRIL CHANTLER: But they must also be licensed to sell.

GARY DICKSON: Again, the licensing varies from State to State. In some cases it is more registering that you exist. In other cases you pay for a licence. It varies considerably, depending on the State you are selling product in.

SIR CYRIL CHANTLER: You will be known to be selling tobacco, it is not underhand, and if you were found to be selling illicit, you would suffer consequences.

GARY DICKSON: There are a number of penal codes. The various

States have their own penal codes. There is the Customs Amendment that went through in 2012 whereby you can end up with a 10-year jail sentence as well.

RACHEL ELLIOTT: But no-one has been penalised under that legislation.

GARY DICKSON: No-one has been penalised at this point in time.

SIR CYRIL CHANTLER: So how much of the total market in illicit is coming through legitimate - these are all legitimate sales, aren't they?

GARY DICKSON: Yes.

SIR CYRIL CHANTLER: This isn't people running a black market, importing it, and then going around youth clubs and so forth?

GARY DICKSON: No.

SIR CYRIL CHANTLER: No. So what proportion is it? Just trying to add it up, it seemed to me about at least 80 per cent from what you have just said.

GARY DICKSON: The unknown is the bucket I talked about. About 38 per cent sits on this bench called "Other", and that includes - it is probably between 70 and 80 per cent, yes.

SIR CYRIL CHANTLER: Is coming through legitimate --

GARY DICKSON: Legitimate sales channels. The bulk would come through family and friends who may go overseas and bring things back in or buy and pass it on to others in the family.

SIR CYRIL CHANTLER: But that's contraband. I mean they are bringing it in themselves. It is licit if it is duty paid when it comes in, so it is not illicit.

GARY DICKSON: Keep in mind that in Australia we've a very low duty-free allowance. It is only 50 sticks.

TABITHA JAY: You can pay at the border, can't you?

GARY DICKSON: You can. I am not sure exactly what happens there, but you can do that, yes.

TABITHA JAY: You know that KPMG made an adjustment for payments

at the border?

GARY DICKSON: They did. Sorry, in the new report we identified that maybe there was a requirement for adjustment and that will be made in the full-year report. They would have briefed you on that.

RACHEL ELLIOTT: Can I add that while it is finding its way into the legitimate supply channels it is largely originating outside of that. So the example you gave this morning, there is a brand called Manchester, which is illicit white.

SIR CYRIL CHANTLER: I know about Manchester, yes.

RACHEL ELLIOTT: For example, criminal groups are dropping it off at a tobacconist, saying, "Here is your supply of Manchester. We will back next week to collect the money, regardless of whether you have sold it."

SIR CYRIL CHANTLER: Yes. Manchester is counterfeit is it not?

GARY DICKSON: No, it is illicit white or contraband. If you like, there is a packet of Manchester. Exhibit 1.

MARK CONNELL: The majority of the product that is coming in is product such as Manchester and other brands that we've got here, which are not legally produced, as we understand it, for any market at all. They are actually produced for the sole purpose of being smuggled. There were reports in the newspaper today about the lack of counterfeit green packs, the Australian regulation packs, and that is true. We did believe that there would be a blowout in the size of the plain packaging numbers because there was a lot of counterfeit of our brands before. That does not occur. It is all of these other packs that seem to come across, including this, chop chop loose leaf.

TABITHA JAY: In that case, do you see it as having anything to do with standardised packaging?

MARK CONNELL: I think the majority of it has to do with price and I think that, in Australia, you have got one of the most expensive tobacco markets in the world. When you have things such as a 25 per cent ad hoc tax increase or these four announced 12.5 per cent ad hoc increases on what is already a very expensive product, there will always be a certain percentage of the market that will start to find it very difficult to continue to use tobacco without finding a cheaper alternative. That will mean illicit or it will

mean finding the cheapest available legal product. These are smokers that are more price sensitive rather than brand loyal, if you like.

GARY DICKSON: To put it into context, the cheapest 20 in the market is about \$12. You will typically find Manchester for \$9 at the moment. It is about 30 per cent cheaper. These are prepacked shares that are prepacked with chop chop. They are sold in packets of 100. Typically you find them for about \$32 for 100 or \$6.40. They are about half the price of a legal cigarette.

TABITHA JAY: Hundreds for how much?

GARY DICKSON: \$32. Chop chop is half a kilo. It is about 60 per cent cheaper than roll-your-own tobacco, to put it into context.

TABITHA JAY: The Roy Morgan survey that is your source of information about the channels by which illicit is sold or is KPMG's source for that, do you know what their methodology was? How do they know?

GARY DICKSON: There is a question in there: Where is your main source of purchase for these products?

TABITHA JAY: Right, so you find people who admit to smoking illicit and you ask them where they bought it.

GARY DICKSON: Yes. What happens - and feel free to jump in as well - it is a web-based survey and an email gets sent to around about - the detail is in the report - 10,000 consumers. Ultimately, there are filter questions and we end up with a sample of about 2,100 as our base for that survey.

