



# TAXES, PRICES, MARKETING CONFERENCE



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## Share and bonds particulars

Share : Isin code - ES0177040013 Reuters - ALT.MC (Madrid) ALDS.PA (Paris) Bloomberg - ALT.SM (Madrid) ALD.SM (Paris)

Bonds : Maturity 02/10/08 - ES017683730 (Reuters) ED147823 / Isin XS0176837309 (Bloomberg)  
Maturity 02/10/13 - ES017683837 (Reuters) ED147819 / Isin XS0176838372 (Bloomberg)  
Maturity 11/12/15 - Code will be known normally on the 13th of December.

# *INTRODUCTION*

# An industry ruled by tax?

- In all countries tax is a very important part of the retail price of cigarettes, or, more generally, of tobacco goods.
- There are not many other goods for which tax represents a similar proportion of the retail price (alcohol and petrol being the other two examples), thus making tobacco goods quite unique. Health concerns and the corresponding regulations still add to it.
- There are many, and sometimes unexpected, implications of the tax on various components of the industry.
- Tax is a key factor to be considered for decision-making in marketing matters.

# Governments get important revenues from tobacco excise duties and expect them to grow

	2000	2001	2002	2003	2004	2005e	2006e
<b>UK (GBP)</b>	<b>7.8</b>	<b>7.7</b>	<b>8.1</b>	<b>8.0</b>	<b>8.1</b>		
<b>Germany</b>	<b>11.5</b>	<b>12.2</b>	<b>13.9</b>	<b>14.3</b>	<b>13.6</b>		
<b>France</b>	<b>8.1</b>	<b>8.2</b>	<b>8.4</b>	<b>8.5</b>	<b>9.2</b>	<b>9.4</b>	<b>9.4</b>
<b>Italy</b>	<b>7.2</b>	<b>7.4</b>	<b>7.8</b>				
<b>Spain</b>	<b>4.5</b>	<b>4.8</b>	<b>5.3</b>	<b>5.6</b>	<b>6.0</b>	<b>6.3</b>	<b>6.9</b>

*Government do not always succeed. The French saying “Trop d’impôt tue l’impôt.” “Killing tax with taxes.” is sometimes proven right. Decrease in government revenues have been observed at times; furthermore, bigger gaps still have appeared between expected and actual revenues.*

# Examples of past and present implications of tax on the industry

## ■ Numerous examples with respect to products :

- Tax defined per pack (and not per cigarette) has led to surprisingly high content packs (up to 50 per pack) in the Australian market.
- Tax defined per weight (and not per stick) has led to ultra-light weight cigars in the UK (using a lot of expanded tobacco).
- Tax defined per product, whether blond or dark in France in previous, whether “white” or kretek in Indonesia, whether filtered or not, ... may favor some products versus others.
- Temporarily, in Germany, taxes have brought to the market very unexpected products ; sticks (also named singles or make-your own), or later back in time, the rolls.

## ■ On investments and factories :

- Expanded tobacco equipments to produce very lightweight and low tar & nicotine products.
- Special equipments to produce sticks (singles / make your own) for Germany.
- Special additions to packing equipments for tax stamps in country where tax is materialised by stamps (Germany, Spain, Russia, ...)

## ■ On the organisation of work :

- Tax stamps sold to manufacturers at given dates leads to intense working days on these very dates in Germany.
- Tax stamps also require the highest quality standards (to avoid destruction).

# Examples of past and present implications of tax on the industry (continued)

## ■ On administration

- Tax stamps require more stringent security measures, management of damaged stamps, ...

## ■ On marketing

- Product variety as seen before.
- Branding. Specific tax has generally been incentivising marketing expenses and branding.

## ■ On pricing

- Minimum duty and / or ban on promotional have brought prices above 3 euros in Italy, above 4.47 euros in France.

## ■ On P&L patterns

- Tax systems orienting towards premium brands and branding expenses lead to a cost structure with a high level of A&P expenses.

## ■ On profitability patterns

- The combination of taxes, market prices, brand portfolio and market portfolio determines the profitability of a company.

*In all examples, companies and consumers have somehow seeked, in the end, to optimise the tax paid.*

# *Ad valorem* versus specific, a never ending story, with latest evolutions towards combined systems

- The definitions are simple :
  - *Ad valorem* excise tax is a proportion of the retail price (very much like VAT).
  - Specific excise tax is a flat amount per unit (e.g. per 1,000 cigarettes).
  
- In many occurrences, and particularly in the EU due to an EU directive, cigarette excise taxes will mix *ad valorem* with specific, although usually with a clear preeminence of one or the other.
  - France, Spain, Italy, Greece, Morocco, ... are giving preeminence to *ad valorem*.
  - The UK, Ireland, Germany, ... are giving preeminence to specific excise.
  
- In mostly *ad valorem* systems, governments currently tend to complement them with additional rules in order to avoid ultra-low pricing.

# *Ad valorem* versus specific, governments and manufacturers points of view

- From a government point of view, there is no utterly obvious preference to be had for an *ad valorem* or a specific type of tax.

The EU system is currently mixed and leaves a lot of room to states to opt for a mostly *ad valorem* or a mostly specific system.

There is also tendency towards combined systems : minimum duties or ban of promotional prices applied to *ad valorem* types bring them closer to more specific types.

- From a manufacturer's point of view, preferences will largely depend on the manufacturer's situation, whether well installed on a market or not, whether its brands have a strong brand equity or not, whether its prices are higher or lower.

# Nevertheless, not all key decision making is tax led

- Germany. When consumers privilege Gauloises, making it the # 3 brand in the market with a 6.5 % market share, it is the result of a virtuous circle of marketing (branding, price position) and consumer preferences.
- Spain. When Altadis had retail price of dark tobacco cigarettes (Ducados negros) catching up with blond cigarettes (Fortuna and Nobel), this was a decision aimed at optimising product, brand and profit management. The same had happened in France, with some tax incentive attached.
- Morocco. When Altadis introduces hard packs of Marquise at the same price as soft packs, although cost is higher, it conforms with a relatively general practice in the industry, wanting at the same time to grant the consumer an upgraded product justifying retail price increases at the same time.
- Regulation and environment. Multi-level regulations (WHO, EU, States) and the environment also play a key role with respect to consumption, levels of A&P expenses, products and equipments (with the requirement of lower tar and nicotine content), pack designs (Byrne directive).

# Facts and challenges of tobacco marketing

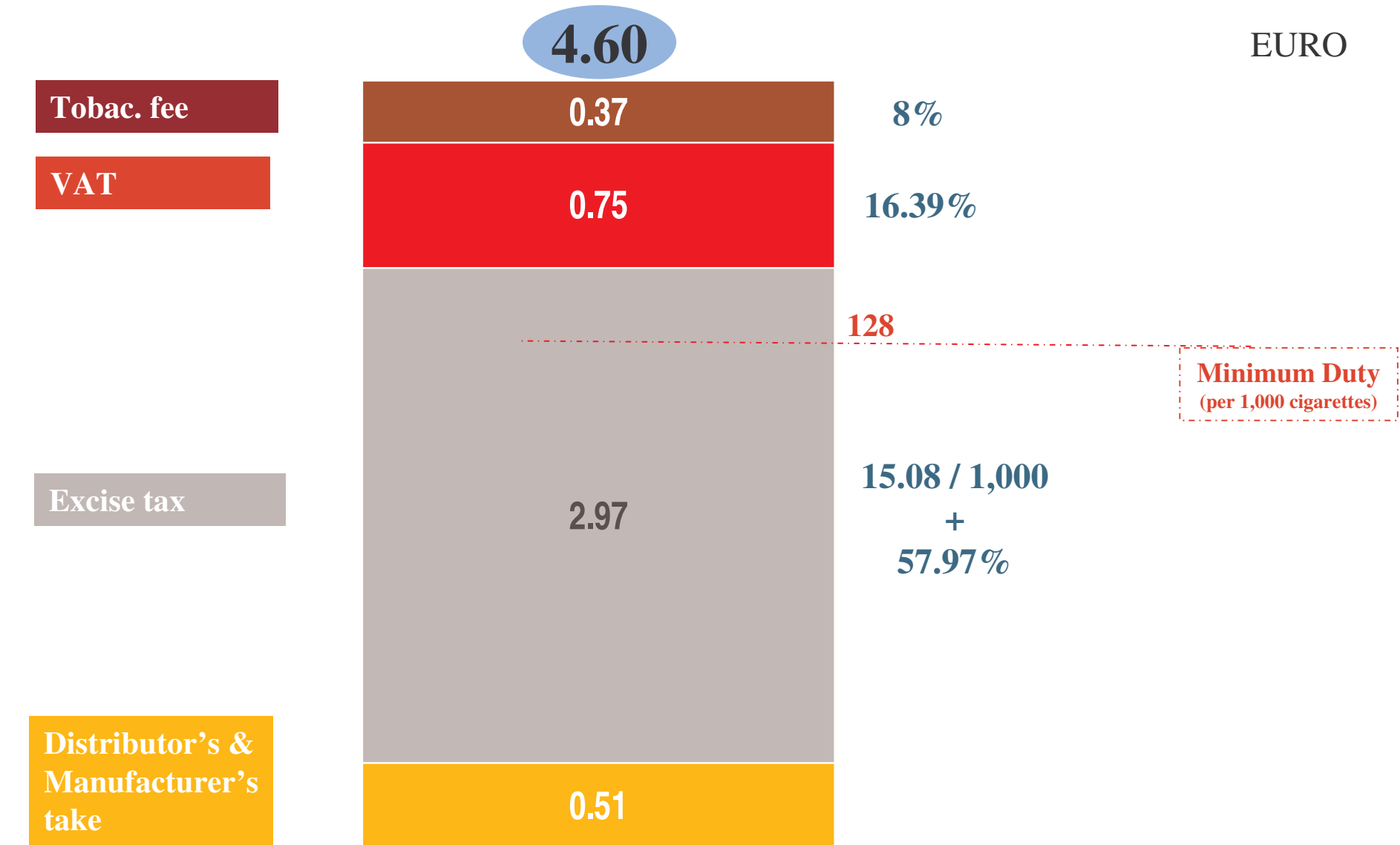
- Brands have always been at the heart of the marketing of tobacco products and particularly of cigarettes.
- Tax has always made tobacco goods an expensive product. One of the marketing challenge is to bring a justification to a high price that is mostly tax.
- Underlying trends are :
  - Prices still increasing.
  - Taxes still increasing (if only in absolute amount when % does not change).
  - Price ranges generally narrowing.
  - Publicity and advertising highly regulated.
- Differentiation, a key marketing task, needs to be adapted :
  - Brands will remain key or even gain more importance.
  - Price differentiation will be more and more limited.
  - Quality both intrinsic and appearance, already key, must be maintained at their current high levels.

