

## Americas: Tobacco

### New cigarette warning labels not likely to be a game changer

#### FDA reveals proposed images for cigarette packs

The FDA revealed 36 colored images accompanied by new warning statements that it is considering using on cigarette packaging. The FDA will survey 18,000 smokers to help determine which 9 of the 36 images will be used before finalizing the choices by 6/22/11. The new warning labels will be implemented in September 2012. The graphics will cover the top 50% of both the front and back of the pack and the 9 selected images will be used evenly across the brands. All cigarette advertisements must also have these images, but they only need to take up 20% of the space. About 39 other countries already mandate that cigarette packaging carry these types of images.

#### Some volume impact possible but we do not expect major change

The timing is still two years away, so we do not envision investor concern rising on this in the near term. In addition, analysis of other countries that use graphic images on packs indicate that outcome should be manageable.

#### 1) The impact of the use of images in other countries not

**conclusive** - Many of the countries do not show clear changes on volume trend from the introduction of images on pack. There are a few countries that showed outsized declines in volumes following the label change (ex. Singapore, Taiwan, Malaysia), but many of these saw simultaneous tax increases which skews the results.

#### 2) Placement on the upper portion of the packs could affect retail display

– Some retailers only display the upper portion of the cigarette pack and in those cases the FDA images could dominate the consumers view rather than the brand since they will cover the top 50% of the pack. That said, the companies are likely to work with the retailers to alter the display after the change.

**3) Graphic displays could deter new smokers** – These graphics will likely have a much more muted effect on existing smokers than on new potential smokers. While the images are slightly more moderate than those used in parts of Europe and Malaysia, some of the images still include graphic depictions of deceased people and diseased lungs.

#### Neutral coverage view; CL-Buy on LO and Buy on PM

We remain constructive on the tobacco sector given steady fundamentals and attractive cash returns.

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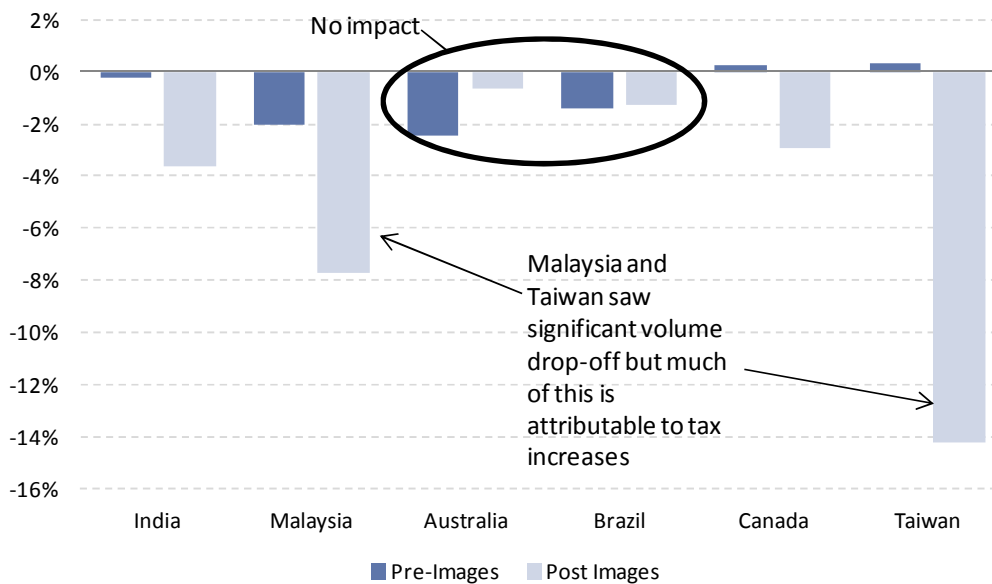
**Exhibit 1: No distinct pattern of volume declines post the implementation of graphics on the packs**  
Cigarette volume change

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Implementation Date of images
India	-4.9%	0.7%	-0.9%	-9.5%	2.9%	2.8%	2.1%	3.6%	1.1%	-1.3%	-8.6%	-1.0%	February 2007
Malaysia	-8.2%	1.3%	0.9%	1.3%	0.5%	0.3%	-0.7%	-4.3%	-8.7%	-3.0%	-2.0%	-7.7%	March 2009
Singapore	-1.3%	-1.1%	-1.2%	-1.3%	-1.9%	-2.3%	-3.0%	-19.5%	-10.4%	5.9%	10.2%	13.3%	August 2004
Thailand	-12.5%	-0.3%	-0.9%	-3.9%	1.2%	6.6%	13.7%	0.3%	-5.3%	2.8%	-0.3%	0.4%	March 2005
Australia	-2.1%	-4.5%	-5.8%	-6.1%	1.0%	2.0%	-1.4%	-2.6%	-2.3%	0.2%	-0.5%	-0.1%	March 2006
Brazil	-4.9%	-0.2%	-0.2%	-0.2%	-3.5%	-5.7%	-1.0%	4.4%	2.3%	0.5%	-1.4%	-6.0%	December 2001
Uruguay	1.0%	-1.2%	-6.1%	0.6%	-10.0%	-6.0%	-2.3%	-2.3%	-10.0%	-6.5%	-9.8%	-5.8%	2005
Canada	0.2%	-0.6%	1.1%	-1.6%	-7.3%	2.6%	-2.2%	1.9%	-11.3%	-6.0%	-3.2%	0.9%	2001
United Kingdom	-6.2%	-9.7%	-9.8%	5.5%	0.3%	-1.2%	0.9%	-4.7%	-2.8%	-3.7%	-3.2%	0.3%	October 2008
Taiwan	0.8%	0.5%	0.7%	1.0%	-0.7%	0.2%	0.5%	0.4%	0.4%	0.4%	-0.7%	-14.2%	January 2009
Romania	1.5%	-1.7%	-0.5%	-0.9%	-2.7%	-1.6%	0.0%	-13.2%	-10.7%	4.1%	16.5%	-4.6%	July 2008
Chile	-2.0%	-2.8%	-0.5%	-2.1%	-1.4%	-1.7%	0.1%	4.0%	1.7%	0.9%	3.2%	0.1%	August 2006
Venezuela	-0.1%	-12.0%	4.4%	2.2%	3.1%	-21.7%	6.6%	7.8%	9.9%	3.5%	-8.6%	-3.2%	April 2007
Belgium	6.2%	9.4%	2.1%	-5.1%	4.0%	-1.6%	-7.7%	-1.8%	-1.6%	-1.5%	-3.8%	-4.0%	April 2007
USA	-2.5%	-7.6%	-2.2%	-3.1%	-3.7%	2.7%	-2.8%	-2.2%	-1.1%	-4.2%	-4.0%	-9.2%	

\*Grey areas depict years when images were in place on the packs

Source: Euromonitor, Goldman Sachs Research estimates

**Exhibit 2: Results are inconclusive as countries with large declines also had simultaneous tax increases**  
Average volume change pre- and post-images on cigarette packs (timeframe 1998-2009)



Source: Euromonitor, Goldman Sachs Research estimates

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