MARK CONNELL: Half the reason we believe that it is increasing, is they are very cheap to produce. When you have a market as expensive as Australia - you know, it costs around about \$200,000 to fill a container, but once that container lands in Australia, it is worth \$2 million. It is quite easy to stock five containers, even if two or three get caught at the border. Customs do their best. One or two getting through --

TABITHA JAY: This is an argument about excise is it, really?

MARK CONNELL: I certainly believe that price is the main contributor to people purchasing cheap and illicit.

TABITHA JAY: Did we interrupt your presentation?

ANDREW GREGSON: You did, but I was more than happy for it to occur. You actually covered quite a bit in that rather broad discussion. In terms of the figures on the illicit market according to the recent KPMG report in the 12 months to the end of 2013, it grew from 11.8 to 13.3 per cent of total consumption, and in a report which I believe we've discussed bringing forward, we are looking at that trend continuing with a further increase. Have we spoken about the provision of that report?

GARY DICKSON: I think Mark covered it briefly.

MARK CONNELL: It was covered at the beginning, but we will endeavour to get that to you.

SIR CYRIL CHANTLER: You say the trend has increased. Do you have the figure for that?

GARY DICKSON: It is still at first draft stage. I wouldn't be prepared to give it at this point in time. I would rather wait until --

SIR CYRIL CHANTLER: Are you telling me it is going up or it has plateaued to 13 per cent? It certainly hasn't dropped to 11 per cent?

GARY DICKSON: No, it hasn't dropped.

ANDREW GREGSON: Nor has it plateaued.

GARY DICKSON: No.

SIR CYRIL CHANTLER: It has gone up further.

ANDREW GREGSON: I didn't say that. We've seen an increase in illicit trade. We expect to continue to see an increase in illicit trade.

SIR CYRIL CHANTLER: Why do Customs and Excise say they haven't seen it?

MARK CONNELL: I think the report this morning was in reference to the green Australian plain packaging standard, not an increase in the smuggling.

TABITHA JAY: You have got seizures as well.

MARK CONNELL: Seizures --

TABITHA JAY: You were saying seizures haven't gone up.

MARK CONNELL: Yes, but my read of this morning's article was very much about these particular Australian plain packaging-style products being caught at the border, not about the majority of the other --

SIR CYRIL CHANTLER: I think it is generally accepted that that hasn't gone up.

ANDREW GREGSON: Yes, that's right.

TABITHA JAY: It hasn't materialised yet.

MARK CONNELL: Yes.

GARY DICKSON: Well you have got small quantities.

SIR CYRIL CHANTLER: As I understand it, the Customs people say that the amount of illicit product in Australia is up 1 or 2 per cent and KPMG says, "No, it is 13 per cent. I can't understand that. In the United Kingdom there is the same methodology from KPMG - discarded packets - and it is not that far apart. There are reasons for the difference because they are different methodologies but they are not that great. Why? I don't understand it.

GARY DICKSON: I am not aware of the detail of the Star report. I thought we were using very similar methodologies.

SIR CYRIL CHANTLER: Yes, I am not doubting that. I am just asking why.

ANDREW GREGSON: The question is why the variance.

SIR CYRIL CHANTLER: I mean it is a different part of the world, but why are the Customs people saying that the amount of illicit is --

TABITHA JAY: Or the Australian Government seems to be saying that the illicit is more like 1 to 3 per cent, whereas KPMG is saying 13 per cent.

GARY DICKSON: That was based on quite an old survey which is currently being updated. When you look at the Customs report

that came out about three or four months ago, it is very supportive of the trend. Yes, the absolute numbers are different. The important thing is that seizures are increasing. I think they went from about from 55 --

ANDREW GREGSON: That was the next part here. They published a report. The *Illicit Cigarette and Tobacco Detection Summary January to June 2013* report produced by Australian Customs and Border Protection confirms that tobacco detections increased between 2007 and 2013, with tobacco seizures doubling over that period. The 2012-13 report notes that detection figures over the year as well as the previous two years indicate a gradual increase in detections of illicit cigarettes.

GARY DICKSON: It supports the trend that we are seeing through the KPMG report, not the absolute number necessarily.

RACHEL ELLIOTT: Customs media reports indicate that Customs only check 1 per cent of containers coming in. Because they are not finding it does not mean it is not there.

KASIA WITON-WANSTALL: You might be aware of the empty pack survey that supports the figures behind illicit. There is a massive survey and that looks --

SIR CYRIL CHANTLER: I know about that. Thank you.

TABITHA JAY: Do you think an empty pack survey that does not look at office waste or domestic waste is a significant methodological limitation?

KASIA WITON-WANSTALL: That doesn't look at the office waste?

TABITHA JAY: As in it looks at outdoor litter and outdoor bins and it doesn't look at - I mean there must be a lot of people who throw away their cigarettes in very different places to that. Is that a bias that is important?

KASIA WITON-WANSTALL: Because of the bans most of the smoking occasions occur at home. People either smoke at home or in their car or a little bit in public places. Obviously they are trying to focus on the areas that follow through those places, but it still becomes the relativity of all the packs within that universe of what is their share of packs that are identified as illicit verses legal.

TABITHA JAY: But smoking in the car and at home would be excluded

from the methodology, assuming that you then would not get out of the car and throw it away on the street.