# *FRANCE*

- The French system is now a combined one with :
  - A mostly *ad valorem* tax.
  - Combined with a ban on promotional prices (i.e. prices below 95 % of the average price of cigarettes).
- Recent and sizeable increase in the tax rate.

# France: Gauloises Blondes price structure

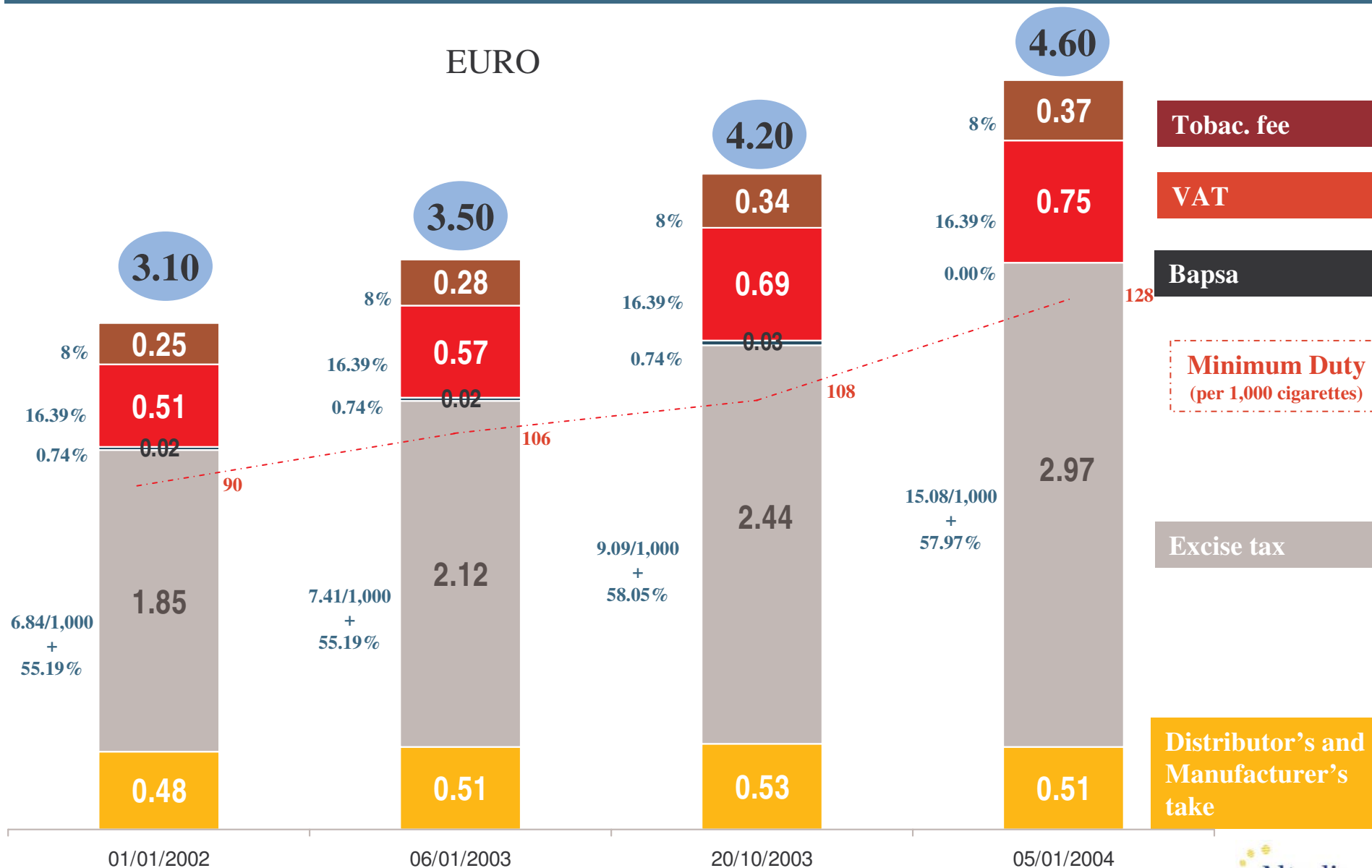
EURO



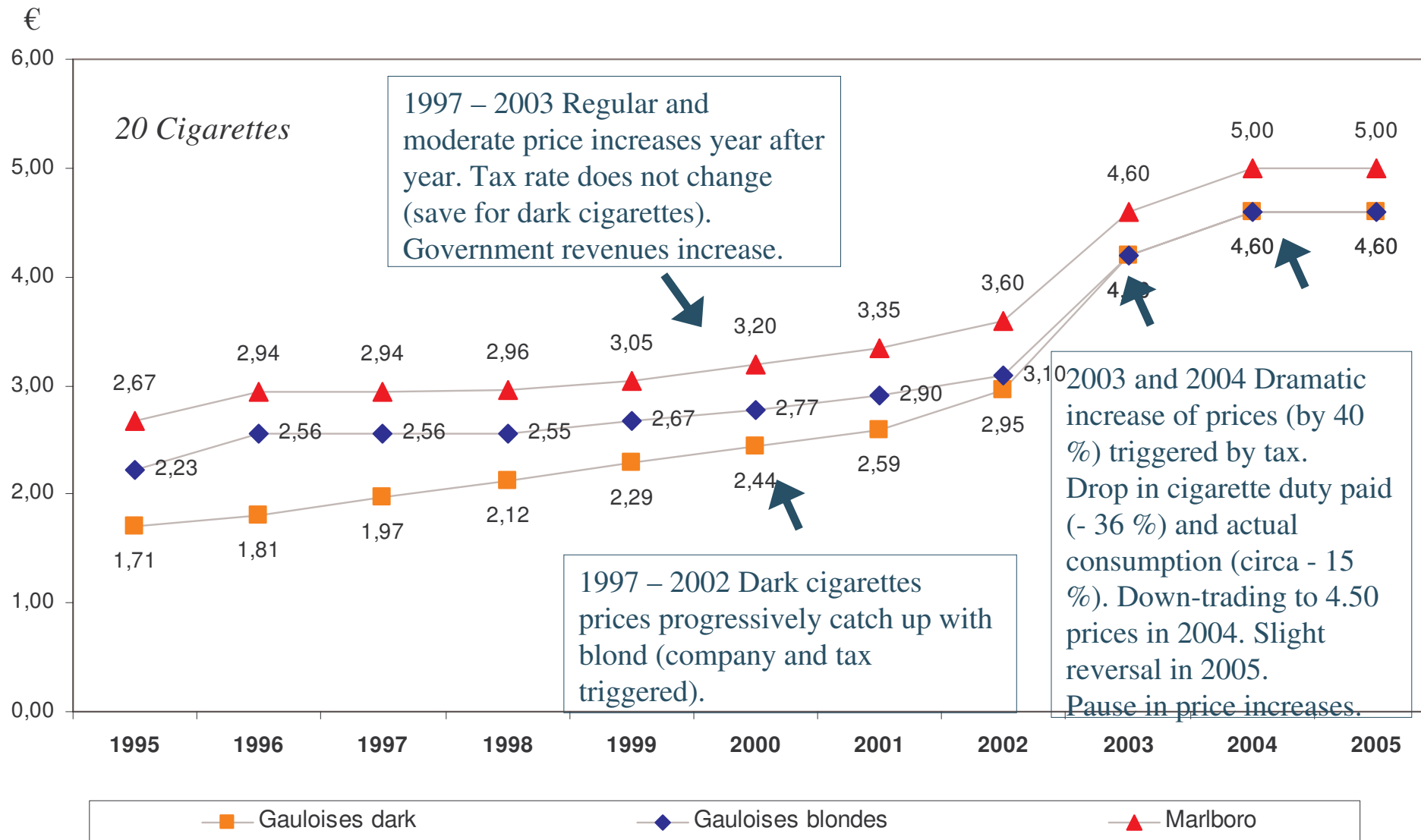
05/01/2004

# France: Gauloises Blondes price structure evolution

EURO



# France: Price evolution 1995-2005

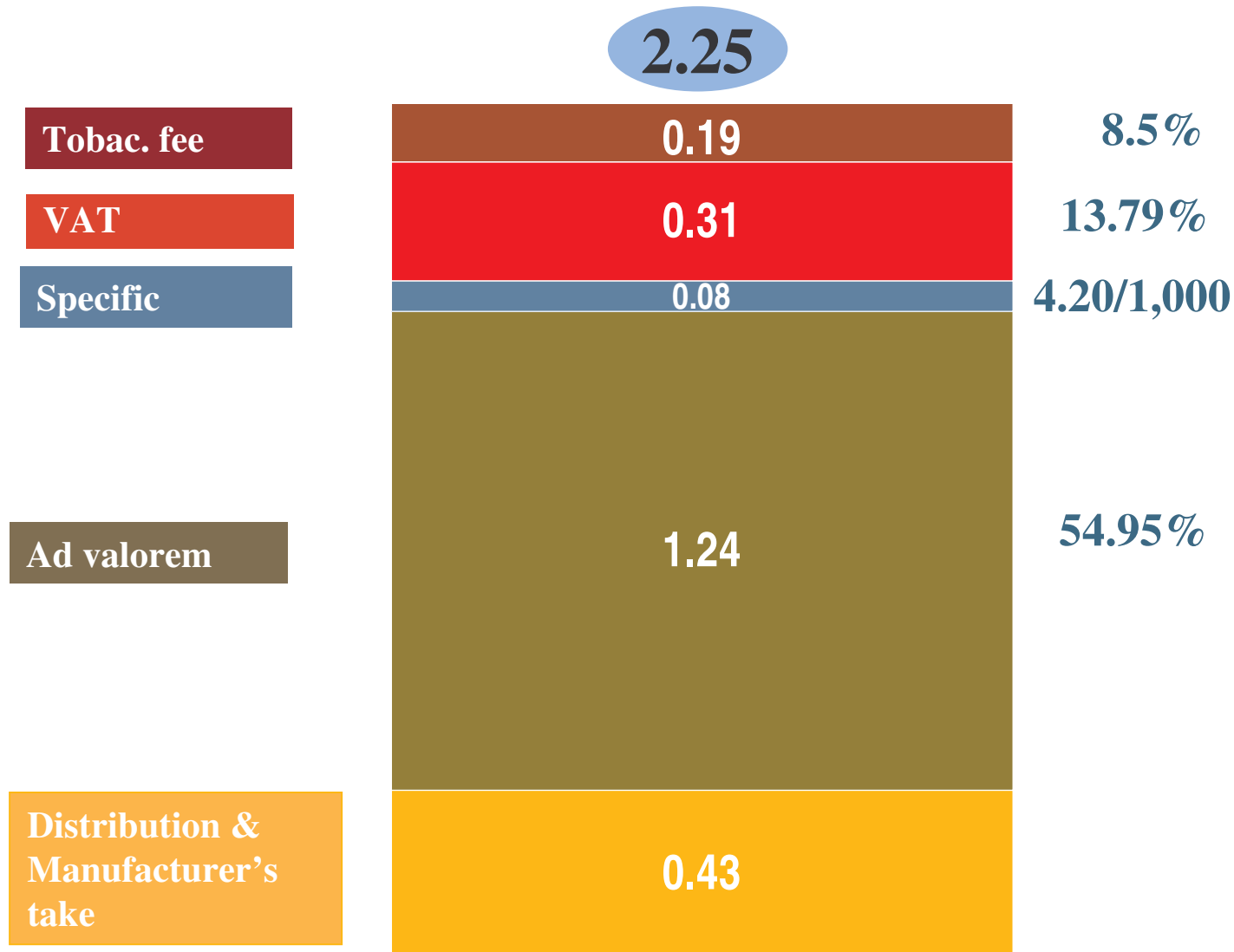


# SPAIN

- Tax is mostly *ad valorem*.
- Recent upward trend of prices has given way to ultra low pricing.

