



# Project SUN

**A study of the illicit cigarette  
market in the European Union,  
Norway and Switzerland**

2015 Results



# Important Notice

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- Nothing in this Report constitutes legal advice. Information sources, the scope of our work, and scope and source limitations, are set out in the Appendices to this Report. The scope of our review of the contraband and counterfeit segments of the cigarette market within the 28 EU Member States, Switzerland and Norway was fixed by agreement with the Beneficiaries and is set out in the Appendices.
- We have satisfied ourselves, so far as possible, that the information presented in this Report is consistent with our information sources but we have not sought to establish the reliability of the information sources by reference to other evidence.
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- In particular, and without limiting the general statement above, since we have prepared this Report for the Beneficiaries alone, this Report has not been prepared for the benefit of any other manufacturer of tobacco products nor for any other person or organisation who might have an interest in the matters discussed in this Report, including for example those who work in or monitor the tobacco or public health sectors or those who provide goods or services to those who operate in those sectors.

# Glossary

GLOSSARY	
<b>Average Daily Consumption</b>	Daily average consumption by the population of the legal smoking age
<b>BAT</b>	British American Tobacco plc
<b>Bn</b>	Billion
<b>C&amp;C</b>	Counterfeit and Contraband, including Illicit Whites
<b>CAGR</b>	Compound Annual Growth Rate
<b>Cigarette</b>	Any factory-made product that contains tobacco and is intended to be burned under ordinary conditions of use
<b>Cigarillos</b>	A short, narrow cigar, which, like cigarettes, is often machine-made and sold in packs
<b>Consumption</b>	Actual total consumption of cigarettes in a market, including Legal Domestic Consumption (LDC) and illicit products as well as those legally purchased overseas
<b>Contraband (CB)</b>	Genuine products that have been either bought in a low-tax country and which exceed legal border limits or acquired without taxes for export purposes to be illegally re-sold (for financial profit) in a higher priced market
<b>Counterfeit (CF)</b>	Cigarettes that are illegally manufactured and sold by a party other than the original trademark owner. In this report, counterfeit volumes are reported from the participating manufacturers of BAT, ITL, JTI and PMI. No other counterfeit is included in the volumes reported due to lack of information
<b>Country of origin</b>	Country from which the packs collected are deemed to have originated. This is determined by either the tax stamp on the pack or in cases where the tax stamp is not shown, on the health warning and packaging characteristics
<b>Domestic Whites</b>	Domestic Whites are packs of domestic market variant, but those that are priced below the minimum tax yield. These products are treated as having not been legally sold in the country in question, and have therefore been reclassified as non-domestic
<b>Duty Free</b>	Cigarettes bought without payment of customs or excise duties. Consumers may buy Duty Free Cigarettes when travelling into or out of the EU (including Switzerland and Norway) by land, air or sea at legal Duty Free shops
<b>EC</b>	European Commission
<b>EPS</b>	Empty Pack Survey
<b>EU</b>	European Union
<b>EU Flows Model</b>	The primary methodology for measuring consumption in a market. The model has been developed by KPMG on a bespoke basis for the specific purpose of measuring inflows and outflows of cigarettes in the scope of this project
<b>FYROM</b>	Former Yugoslav Republic of Macedonia
<b>Green Leaf</b>	Uncut dried tobacco leaf, which smokers cut themselves
<b>Illicit Whites (IW)</b>	Cigarettes that are usually manufactured legally in one country/market but which the evidence suggests have been smuggled across borders during their transit to the destination market under review where they have limited or no legal distribution and are sold without payment of tax
<b>Illicit Whites with no country specific labelling</b>	Packs of Illicit White Cigarettes which have "duty free" or no identifiable labelling on the packs
<b>IMS</b>	In Market Sales (the primary source of legal domestic sales volumes)
<b>Inflows/Outflows</b>	Inflows of non-domestic product into a market / outflows of product from a market
<b>ITL</b>	Imperial Tobacco Limited
<b>JTI</b>	JT International SA
<b>LDC</b>	Legal Domestic Consumption is defined as Legal Domestic Sales (LDS) net of outflows

# Glossary

GLOSSARY	
<b>LDS</b>	Legal Domestic Sales of genuine domestic product through legitimate, domestic channels based on In Market Sales (IMS) data
<b>Mn</b>	Million
<b>MPPC</b>	Most Popular Price Category
<b>MYO</b>	Make Your Own tobacco products
<b>ND</b>	Non-Domestic product – product that originates from a different market than the one in which it is consumed
<b>ND(L)</b>	Non-Domestic (Legal) – product that is brought into the market legally by consumers, such as during a cross-border trip
<b>NMA /TMA</b>	National Manufacturers' Association /Tobacco Manufacturers' Association
<b>OLAF</b>	Office Européen de Lutte Antifraude also known as the European Anti-Fraud Office
<b>OTP</b>	Other Tobacco Products (RYO/MYO, cigarillos, portions, rolls and cigars; excluding smokeless tobacco and water-pipe tobacco)
<b>PMI</b>	Philip Morris International Management SA
<b>RYO</b>	Roll Your Own tobacco products
<b>Smoking prevalence</b>	The percentage of smokers in the total population of the legal smoking age
<b>Tobacco taxes</b>	The sum of all types of taxes levied on tobacco products, including VAT. There are two basic methods of tobacco taxation: Normal or specific taxes are based on a set amount of tax per unit (e.g. cigarette); these taxes are differentiated according to the type of tobacco. Ad valorem taxes are assessed as a percentage mark up on a determined value, usually the retail selling price or a wholesale price and includes any value added tax
<b>Unspecified</b>	Unspecified market variant refers to cigarette packs which do not bear specific market labelling or Duty Free labelling
<b>UNWTO</b>	World Tourism Organisation
<b>WAP</b>	The weighted average price for cigarettes calculated by reference to the total value of all cigarettes released for consumption, based on the retail selling price including all taxes, divided by the total quantity of cigarettes released for consumption. The WAP is provided by the European Commission Excise Duty Tables