GARY DICKSON: It does happen.

KASIA WITON-WANSTALL: You would be surprised.

GARY DICKSON: Yes.

TABITHA JAY: Okay. Well, home and office is obviously not included.

KASIA WITON-WANSTALL: Yes. I will have to check. I will have to check on the home. Let me just double-check the details.

GARY DICKSON: I do not think home is included. There are a number of sites in the 15 major population centres around Australia. It includes garbage bins, where they are accessible, but it does not include office waste or home waste, you are right.

TABITHA JAY: Which might make a difference to the sample?

GARY DICKSON: I don't know.

ANDREW GREGSON: I can't imagine that office waste would be a significant bias, given that largely you can't smoke in offices in Australia. As a result, anybody engaging in smoking has come from an office environment and is probably on the street to do it. I will skip a large amount of this because we've covered it in a more general discussion.

SIR CYRIL CHANTLER: Okay.

ANDREW GREGSON: There is one point here that I thought was useful, given your terms of reference. Obviously illicit trade results in significant lost government revenue but, more importantly, I think, from your perspective it undermines health initiatives to curb tobacco consumption and, of course, is often linked to organised crime activities. It only takes a brief glimpse at the packaging that is before you there to tell you which one sees those public health initiatives pursued and those that don't. Rather than read the rest of this to you, I think perhaps a discussion is more useful.

SIR CYRIL CHANTLER: Thank you. Good.

KASIA WITON-WANSTALL: May I add one point, because your point of

reference is about youth. As a business, we never measure anyone under 18. Legally we are not allowed and we do not do that, so we only look at 18 plus. The only number from Roy Morgan that we were able to look at to understand what is happening is the increase in the number of 18- to 24-year-olds as the total make-up of all the smokers between 2012 and 2013. So your 18 to 24 age group increased from 15.7 to 16.6 as a share of all the smokers. So we are not seeing a big drop of those younger in the under 30 age groups in terms of smoking incidence.

SIR CYRIL CHANTLER: Okay.

TABITHA JAY: In terms of price, you mentioned that Imperial's market share was the one that increased in 2013. Can you tell me a bit about the changes in the different price categories and which price categories did best in 2013 and how that changed?

MARK CONNELL: Sure. In fact I think we've got something.

GARY DICKSON: There is a chart there.

KASIA WITON-WANSTALL: This one.

MARK CONNELL: I will pass that across.

KASIA WITON-WANSTALL: This is for you to take.

MARK CONNELL: As you can see from 2009 to 2013, it is the bottom segment that has increased, 2012 to 2013 being the largest increase in that low segment. We call it low segment, but different companies have different segments that they focus on.

TABITHA JAY: That is quite a consistent trend towards the value category getting bigger?

MARK CONNELL: Yes.

ANDREW GREGSON: Yes.

TABITHA JAY: The big excise change was at the end of 2013, so it does not have much to do with --

MARK CONNELL: The really big one was in 2010. That was the 25 per cent ad hoc.

GARY DICKSON: Ad hoc, yes.

KASIA WITON-WANSTALL: It is worth pointing out that in 2010 there was a 25 per cent increase. In December 2013, it was 12.5, but because the prices have increased significantly, the absolute dollar increase is very similar or slightly higher than in 2010. Obviously prices across all the cigarettes have been going up. Even though you hear 12.5 per cent, in terms of absolute dollar value, it is a slightly higher increase than in 2010.

SIR CYRIL CHANTLER: Are you tempted to reduce your profitability to maintain your sales?

MARK CONNELL: Certainly from the BAT perspective, no, because we've been very fortunate in that our consumers have stayed largely loyal to their brands. We tend to operate in the more premium - what we call aspirational mainstream area. We've been quite fortunate in that maybe those that can afford to buy those products continue to buy those products. We do have brands in the lower segment that compete with others.

SIR CYRIL CHANTLER: Faced with a declining market, you normally reduce your profitability to maintain --

MARK CONNELL: You certainly can reduce your profitability if you want to maintain your share but then you have shareholders and others to answer to. The issue or any correlation that could be found with the standardised packaging is the fact that when the trademarks existed, or when the brands existed, it was much easier for a consumer to find the brand they wanted and to choose the brand they wanted. They could see in that brand the various indicators of taste, strength, what it was they were looking for. Once all those things are taken away, then the only competition left amongst all of those brands if they all look the same - a premium looks the same as a very cheap low - is price.

TABITHA JAY: Is there no difference in the product?

MARK CONNELL: The product is very important, but you have got to hope, and, we are very fortunate that we have consumers that are staying to our brands because they like the taste or the strength, or whatever you want to call it, but you can't deny as a result of all of this and excise and price increases that the bottom segment continues to grow. I think it is because there is more competition placed on price as a lever as opposed to the brands themselves or what a consumer's perception of those brands mean to them.

SIR CYRIL CHANTLER: You said that you thought the biggest driver

to illicit was the price, not the plain packaging. I would have thought that maybe if you were concerned that you are losing sales to illicit, you might be tempted to counteract the bottom price by reducing your profit margins and then maintain - sorry, I am not in this business. I am just asking a question that occurs to me.