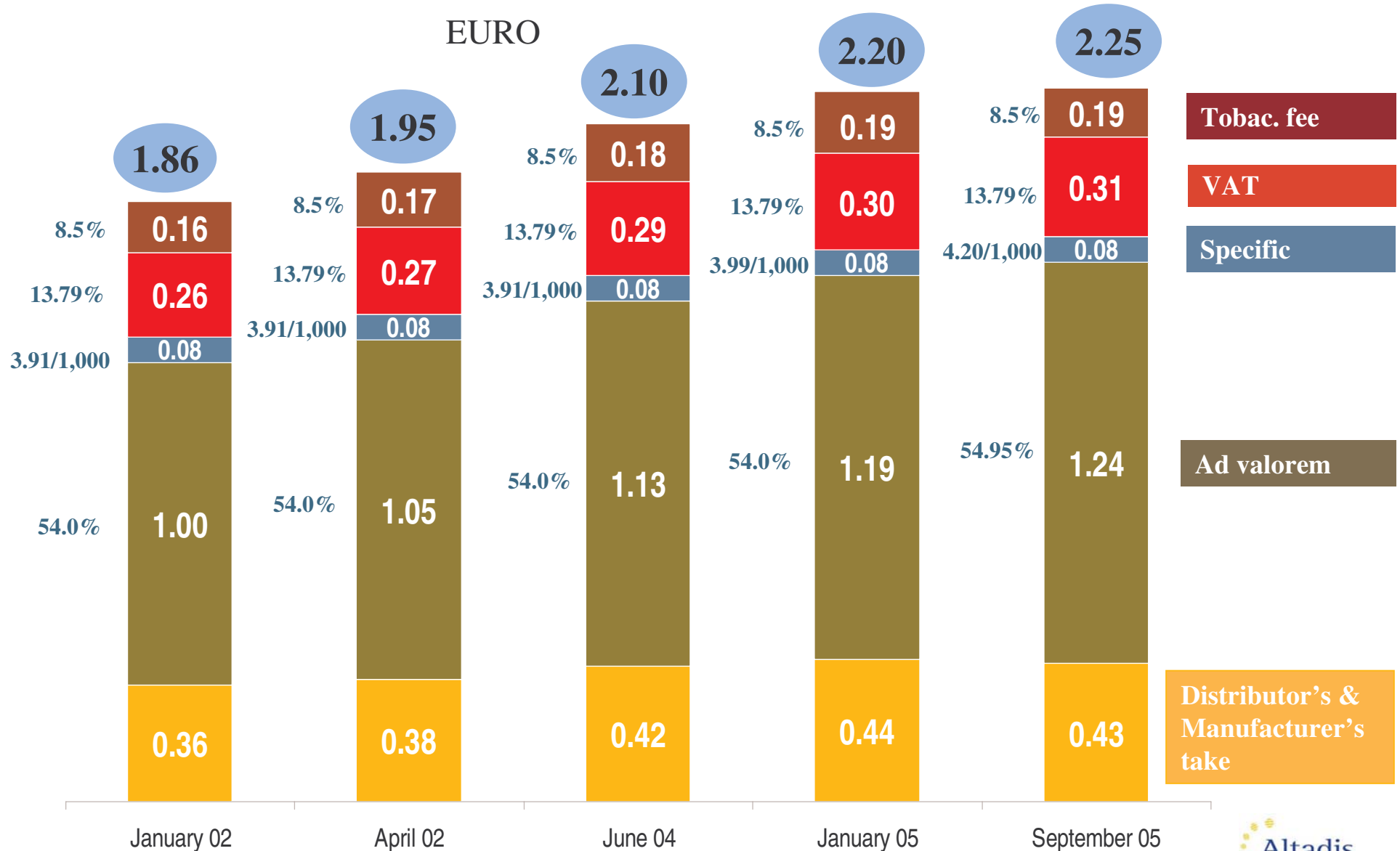
# Spain: Fortuna price structure

EURO

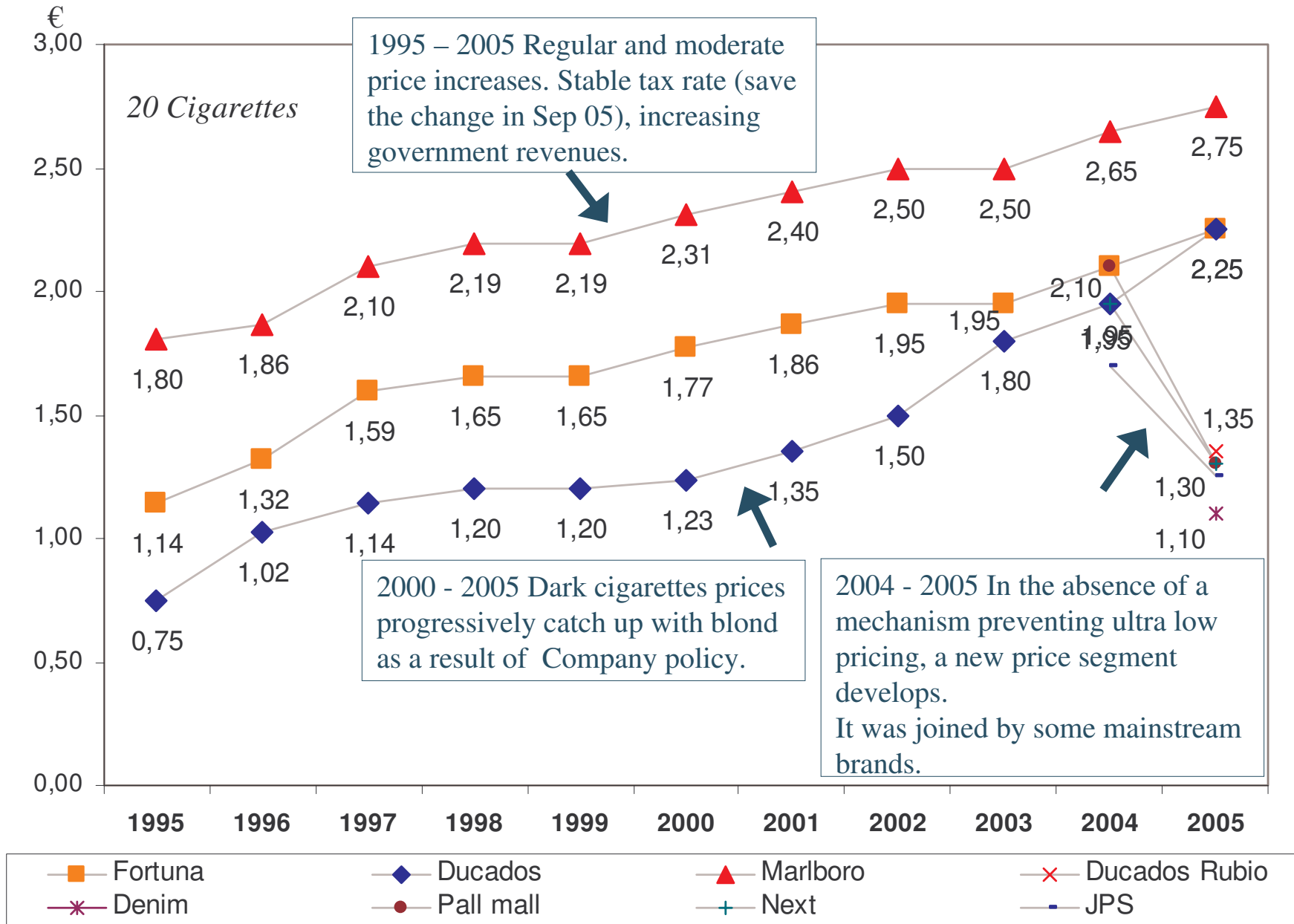


September 05

# Spain: Fortuna price structure evolution



# Spain: Price evolution 1995-2005



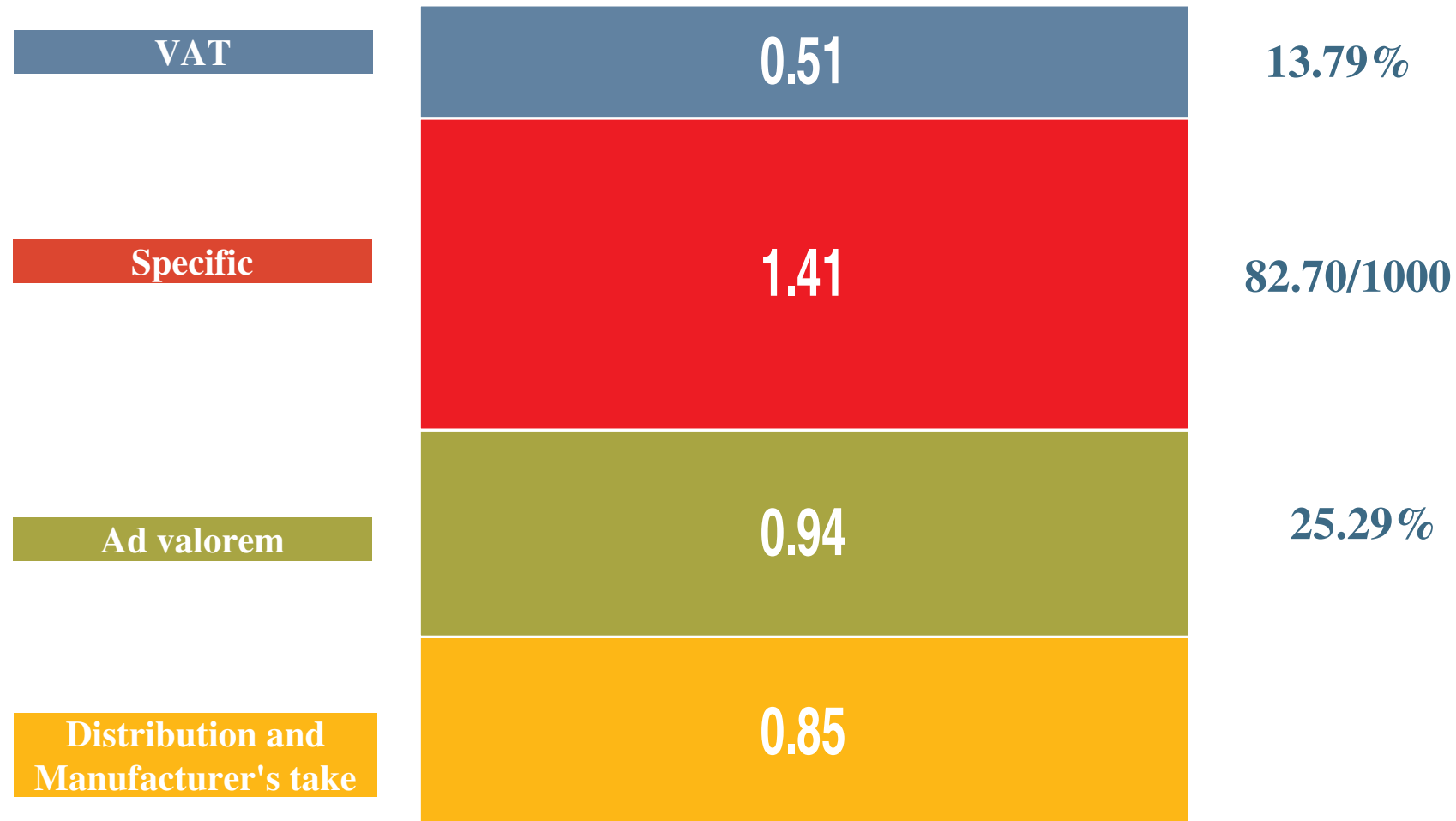
# *GERMANY*

- Tax is mostly specific.
- A minimum tax is part of the excise duty system.
- RYO tax tolerance for sticks ends March 2006.