# Executive Summary

## Key findings

### Illicit trade has accounted for 1 in 10 cigarettes consumed since 2010

- Counterfeit and Contraband (C&C) as a proportion of total consumption declined marginally from 10.4% in 2014 to 9.8% in 2015
- The total volume of C&C consumed in the EU was 53.0 billion cigarettes with France and Poland experiencing the highest volumes
- If the C&C volume in the EU had been consumed legally, an additional tax revenue of €11.3 billion would have been raised

### The marginal decline in C&C may be attributed to several factors including improvements to supply chain controls, law enforcement and improved economic conditions

- By 2010 all four participants had signed agreements with OLAF committing to additional supply chain controls. C&C from lower priced countries within the EU has since declined from 22.2 billion to 6.5 billion cigarettes
- Legal domestic consumption remained stable against a backdrop of improved economic conditions in many countries, whilst non-domestic legal (ND(L)) increased, supported by travel trends
- Increased anti-illicit trade activity and border security reflected by a doubling in the volume of OLAF supported seizures, contributed to this overall decline of C&C

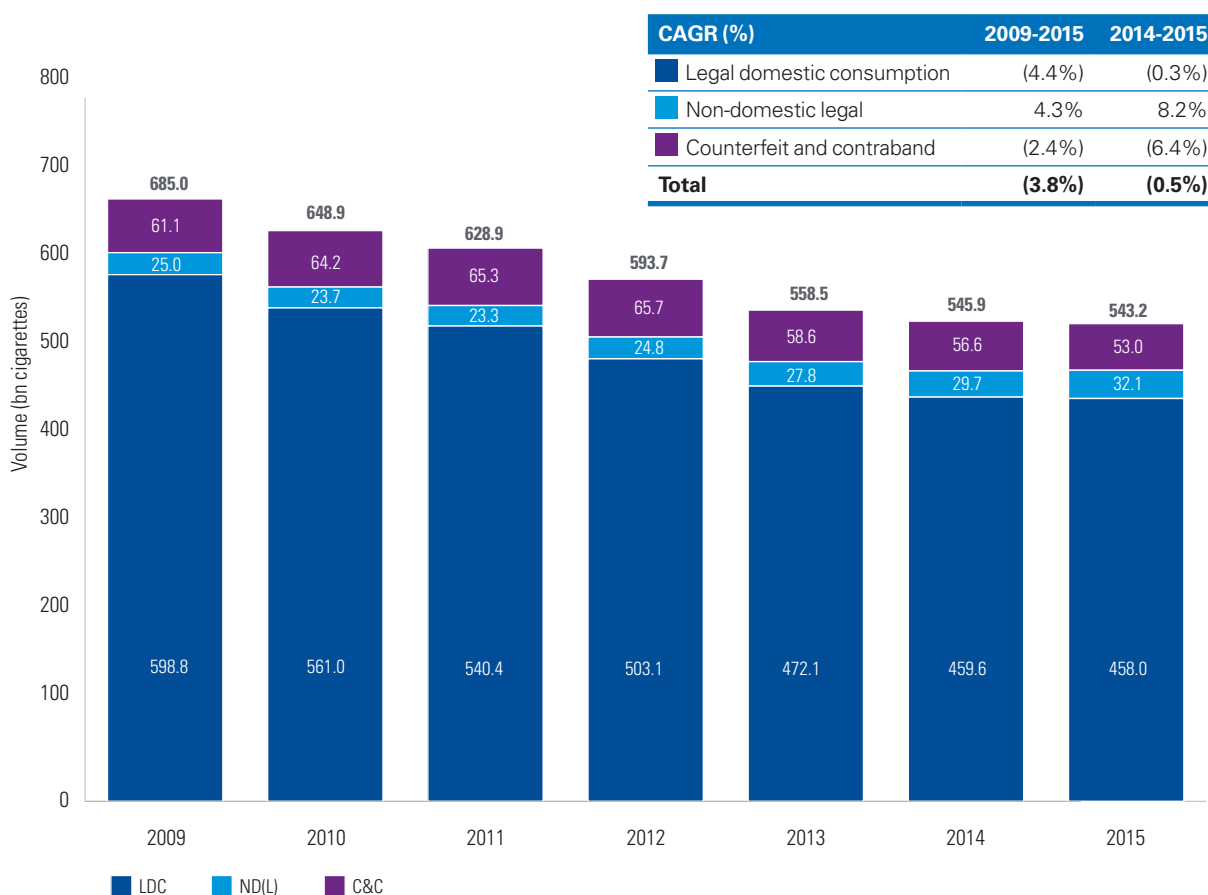
### Counterfeit and Illicit Whites brand flows made up a larger proportion of C&C in 2015 compared to previous years