KASIA WITON-WANSTALL: It is worth mentioning because obviously those illicit products do not pay excise. Of all the packs in the market, minimum \$10 is an excise. There are products that are \$12, \$13 that have a small profitability and consumers are going to those, but \$10.24 is pure excise, so therefore those illegal products --

SIR CYRIL CHANTLER: Particularly the top end of the market.

ANDREW GREGSON: Even if we wanted to compete with illicit trade, on sheer dollar value alone, we couldn't. We can't.

RACHEL ELLIOTT: We pay tax --

SIR CYRIL CHANTLER: It is just that you made the link that illicit is going up because price is going up. That is what I have understood to be the point.

ANDREW GREGSON: Yes, that is certainly the link, but I think your question at this point is more about down trading within legal categories and what has driven that.

TABITHA JAY: Yes. It looks like a fairly steady trend towards the value category getting bigger. Is that part of the reason that Imperial's market share - have you got lots of relatively value brands?

ANDREW GREGSON: Imperial has a range of brands, but, yes, we've most certainly picked up in the value category. I think, from memory, that table largely shows that the down trading has occurred from the middle of the spectrum rather than from the top.

KASIA WITON-WANSTALL: You are absolutely right, Andrew. Premium brands have remained very stable, which, in a way surprised us because you think that people are - actually your top premium brands have remained very, very stable. This is a category where people are quite loyal to their brands. About 50 per cent of smokers have only one brand in their repertoire. People don't swap and change unless they have to. The remaining amount of

smokers smoke, on average, 1.5 brands. They have one main brand and then they have occasionals, so they are trying to manage their budget with different brands. But a lot of people are very loyal. It is the top segment. You are right, it is the middle that has suffered most.

TABITHA JAY: And what has happened to the average price of premium cigarettes, if that is a question that makes sense to you?

KASIA WITON-WANSTALL: \$20 for a 25 pack.

TABITHA JAY: Has that stayed the same? Apart from excise, has the non-excise part of premium gone up or down?

KASIA WITON-WANSTALL: Not really. It was very much driven by excise, so the relativity of price increases has been very much the same, so it is not like premium products have increased their prices more.

TABITHA JAY: They have not increased above excise increases?

KASIA WITON-WANSTALL: No.

MARK CONNELL: On average, no. I think that is one of the areas where product does make a difference. The premium products are going to be a much better product that are worth paying for.

TABITHA JAY: Quite right.

SIR CYRIL CHANTLER: Over the last three years, apart from the excise, there has been no increase in the price of premium products?

KASIA WITON-WANSTALL: Except August. If you remember, the Government increased prices twice a year. Until the end of 2013 it was always February, August.

SIR CYRIL CHANTLER: But apart from taxes, the product has not increased in price over the last three years?

KASIA WITON-WANSTALL: The price increases are always correlated with the excise.

SIR CYRIL CHANTLER: It may be correlated, but are they entirely determined?

KASIA WITON-WANSTALL: Yes.

TABITHA JAY: They don't exceed the excise.

MARK CONNELL: The other issue we've got, it is an unregulated marketplace out there. We can't tell a retailer what to charge, so you can actually go to the end of the street and go to three different tobacconists and find three totally different prices within a dollar or \$2.

SIR CYRIL CHANTLER: But the manufacturer has not increased the price of premium cigarettes apart from the price going up because of the excise over the last three years?

KASIA WITON-WANSTALL: As a manufacturer, you have an opportunity to re-adjust. You go with your minimum excise, but you can decide which brands have a slightly lower price increase.

SIR CYRIL CHANTLER: So some prices have gone up?

KASIA WITON-WANSTALL: Correct, so you can look at your portfolio and you have to decide what is going to be the best for the consumer and your portfolio, but you always work with your minimum.

SIR CYRIL CHANTLER: On the premium cigarettes, some prices have gone up over the last three years in excess of the duty. Is that correct?

KASIA WITON-WANSTALL: I would have to double-check.

MARK CONNELL: We would have to look, but I would assume that just as likely the price can go up it can go down as well, depending on the market itself.

SIR CYRIL CHANTLER: I am just trying to work out between this and illicit.

KASIA WITON-WANSTALL: I will come back to you. Rather than answer, I would like to double-check. We obviously stick to excise.

SIR CYRIL CHANTLER: It is probably a small point.

KASIA WITON-WANSTALL: Yes, but it is also important to mention that, as an industry, it is a heavily discounted industry. At the end of the day the consumer still gets a price below the increase, anyway, because as a total industry there is a very significant discounting budget.

SIR CYRIL CHANTLER: Thank you.

TABITHA JAY: I can't understand that at all, but anyway maybe it doesn't matter. The middle category, why has that particularly gone down?

MARK CONNELL: Again, the segment that is bordering on or getting to that cheaper segment, so you have got people who were purchasing brands who were not necessarily in that premium segment but were making their way down towards the cheaper. I think it is fair to say, and this is probably about as much as I can say, that different brands have undergone different changes in terms of share over the past few years. You can look at that and there might be one particular brand that, for some reason, has suffered more than others, and that has also contributed to that particular segment becoming smaller.