# Germany : Gauloises Blondes price structure

**3.70**

EURO



Sept. 05  
Retail price for a pack of 17 cigarettes from Sept. 05

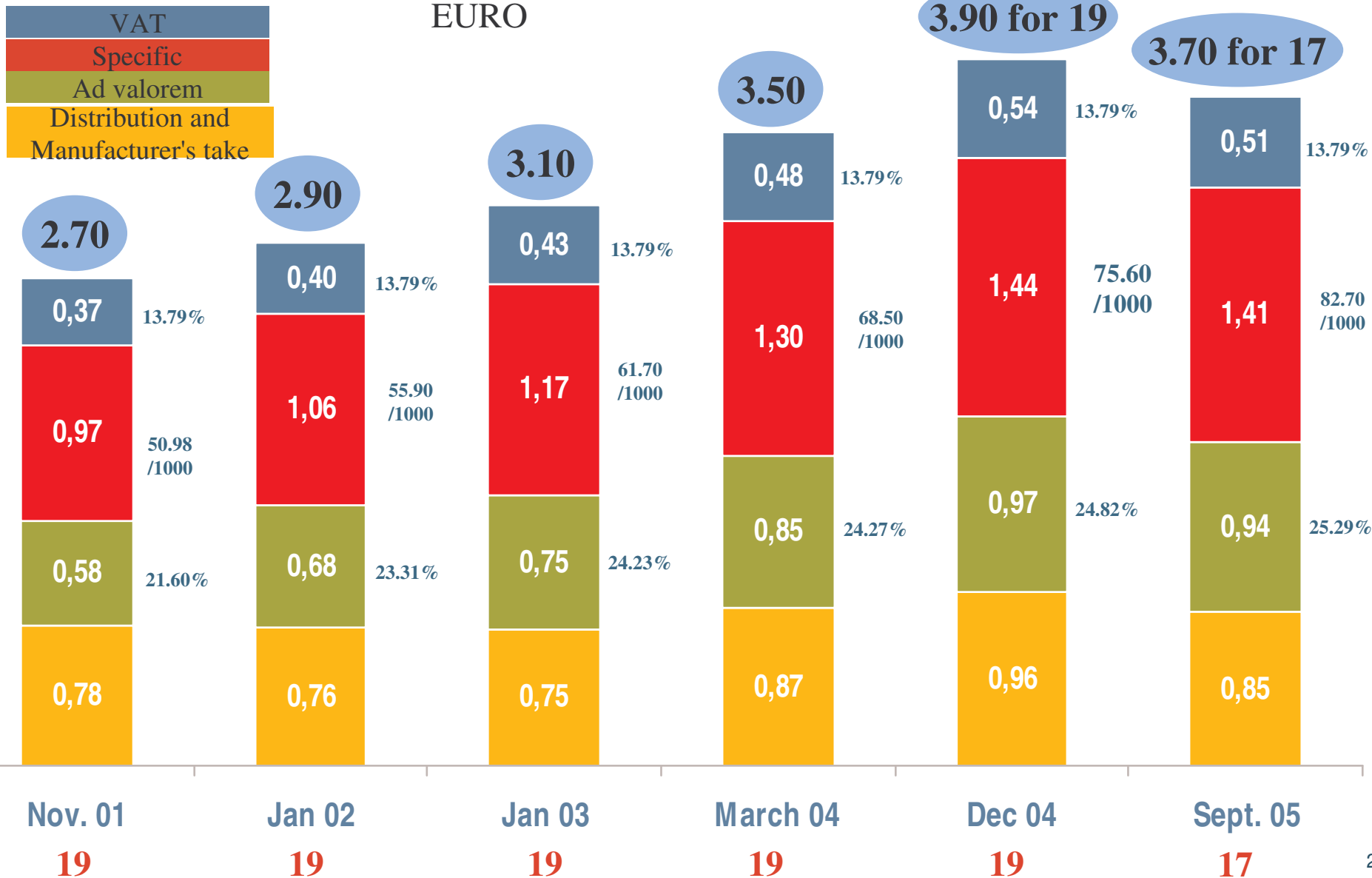
# Germany : Gauloises Blondes price structure evolution