- Illicit Whites brand flows, with limited or no legal distribution in the EU, again accounted for over one third of C&C, of which 5.3 billion cigarettes had Belarusian labelling
- Counterfeit identified by the four participating tobacco manufacturers increased by 28% but remains less than 9% of illicit cigarette consumption in Europe
- The changing mix of source countries and the increasing number of Illicit Whites brands demonstrates the flexibility of illicit cigarette flows

## Counterfeit and Contraband (C&C) declined by 6% against a backdrop of improved economic conditions and increased anti-illicit trade activities

- Personal Disposable Income (PDI) increased by an average of 2.6%<sup>(2)</sup> across all EU member states, which may have contributed to a stabilisation of Legal Domestic Sales, reversing a five year trend
- Many countries, especially in the Eastern EU, experienced more stable prices compared with 2014 when tobacco taxes increased to meet minimum EU excise requirements
- Increased anti-illicit trade activity, as evidenced by a rise in the number of seizures made across Europe, may also have contributed to the C&C decline<sup>(3)</sup>

### Manufactured cigarette total consumption – 2009-2015<sup>(1)</sup>

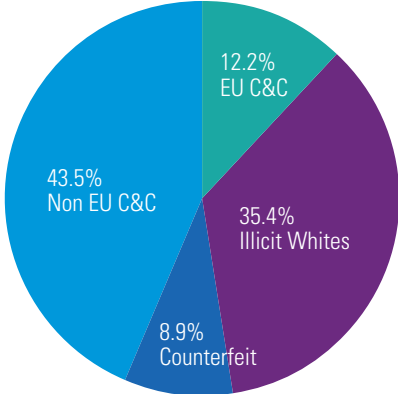


Sources: (1) KPMG EU Flows Model 2009-2015 (2) Economics Intelligence Unit, 2015 (3) The OLAF Report, 2015

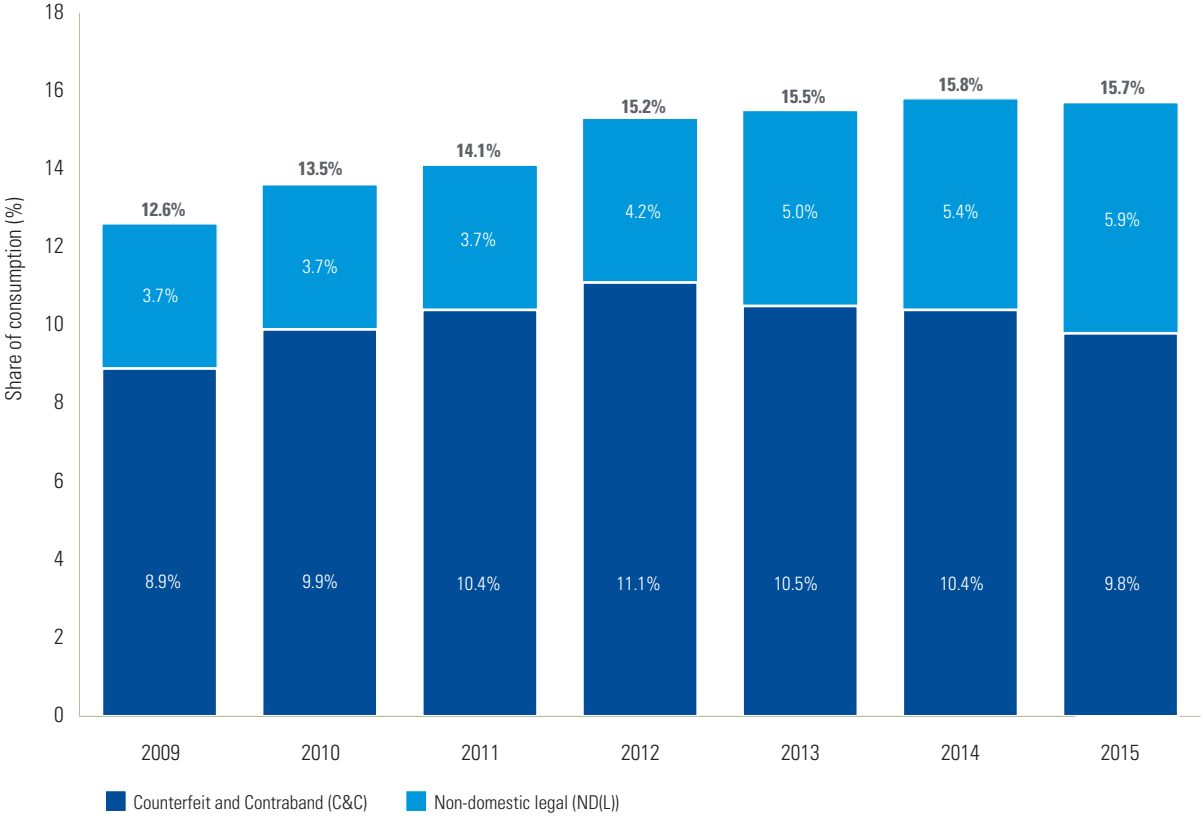
# C&C remained at around 10% of total consumption, with Illicit Whites and counterfeit representing a greater share of illicit consumption