ANDREW GREGSON: I don't think it's unique to tobacco that brand affinity tends to be a lot stronger at the higher end than it does in the middle or at the bottom. In terms of anything, when you commoditise the middle ground you will see down trading based on price.

TABITHA JAY: Some of the arguments put forward by the tobacco industry have been that standardised packaging will, in the long run at least, lead to a commoditisation of the market. Would you say that there is evidence that that has happened already or do you think that this is an excise story that we are looking at here?

MARK CONNELL: From a BAT point of view, I think this is still very much largely an excise and pricing story. We've talked about this a lot in that it is very difficult to predict what may happen in the future, because we actually don't know what government policy may change in the future, whether there will be changes to the tax system or changes to retailers' laws, licensing, et cetera. Without knowing all of those other factors, it is very difficult to predict whether this is a long-term --

ANDREW GREGSON: I do not think you can pinpoint one over the other.

MARK CONNELL: It is never one thing.

ANDREW GREGSON: To say was the down trading driven by plain packaging or was it driven by excise would depend entirely on the individual and an individual's choice as to what reason led

to the down trading. You can see down trading pretty clearly from that evidence. Similarly, you can see from the evidence that down trading occurred, not a drop in consumption.

SIR CYRIL CHANTLER: The down trading there has been going on in a step-wise fashion before plain packaging came in.

KASIA WITON-WANSTALL: Absolutely.

TABITHA JAY: And in other high-priced markets similarly.

KASIA WITON-WANSTALL: Absolutely. And there is no deviation from that trend.

ANDREW GREGSON: I am not trying to deny that. There is clearly a price driver to down trading, but I wouldn't want to say it is solely about price. I suspect that part of the deal with plain packaging, particularly in that middle ground, led to some down trading.

MARK CONNELL: The issue that we see is that price and taxation and the regulation around the product has been designed to give some sort of incentive to a smoker to give up or to quit or to smoke less because it is too expensive to continue to use the product. Once that goes to a certain level, you will see this increase particularly at the low end where it will be more price driven, and what you could find, what we are seeing right now is that there are a percentage of people probably spending less on a pack of cigarettes today than they were paying a year ago, purely and simply because they have made a choice to go from one brand to another, so that incentive to give up has vanished. To me, that helps justify and answer this issue of why has incidence gone flat and why volume is not declining the way it did before.

TABITHA JAY: Are you saying that average prices in 2013 are lower than average prices in 2012?

KASIA WITON-WANSTALL: No, I think what you were saying was that people go - because they go from the middle where they were paying more, they now choose to down trade, paying less, but they are not reducing how much they smoke, or they are not choosing to quit, so they make the choices based on price, and they choose the brands that have an attractive price, but those changes are not leading them to exit because from the incidence and average daily consumption, we are not seeing those changes.

TABITHA JAY: If standardised packaging is introduced and - against

your worst fears you are arguing - led to stabilisation of a previously declining market, does that make you now supportive of standardised packaging?

ANDREW GREGSON: That's one I am prepared to answer, if I may. It is a fair question and it is one that you see quite regularly. "Well, hang on, if you haven't seen a massive drop-off in tobacco consumption, what's the problem?" We are commercial entities. Our job is not just to sell tobacco. Our job is to sell tobacco at the greatest margin for our shareholders that we possibly can. That is what has changed. We have seen down trading in the categories. We've seen people drop from a more expensive brand to a less expensive brand. From your perspective, you have ended up with a flat line or even a slight growth. From our perspective, we've lost one of our main competitive angles. We are still selling the same amount of --

SIR CYRIL CHANTLER: You haven't actually lost it just yet.

TABITHA JAY: So are your profits down in 2013?

SIR CYRIL CHANTLER: Because we've just had the conversation that that has not actually occurred yet in relation to that. It is still a risk from your point of view.

ANDREW GREGSON: I think the evidence in front of you shows that is a pretty significant trend.

SIR CYRIL CHANTLER: I thought price was the main thing for this.

TABITHA JAY: Does that mean all three of your profits in 2013 are less than they were in 2012?

ANDREW GREGSON: No, simply because of a change in product - actually I should not answer definitively on that question because after five weeks I don't know, and I don't believe it has been announced yet for the current financial year. No.

What I am simply suggesting, and the data is sitting in front of you, is that the product mix has changed and is now driven by price alone, so the opportunity for us to deliver that value to our shareholders based on something other than price is where we are challenged.

SIR CYRIL CHANTLER: Okay.

TABITHA JAY: But that does not totally fit with what we are hearing from BAT that prices have stayed the same.

ANDREW GREGSON: The prices of the products, or the price that people are paying for tobacco, or the volume that is being smoked, they are three different things.

TABITHA JAY: Yes.

MARK CONNELL: We've been very fortunate that our consumers have stayed with the premium brands and that they are prepared to pay for that.

TABITHA JAY: Without you having to reduce prices.