Retail price for a pack of 19 cigarettes & 17 cigarettes from Sept. 05

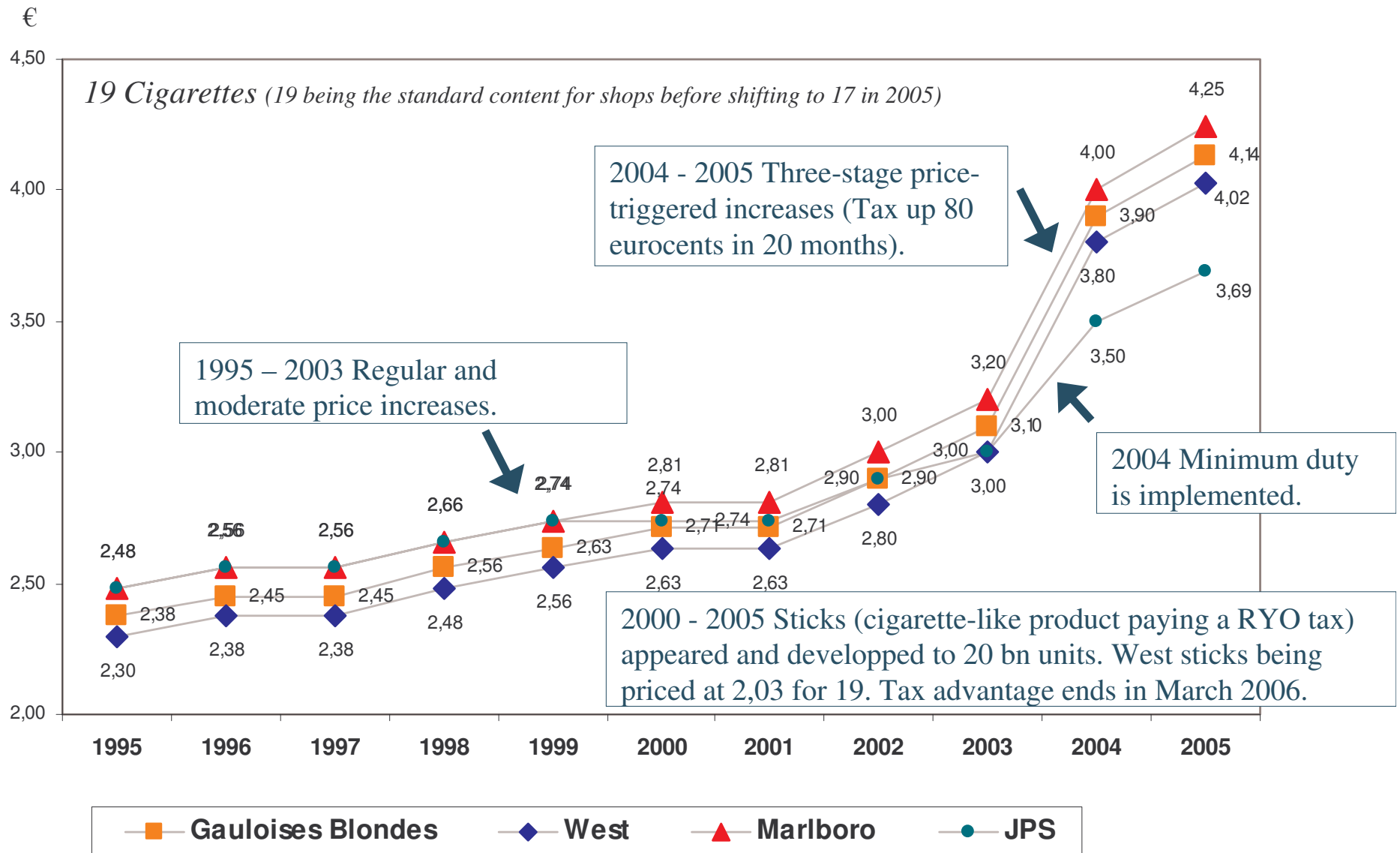
EURO

3.90 for 19

3.70 for 17



# Germany: Price & Tax incidence evolution 1995-2005



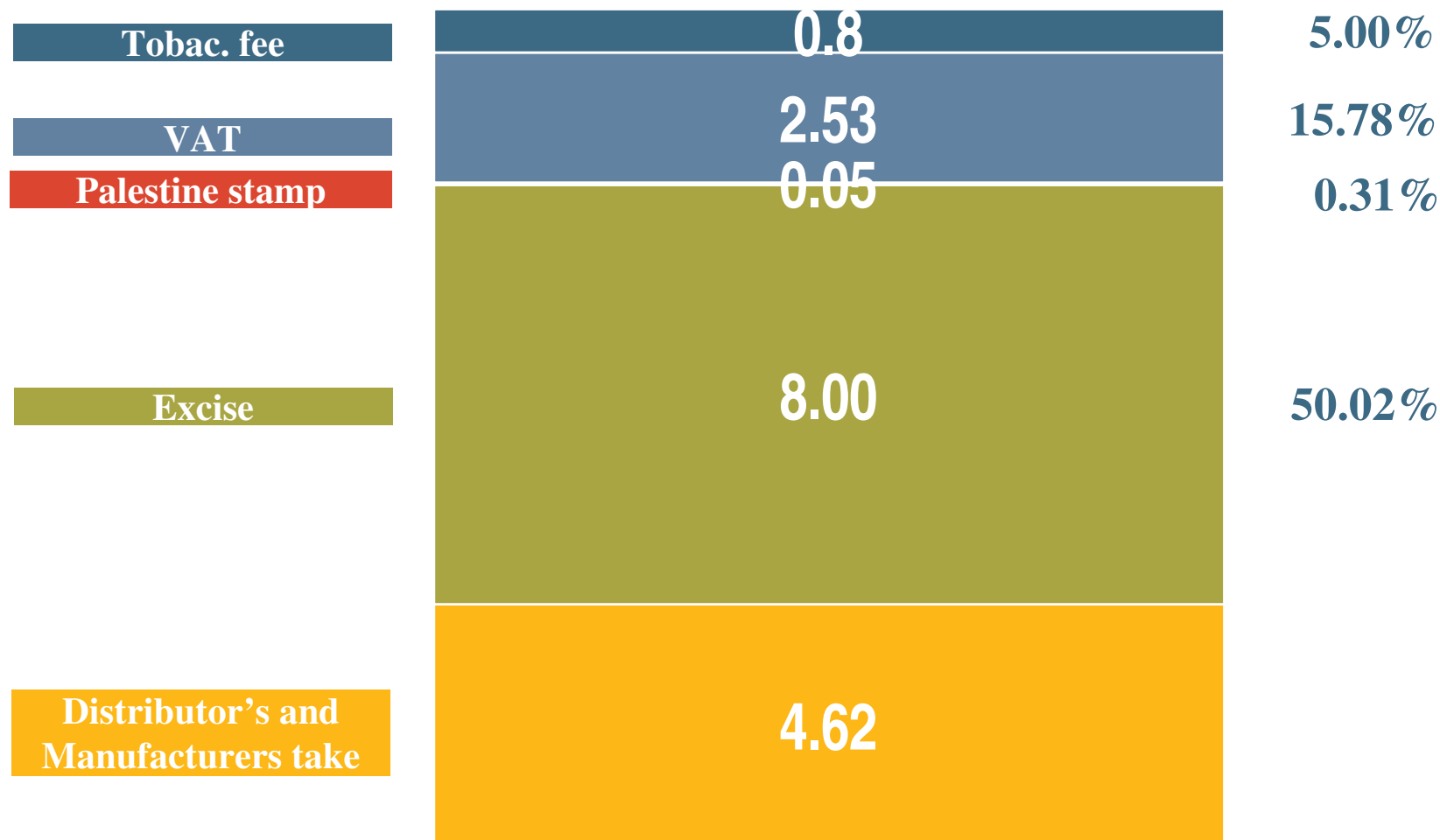
# MOROCCO

- Tax is *ad valorem*.
- Altadis policy is to :
  - Increase prices moderately but regularly.
  - Extend the brand portofolio to all key price points.
  - Narrow the gap between blond and dark.