- Flows of C&C from outside of the EU were the largest component of C&C identified in the study
- The overall proportion of Illicit Whites brand flows and counterfeit has grown to 44.3% in 2015
- The increased volume of seizures in Europe mainly identified counterfeit and Illicit Whites brand flows. Seizures of Duty Paid product from both within and outside the EU were limited

Type of C&C – 2015<sup>(1)</sup>



ND(L) and C&C share of total EU28 consumption – 2009-2015<sup>(1)</sup>



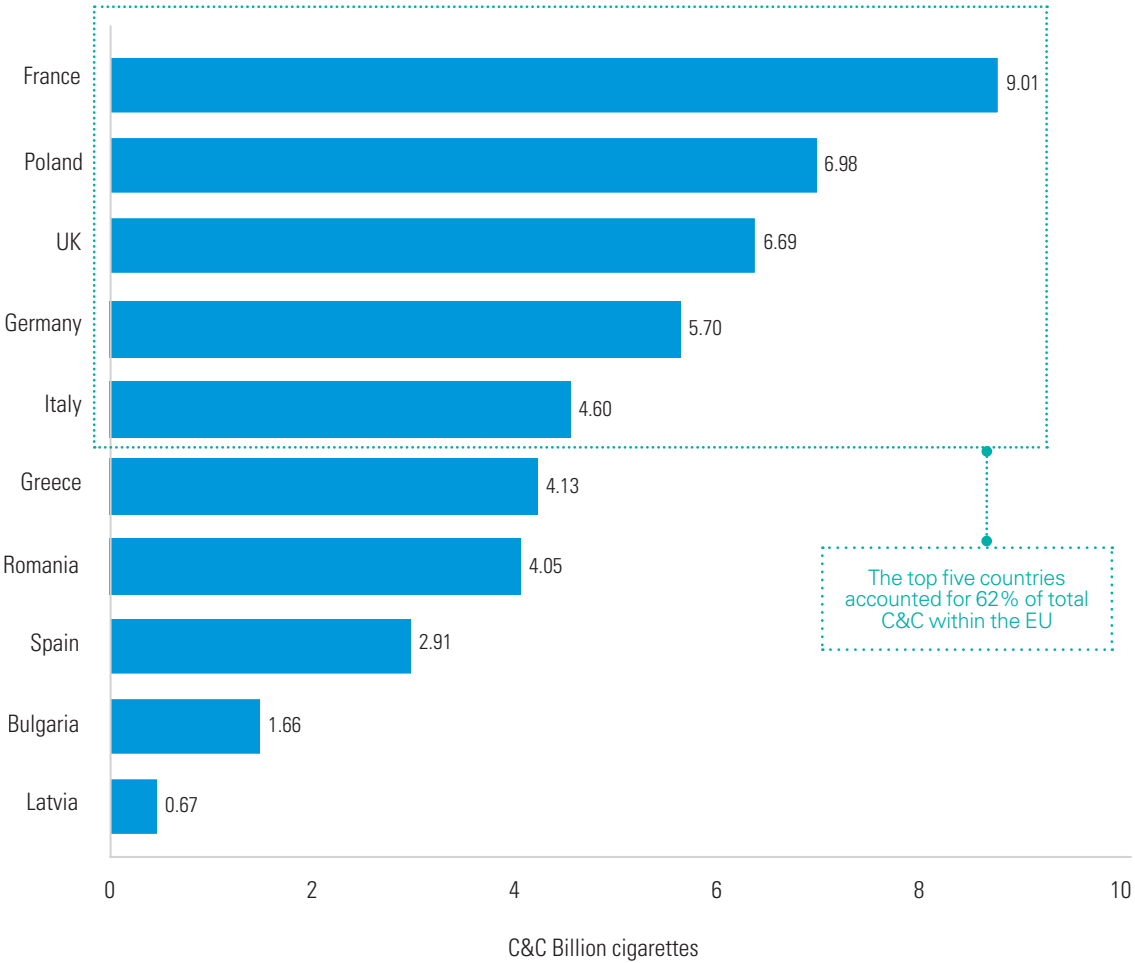
Project SUN — Executive Summary

Sources: (1) EU Flows Model 2009 – 2015

# C&C as a percentage of consumption was often highest in EU countries bordering lower priced non-EU countries

- Eastern EU countries with high levels of C&C mainly bordered non-EU countries where average prices were 4 times lower
- C&C as a percentage of consumption was also high in Greece, Norway, UK and Ireland, which also have the highest prices within Europe
- Whilst not having the highest level of C&C as a proportion of consumption, the highest volume of C&C was identified in France