MARK CONNELL: Yes. At the bottom end, you are probably talking about certain demographics that can probably least afford to pay what is a very high price and have no choice but to go directly to the bottom or to the illicit market. It is getting to a certain point where you are talking about \$20 plus, or \$US20 plus for a packet of cigarettes that, if it is a regular habit, it is a very expensive one.

The other question, of course, was if the market is stabilising, et cetera. In relation to the people who designed standardised packaging and the intention of the policy itself, which was to have people give up or not begin to smoke or smoke less, whatever it may have been, if the market is stabilising then it's not a great sign that the policy itself is achieving a great deal.

SIR CYRIL CHANTLER: In fairness, that is not what I have been told.

TABITHA JAY: That is not what the legislation says about what the objectives are.

SIR CYRIL CHANTLER: It is actually about reducing the appeal, increasing the sales warning, and increasing perception of harm. That is what they say is the policy.

ANDREW GREGSON: It is interesting that you raise the issue of perception of harm. It would be interesting to know, and I am not sure if there has been any research done on it, whether there has been an increased perception of harm. We had text health warnings, then graphic health warnings and now full pack. The question is whether the perception of increased harm did increase. I know we had an example here of - where is this from?

RACHEL ELLIOTT: This was taken from the Department of Health research called Market Research. It is still available on the Department of Health website. Essentially, as plain packaging was going through Parliament, they looked to research the new graphic health warning information messages, so there are some findings that we can share with you. I can send them to you, because it is quite detailed. Essentially they found that when the plain packaging and the graphic health warning was used combination, there was no increased highlighting in terms of sensitivity to the graphic health warning. If that was the stated objective, the online research found that that didn't increase. There was also --

ANDREW GREGSON: It is worth reading out a direct quote from that report from the Department of Health. "When the graphic health warning had 75 per cent pack coverage, plain packaging had limited additional impact on the noticeability of health warnings. Findings indicate that once the 75 per cent coverage is used, the health warning was very noticeable, regardless of whether the pack was branded or not."

SIR CYRIL CHANTLER: Yes. There is quite a lot of material in the literature about this, which I have now read.

TABITHA JAY: I will check whether I have had all my questions answered.

SIR CYRIL CHANTLER: I have asked all my questions. I need to go back a little bit because it is a source of confusion to me. Can you explain to me again item 8, the volume of tobacco? Where does that information come from and how can I get to its source?

GARY DICKSON: Is that the chart you have been given?

SIR CYRIL CHANTLER: No, the volume of tobacco - that is the number of cigarettes, including your own - sold in Australia has been declining each year but it has now stopped declining. Where is that information?

GARY DICKSON: At the end of every month the three manufacturers - BAT, ITA and Philip Morris - provide their sales data to a company called InfoView, who play a similar role to KPMG in the UK. I think KPMG did the same thing. InfoView then take that data and combine it into a single file with the sales information of all three companies in it. It is then passed back to us as industry information which we use to dissect, do our business planning and all that kind of stuff.

SIR CYRIL CHANTLER: That is generally available?

KASIA WITON-WANSTALL: Yes.

GARY DICKSON: Yes.

SIR CYRIL CHANTLER: I can get the source of that?

KASIA WITON-WANSTALL: Yes, and we've got the data for you as well.

SIR CYRIL CHANTLER: Thank you. Is there a website I can go to to check it?

GARY DICKSON: No, I am not sure about that.

SIR CYRIL CHANTLER: If it is publicly available and governments can get hold of it and -

GARY DICKSON: I am not sure.

MARK CONNELL: The InfoView stuff?

SIR CYRIL CHANTLER: InfoView.

MARK CONNELL: I am not sure.

SIR CYRIL CHANTLER: Is it in the public domain?

MARK CONNELL: We would have to check whether there are competition issues there because you have got three companies submitting--

TABITHA JAY: But if you can all see it there can't be a competition issue with government seeing it.

KASIA WITON-WANSTALL: Yes, because we share all our publications, so it is something that we've always consistently used. I don't know if, as a public person, you can go to a website to access it. I am not sure.

TABITHA JAY: But can you share it with us?

KASIA WITON-WANSTALL: Yes, and we go back to '94, so we will give you the numbers so you can see the long-term trends.

SIR CYRIL CHANTLER: That is where that information comes from?

KASIA WITON-WANSTALL: Yes.

SIR CYRIL CHANTLER: Thank you. I know I can get the Roy Morgan survey that you mentioned.

KASIA WITON-WANSTALL: Yes.

TABITHA JAY: One of the things about that is you said there is a bit of an issue when an excise duty comes in and is pre-announced, with people buying up the cheap or increasing stock before the price increase comes in.

KASIA WITON-WANSTALL: Yes.

TABITHA JAY: What kind of percentage could that be of the year's sales? Could they buy 5 per cent of their whole year's stock in November?

KASIA WITON-WANSTALL: They can't. Someone who buys a single back is likely to go and buy a twin pack, because it is from --

TABITHA JAY: But I don't think this was consumer data. This is wholesale data, isn't it?

KASIA WITON-WANSTALL: Yes.

GARY DICKSON: What happens is that the Government places excise quotas on us, so we are managed by a quota of what we can sell. We can't sell above that otherwise we incur penalties.