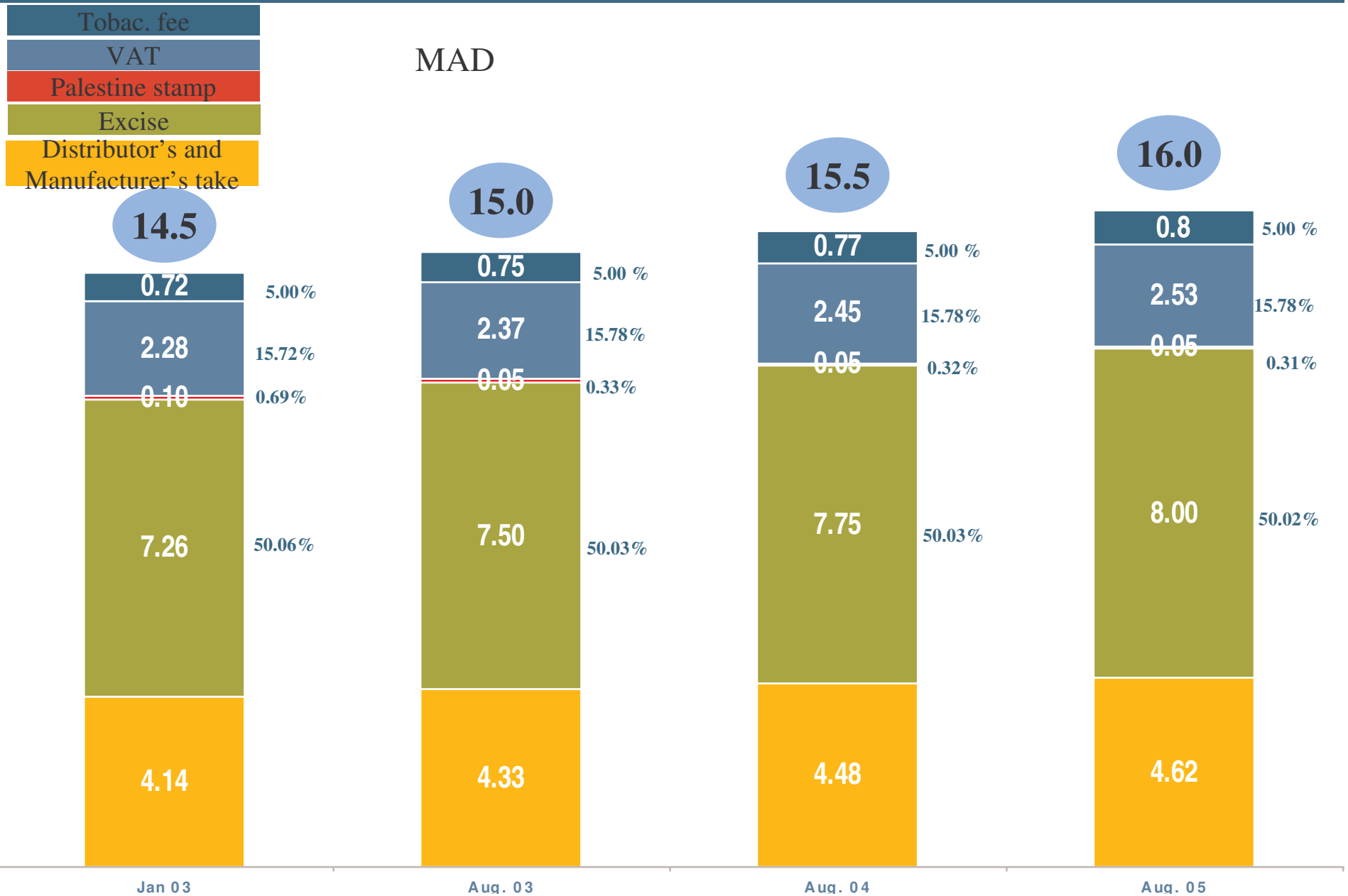
# Morocco : Marquise price structure

MAD

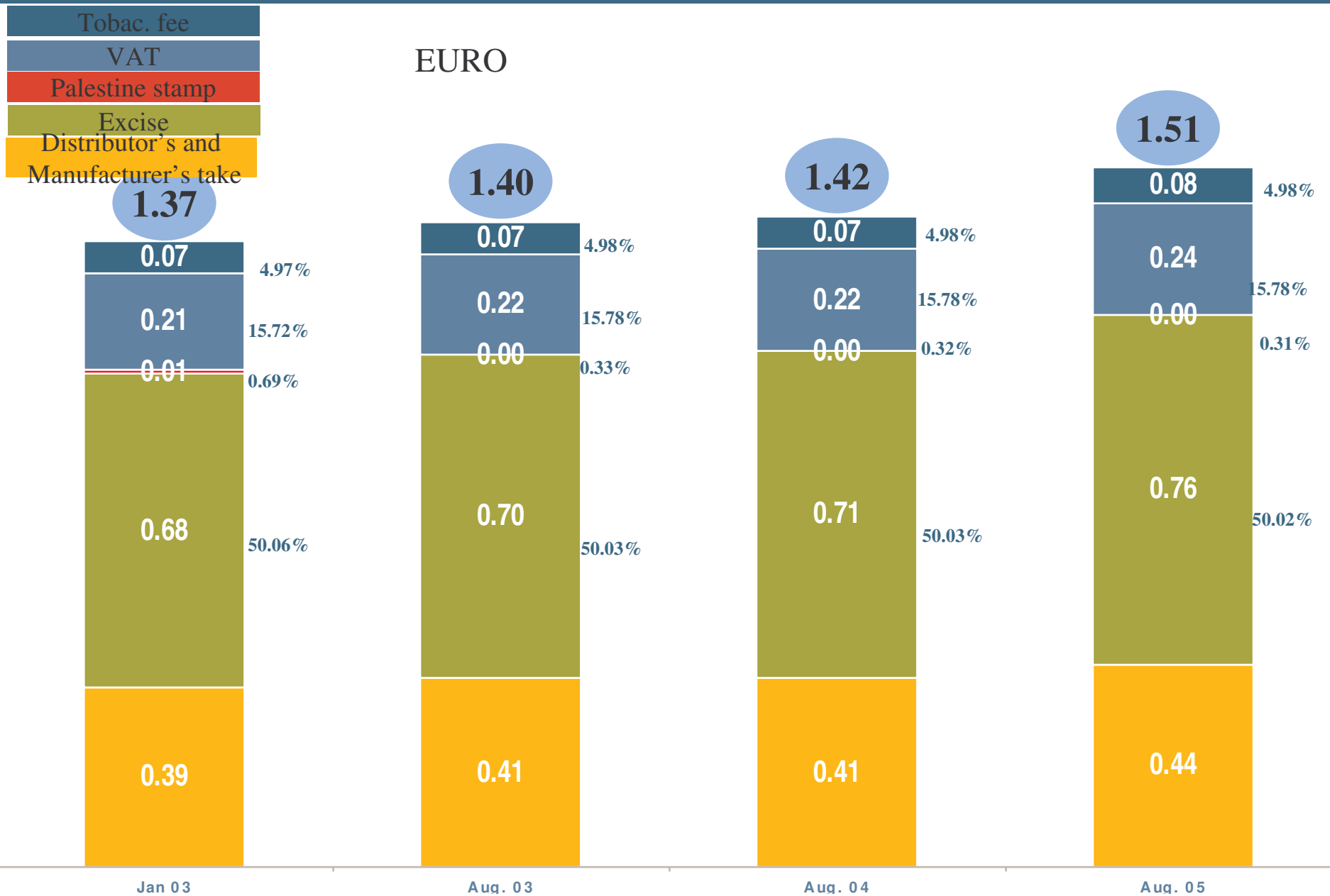
**16.0**



# Morocco : Marquise price structure evolution



# Morocco : Marquise price structure evolution

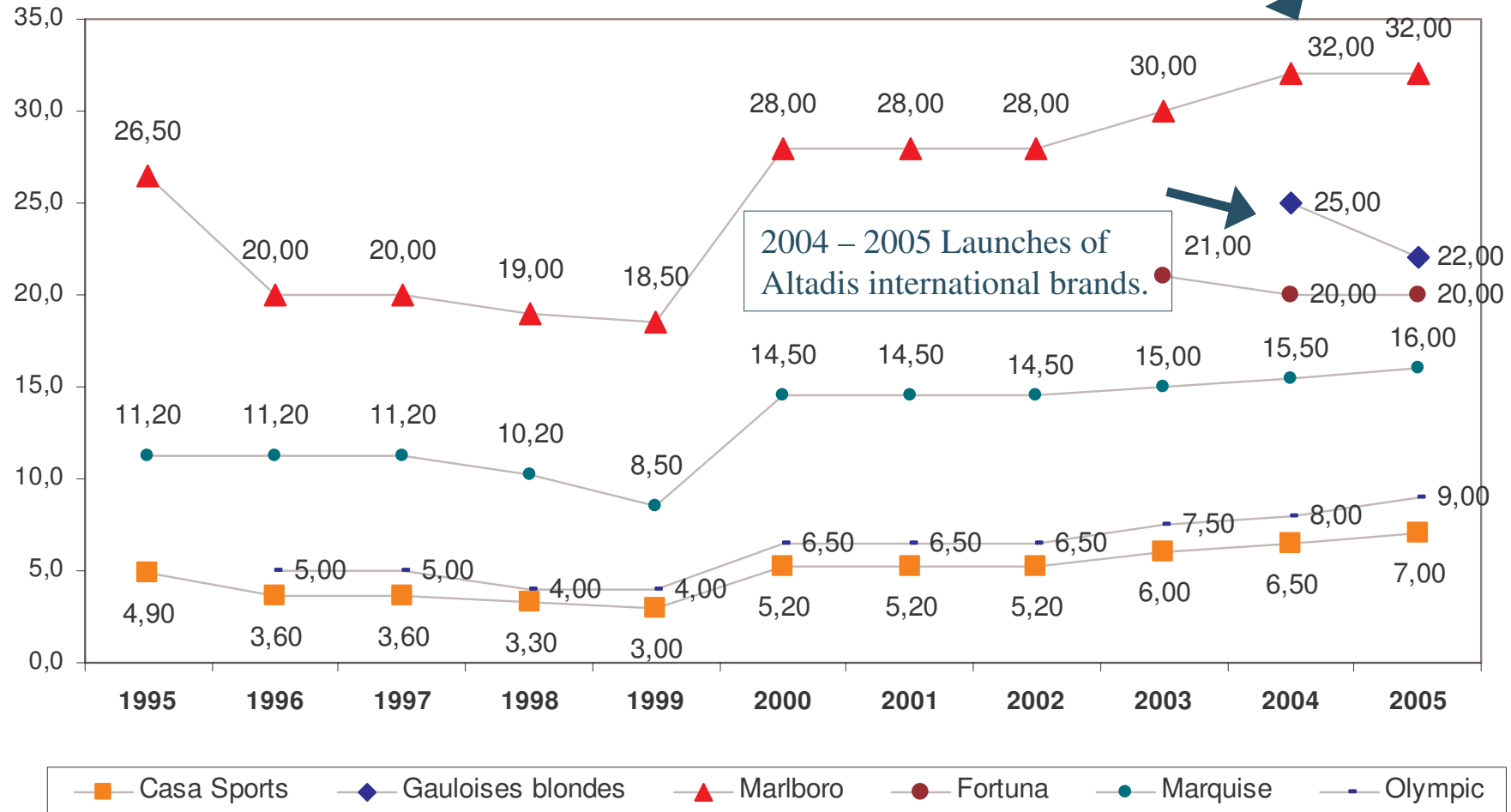


# Morocco: Price evolution 1995-2005

MAD