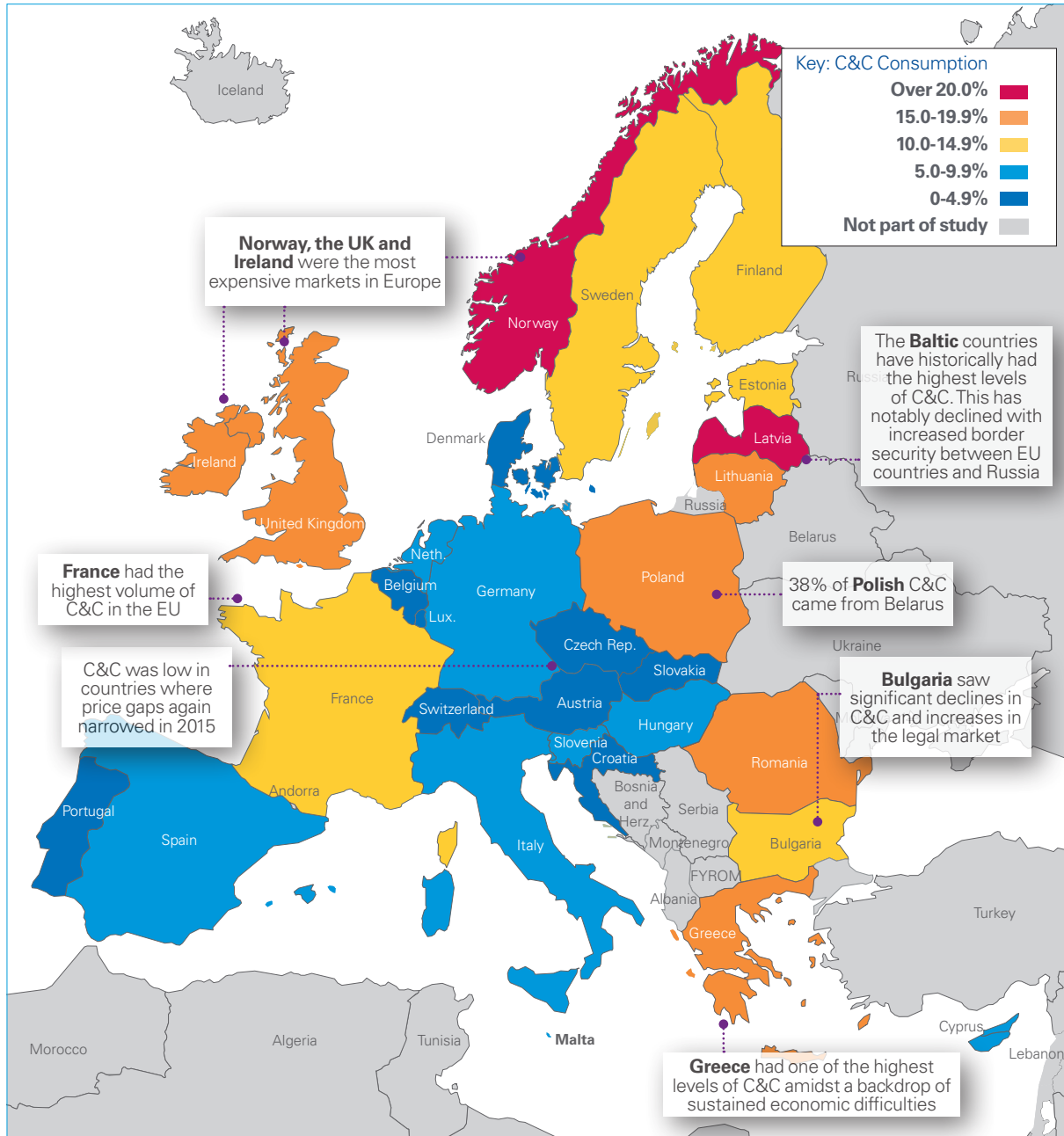
**Top 10 C&C countries by volume, 2015<sup>(1)</sup>**



Source: (1) KPMG EU Flows Model 2009-2015



Counterfeit and contraband consumption as a percentage of overall consumption – 2015<sup>(1)</sup>