MARK CONNELL: So it is quite well regulated. Twice yearly it used to be CPI. Now it is a different calculation. Everybody knew that CPI would come out on these particular dates and that is what would cause the - I mean the market knew because of the time.

TABITHA JAY: So people would fill their warehouses just before?

MARK CONNELL: Yes. At the same time, the Tax Office knew this and started to put quotas on what could be sold.

TABITHA JAY: So it is quite smooth across the month?

KASIA WITON-WANSTALL: Yes.

GARY DICKSON: Over time.

MARK CONNELL: There are other ad hocs where a decision is made and

announced and nobody is really prepared.

SIR CYRIL CHANTLER: This InfoView data is what the excise use to calculate your tax liability?

GARY DICKSON: I would think that they use their own internal Tax Office or Customs information to do that. I am not sure. I would need to find out for you. We pay our excise every week. We send our cheque off to the Government. I imagine their quota would be based on the information that we provide to them on that weekly basis.

RACHEL ELLIOTT: I understood that it was agreed in advance. There is a system - I would have to check as well - whereby the total payable for the year is agreed in advance based on previous averages. So it is internally calculated and sent off.

SIR CYRIL CHANTLER: Where do they get the information from? Is it from InfoView or is there some other source of information that tells you how much tobacco product has been sold to the wholesaler?

RACHEL ELLIOTT: Again, my understanding is that the tax department, anyway - it is agreed in advance based on internal figures based on previous year's sales. That is something we can check.

SIR CYRIL CHANTLER: And the internal figures come from InfoView?

GARY DICKSON: No, probably internal finance information. What happens, the product comes from a factory, it will go into an under-bond warehouse. When it is moved from under bond into excise paid, the volumes that move across that theoretical line would be what we remit to the Government on a weekly basis as part of our excise payment.

SIR CYRIL CHANTLER: What is the point that you give the information to InfoView?

GARY DICKSON: Basically at the end of each month we give them our sales information: this is what we sold during the course of the month.

SIR CYRIL CHANTLER: To the wholesaler?

GARY DICKSON: To the wholesalers, to individual stores. It would be a combination of both.

ANDREW GREGSON: It is not a straight-line arrangement where it goes from us to a wholesaler to a retailer. There are multiple channels.

GARY DICKSON: We all have call centres. A lot of our products go direct to a small independent store and not through a wholesaler as you would find in the UK. It is slightly different.

SIR CYRIL CHANTLER: The duty you have paid on the product to excise is a stage before this?

GARY DICKSON: It is a separate process altogether.

SIR CYRIL CHANTLER: Separate process.

GARY DICKSON: Separate process, yes.

SIR CYRIL CHANTLER: So all the stuff that you sell which goes to InfoView is duty already paid?

GARY DICKSON: Yes, in theory.

ANDREW GREGSON: It would not go to InfoView before duty is paid?

GARY DICKSON: No, but it would equal what we pay during the course of the month, yes.

SIR CYRIL CHANTLER: Yes. Thank you.

TABITHA JAY: To ask both companies, in terms of what you forecast would happen, how has the reality of the first year of standardised packaging differed? You mentioned some differences.

RACHEL ELLIOTT: In terms of illicit trade?

TABITHA JAY: Yes.

RACHEL ELLIOTT: This was based on an understanding of Alison's Coopers comments. We expected illicit trade to really spike. It has spiked. It is possibly not as bad as it could have been, but it is still quite high. As Gary mentioned, it is still increasing, so the upward trend is still increasing. I don't think that differs from what we expected. We thought illicit trade would increase and it is increasing.

TABITHA JAY: Are sales bearing out your predictions of

post-standardised packaging - world sales and price?

RACHEL ELLIOTT: We did say we didn't think that plain packaging would have an impact. We didn't think there was evidence to support the implementation of plain packaging as a policy. All along, we said that plain packaging wouldn't achieve its stated outcomes and I would suggest that that hasn't been working.

MARK CONNELL: We were quite vocal on a number of different issues in the lead-up of plain packaging being introduced. One of the things that we did say, you are quite correct, is that there would be an increase in counterfeit of the standardised packaging. In other words, the legislation was virtually a blueprint that was given to counterfeiters. That is right, that hasn't happened but it is being replaced --

ANDREW GREGSON: It hasn't happened yet.

MARK CONNELL: Well, it may have happened in small quantities, but it is largely being replaced with these branded packs with no health warning on them whatsoever. The interesting thing is that our biggest brand, which was counterfeited all the time, very professionally I have to say, at least contained a health warning and a graphic health warning, whereas these products don't have anything on them at all. That was the counterfeit of one of our brands compared to this (indicating). Of course, yes, it is easy to counterfeit a standardised pack, but you have always got to make the space and the cost of changing the brand on that particular pack. Whereas this stuff has already been rolled off a machine somewhere. We can talk a lot about price and the fact that prices may reduce.

TABITHA JAY: Sorry, you are saying that it is more expensive to make the counterfeit packaging than it is to make illicit whites?

MARK CONNELL: I am assuming that if we've not seen an increase in standardised counterfeit packaging, the companies that are producing the product have decided it is cheaper to continue their print run of all of these other Manchester-style brands and send the containers across. It is logistically easier.