2003 – 2005 Regular and moderate price increases.

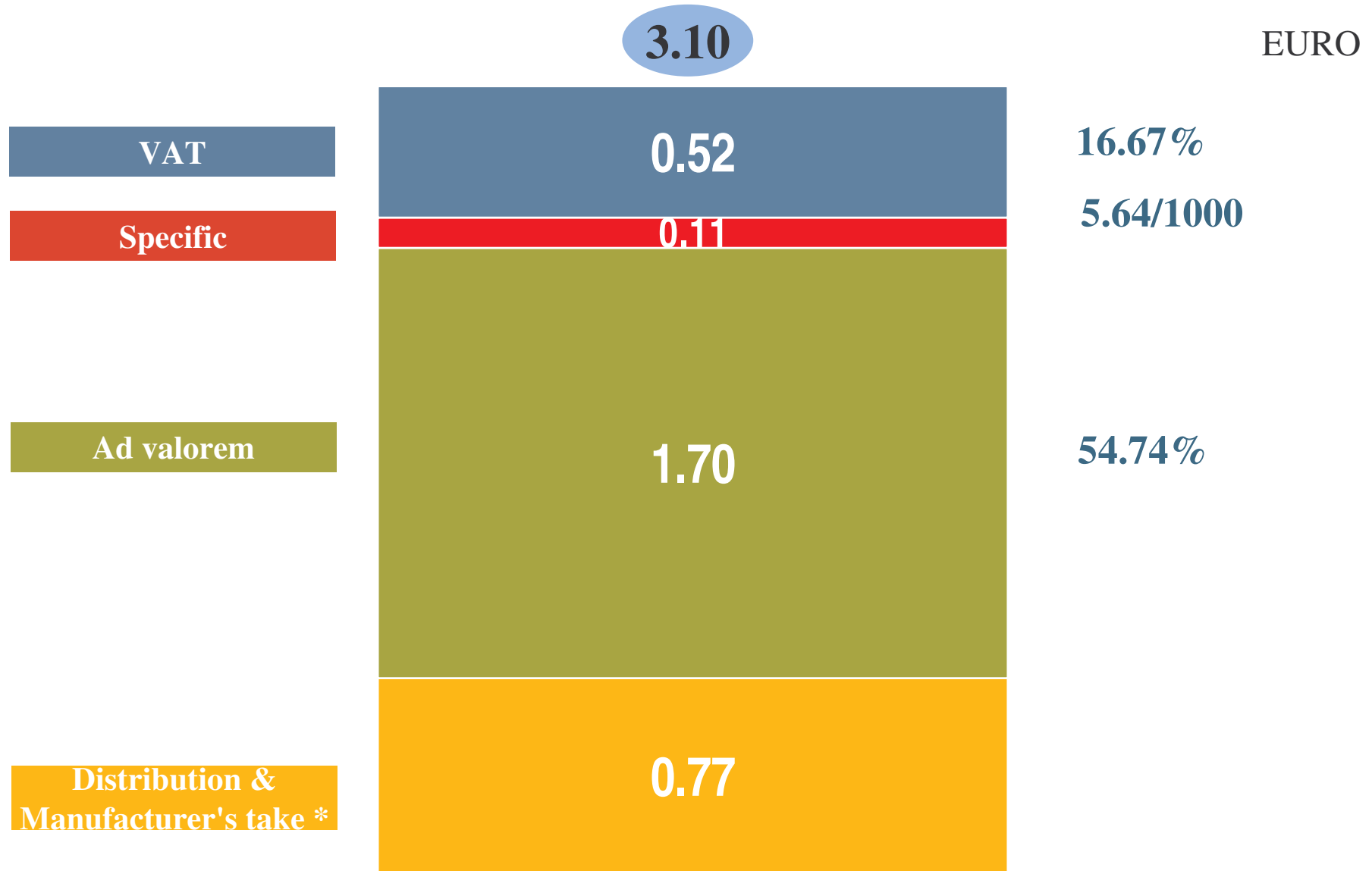
20 Cigarettes



# ITALY

- Tax is mostly *ad valorem*.
- A minimum tax implemented in 2004 and a minimum price implemented in 2005 has eliminated value pricing and risk to government revenues.