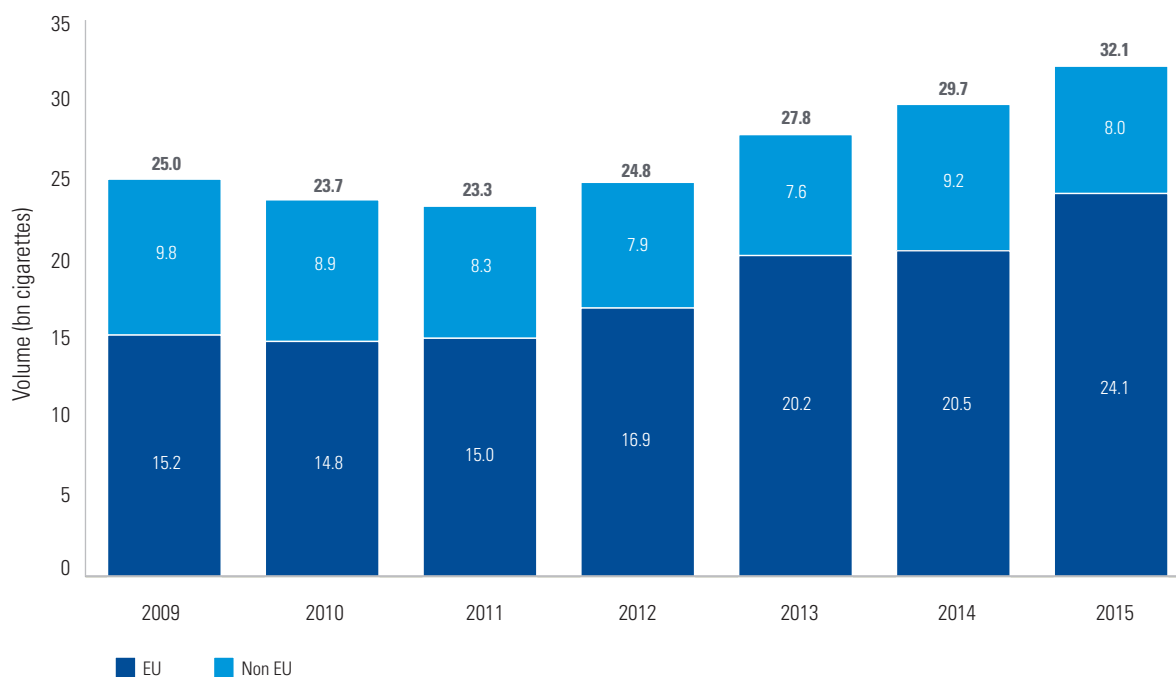


Source: (1) KPMG EU Flows Model 2015

# Non-domestic legal (ND(L)) continued to increase against a backdrop of travel trends and price incentives

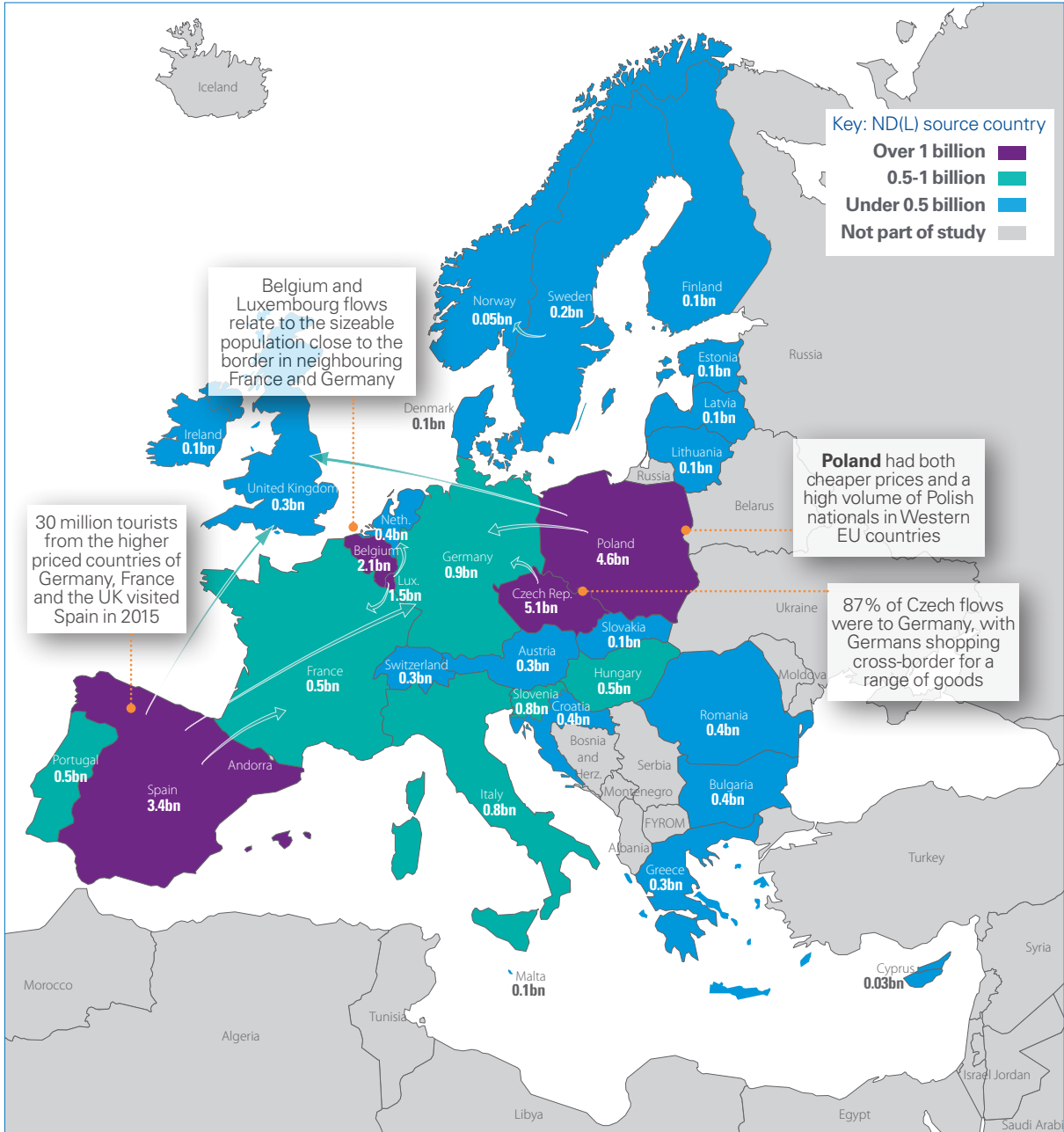
- Overall travel increased by 3.5%, but travel to some major source countries which were also tourist destinations increased further (e.g. travel from France to Spain increased by 8.5%)
- Consumers continued to take advantage of cross-border shopping from neighbouring lower priced EU countries with legal excise allowances
- Countries with the highest level of ND(L), as a percentage of overall consumption, bordered countries where prices were at least €1 lower per 20 pack