TABITHA JAY: So have you actually seen a decrease in counterfeit?

MARK CONNELL: Absolutely.

TABITHA JAY: You have seen an absolute decrease in counterfeit?

MARK CONNELL: Absolutely, absolutely.

GARY DICKSON: I think in the last Deloitte report it was about 7 per cent. KPMG, as you have already seen, it was around 4 per cent.

MARK CONNELL: Conversely, of course, there has been an absolute increase in the branded non-health warning packaging.

TABITHA JAY: You see that as mostly about excise?

MARK CONNELL: No. In this case, these particular companies that are bringing in the smuggled product are finding it cheaper to send this stuff across rather than to counterfeit.

TABITHA JAY: Cheaper. You don't think that people find it more appealing than the standardised packaging?

MARK CONNELL: They could, but when it comes to something that is half the price --

ANDREW GREGSON: The only way you would find that out is if it was the same price.

MARK CONNELL: Yes.

ANDREW GREGSON: And they are so dramatically cheaper.

MARK CONNELL: If it is half the price of something that is \$20 or so, that is a lot less that a young person has to pay. When we talk about what did we think 12 months ago and what has happened, we talked a lot about --

TABITHA JAY: Can I interrupt?

MARK CONNELL: Sure.

TABITHA JAY: You are partly saying that none of this is to do with standardised packaging, it is just to do with tax changes, but it does sound like that very much against forecast and concerns potentially counterfeit would radically spike because you'd given counterfeit as a blueprint. Instead, counterfeit has actually fallen.

MARK CONNELL: Counterfeit has fallen, but it has been replaced by branded packaging.

TABITHA JAY: You just see the whole thing as an excise story or do you see that standardised packaging has had something to do with it?

MARK CONNELL: There has been radical change to the market with plain packaging regulation. There is no one thing. I don't think that anybody could say this is one thing that has affected this change. Certainly somewhere along the line people have decided it is a lot cheaper to send this type of stuff over. More importantly, was that really the intention of the policy? Was that really the intention of the legislation? We can talk about the loss of revenue to a government, but what we are really talking about is product that is so much cheaper and, therefore, more widely available and more affordable for young people.

TABITHA JAY: But there are lots of people who argue, aren't there, that great levels of illicit are a function more than anything of effective enforcement and sanction regime, and a country with low corruption, and those kind of things.

MARK CONNELL: Absolutely.

TABITHA JAY: So, yes, high taxed countries could be more at risk, but it is not a pure market, is it? Of course, if it was, then everyone would always buy illicit.

MARK CONNELL: I agree. This particular pack here, I think the legislation has fines of up to \$340,000 per pack. If I am a retailer and I am caught selling something that does not have this particular health warning, it is \$340,000. Also, we've 25,000 retailers in the country and, from what I can gather, there has been less than 100 visits, compliance checks, if you like. Compliance is a big issue. If there is no compliance in the market, of course we will see an increase in these sorts of products being made available because as a retailer I am going to make a much greater margin and, at the same time, I am not going to get into any trouble.

TABITHA JAY: That makes total sense but it has nothing to do with standardised packaging. Would that be a fair conclusion?

ANDREW GREGSON: I am not sure it is a fair conclusion. The data for the middle ground shows it. There were people who were brand loyal. Their brands were commoditised; therefore, their sole driver became price. Therefore, I would argue they are more likely to consider illicit than they were previously. It is an element of both.

MARK CONNELL: It is not plain packaging that has caused it, but the purpose of the legislation in the first place is what is being undermined as a result of these changes in the market.

TABITHA JAY: Of course, if Australia decided to introduce plain packaging and open its borders at the same time, then of course that would be an absurd thing to do. It is two separate things, isn't it?

MARK CONNELL: Certainly the compliance issue has surprised us. We've spent an enormous amount of time with the Department of Health. They will no doubt tell you the same. People have gone over this packaging with a microscope and said we are one millimetre to the left of the centre of the packet, whether the picture is not clear enough, et cetera. It has cost us millions of dollars to change this packaging constantly so that people are happy. That is fine, but we are the legitimate players who are always going to have packaging that adheres to the law. There is an enormous focus on us. We already adhere to the law. If there are any changes, out of goodwill we make those changes. It costs millions of dollars. In the meantime, there is no compliance whatsoever, and this stuff is coming across in containers with very little compliance in the market or a crackdown. I would have thought at least two or three \$340,000 fines would have sent a message to somebody.

TABITHA JAY: We should catch our plane, shouldn't we?

SIR CYRIL CHANTLER: Yes, we should. As I say, the thing that is still troubling me is the question that I can't reconcile the notion that the chief executive of Imperial says it has fallen by 2 per cent and the volume so that InfoView says no, it hasn't. I can't reconcile it. There must be an explanation.

RACHEL ELLIOTT: We will check that and get back to you.

SIR CYRIL CHANTLER: Thank you. It has been very helpful. Thank you.

MARK CONNELL: Thank you for seeing us.

(2.37 pm)

(Meeting concluded)

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