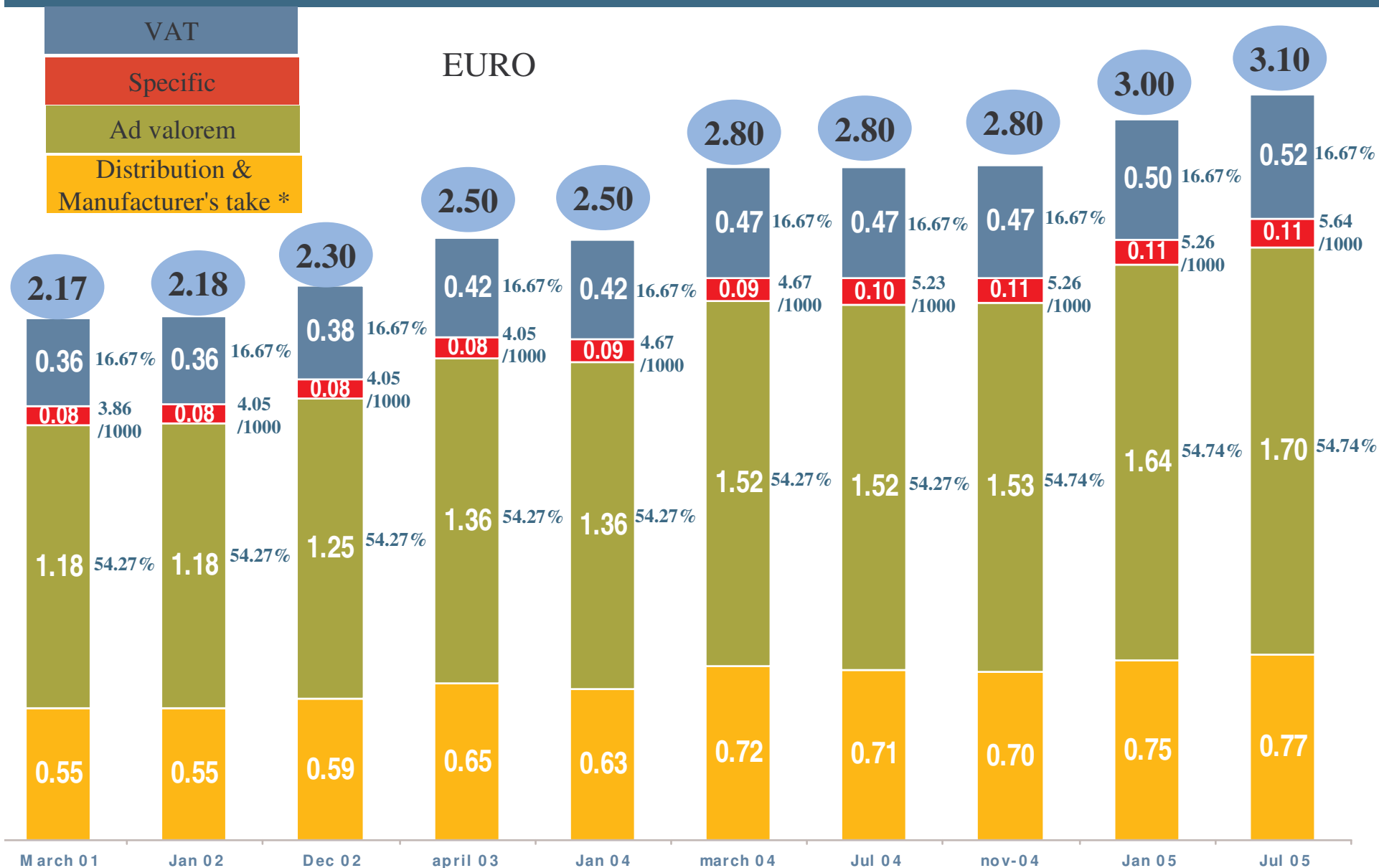
# Italy: MPPC price structure



01/07/2005

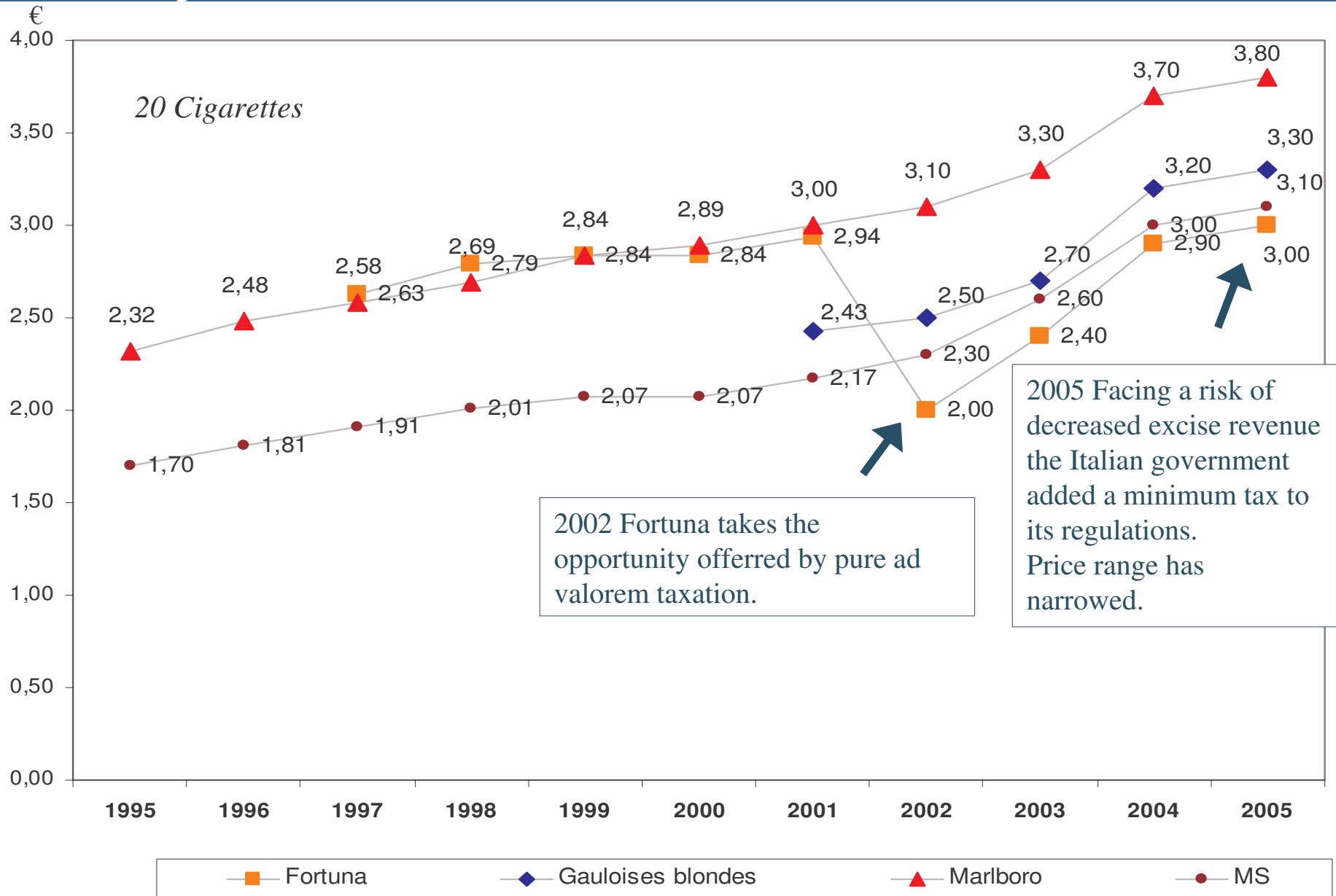
\* : Tobacconist fee is 10 % of retail price.

# Italy: MPPC price structure evolution



\* : Tobacconist fee is 10 % of retail price.

# Italy: Price evolution 1995-2005



# *CONCLUSION*

# Two important guidelines

- Keep brand equity management as a key priority : in a world of prices that are high and still growing, of narrow price ranges, and restricted communication, brands, as an important differentiating factor, will prove to be a vital asset.
- Adjust to the conditions of each market.
  - Use pricing power in emerging and low price countries, Morocco, Russia, Spain again in the coming future, ...
  - Use brand portfolio to satisfy consumer expectations (offering a wider and more international range of brands) and at the same time upgrade products and sales, particularly in Morocco and Russia.
  - Take the opportunity of restrictions on A&P expenses to improve margins and develop in new markets

# *APPENDICES*

# Corporate Calendar - Contacts

## CALENDAR

February 21st, 2006 (tentative date)	2005 FY Results
March 21st, 2006 (tentative date)	Interim dividend payment
May 10th, 2006 (tentative date)	2006 Q1 Results
May 2006	Annual Report
June 13th, 2006 (tentative date)	Annual General Meeting
June 20th, 2006 (tentative date)	Complementary dividend payment
August 30th, 2006 (tentative date)	2006 H1 Results
November 8th, 2006 (tentative date)	2006 Q3 Results

**Closed periods start one month ahead of publications**

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# Pricing power in some key markets

Retail price in Euro per pack  
of 20 cigarettes as of October 2005



Total taxes (excise tax + VAT) on retail price, for MPPC - Most popular price category

<sup>1</sup> Retail price for packs equivalent of 20 cigarettes. For 25 cigarettes prices are Caro: Euro 1.53 and Fox: Euro 1.47 and for 30 cigarettes, Spike: Euro 1.75

<sup>2</sup> Retail price for packs equivalent of 20 cigarettes. For 17 cigarettes (which is the standard) prices are respectively Euro 3.80, Euro 3.70, Euro 3.60, Euro 3.30 and Euro 3.10

<sup>3</sup> Retail price for packs equivalent of 20 units, 30 units being the standard format



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