Source of ND(L) – 2009-2015<sup>(1)</sup>



Source: (1) KPMG EU Flows Model 2015

Total volume of ND(L) by source country – 2015<sup>(1)</sup>

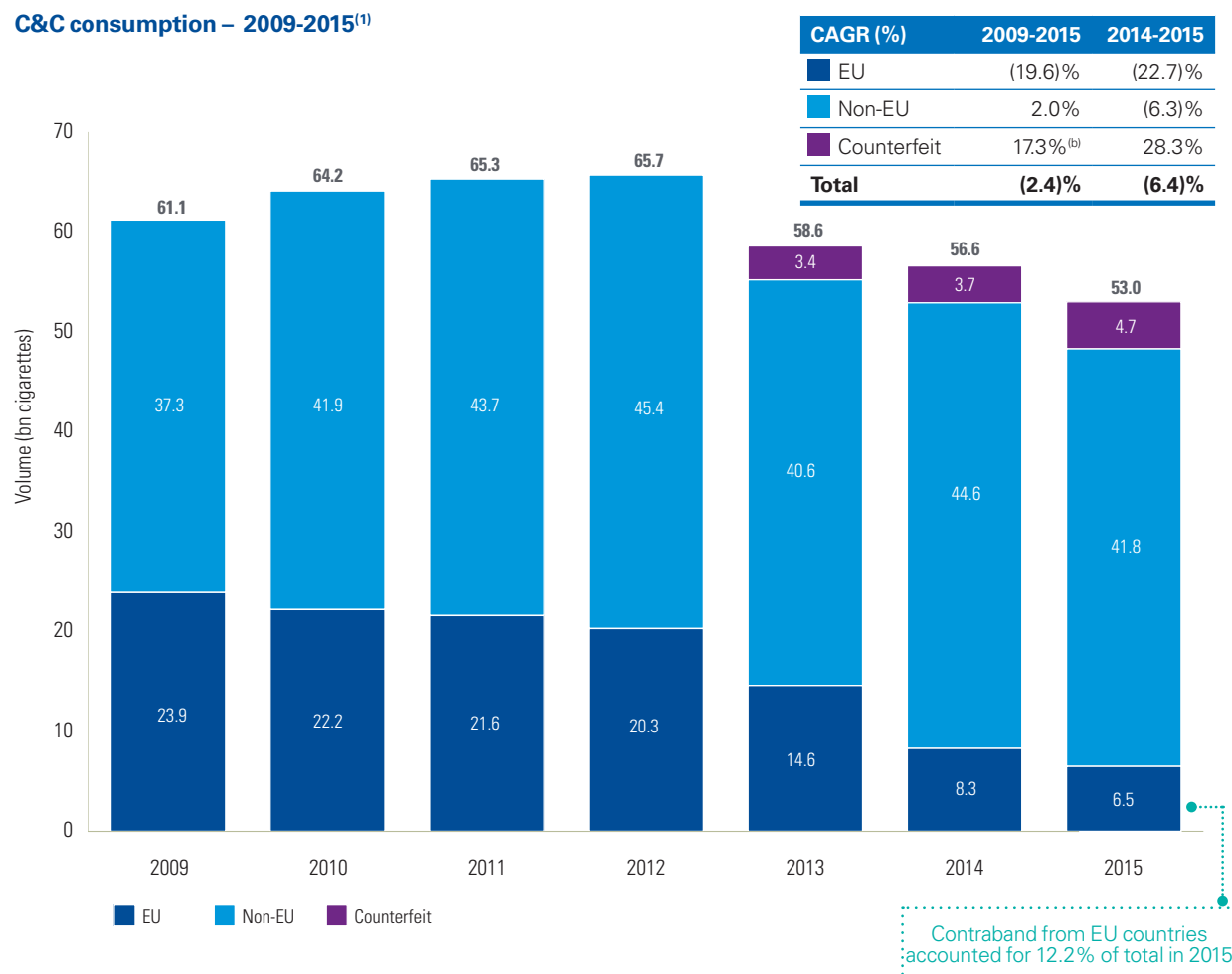


Source: (1) KPMG EU Flows Model 2015

# Non-EU source products and counterfeit contributed an increasingly greater proportion of C&C

- Belarus remained the largest source country, followed by Ukraine, Algeria and Russia. However, the mix of product from non-EU countries has shifted, indicating the flexibility of illicit cigarette sources
- The volume of C&C from EU countries continued to decline as the share of C&C from the OLAF agreement participants declined<sup>(a)</sup>
- Cigarettes seized with OLAF support<sup>(c)</sup> were in excess of 0.6 billion cigarettes, compared with 0.3 billion in 2014, indicating additional law enforcement activity<sup>(2)</sup>
- Whilst the overall volume of seizures increased in 2015, the proportion of cigarettes identified from OLAF agreement participants remained at 3% of the total<sup>(2)</sup>

**C&C consumption – 2009-2015<sup>(1)</sup>**



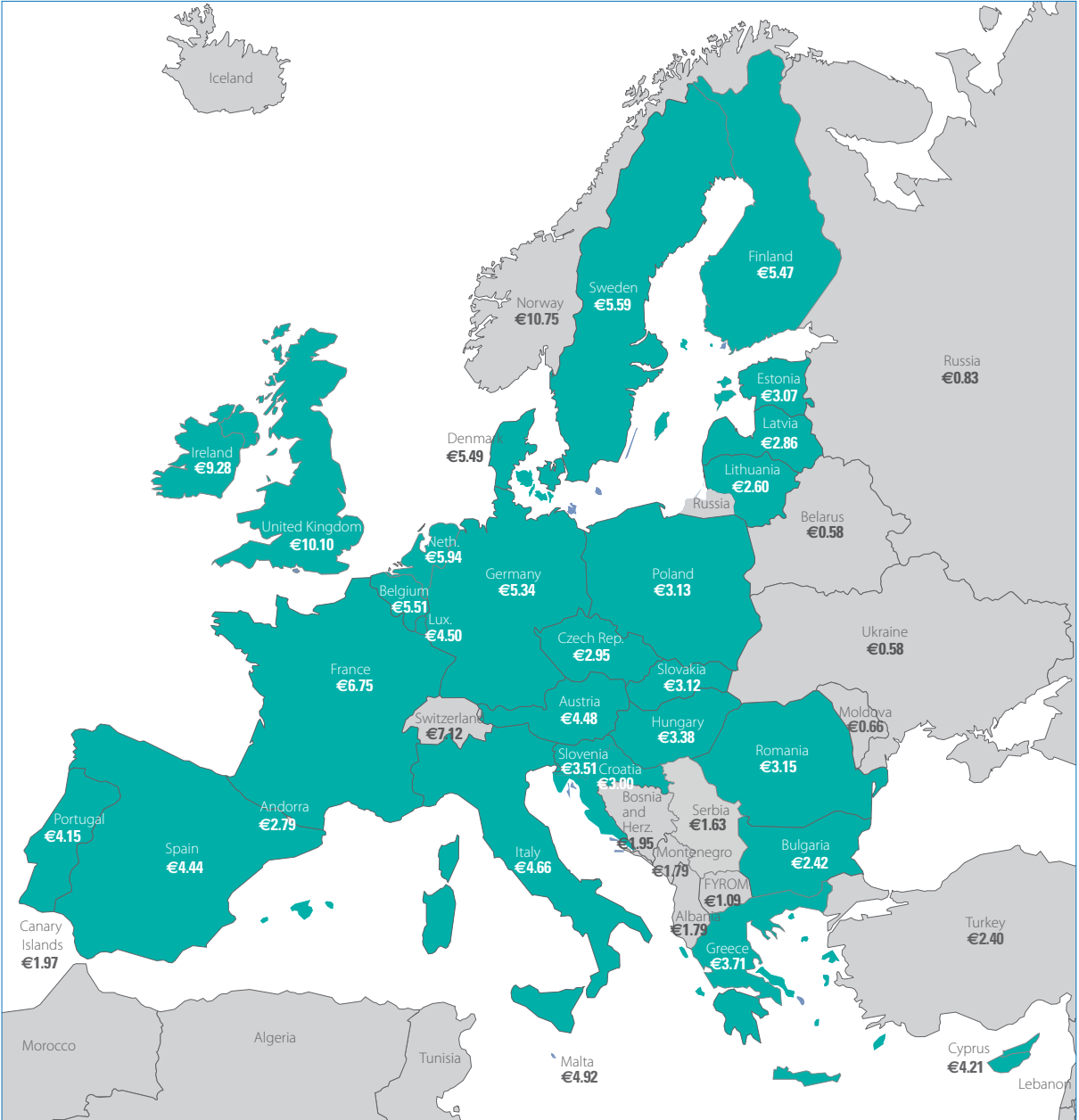
Notes: (a) OLAF agreement participants are those companies who have signed legally binding agreements with the European Union and Member States on anti-illicit trade cooperation (JT International SA, Philip Morris International Management SA, Imperial Tobacco Ltd, British American Tobacco Plc) (b) Counterfeit growth rate of 17.3% is for the period 2013-2015 (c) OLAF provides analysis, technical support and information obtained from Member States and third countries with the help of law enforcement agencies and other sources

Sources: (1) KPMG EU Flows Model 2009- 2015 (2) KPMG analysis of OLAF Press Release No.13, 2015; European Commission ST-6279-2016, February 2016; The OLAF Report, 2015

# The largest C&C source countries were those with the lowest prices on the Eastern EU border

- Prices stabilised in 2015 in many EU countries, especially those in the Eastern EU, as member states met minimum EU excise requirements in 2014
- Prices increased by 3 percentage points less in 2015 than in 2014 and legal domestic consumption stabilised

Map denotes weighted average prices for a pack of 20 cigarettes - January 2016<sup>(1)(2)(a)</sup>



**Key:**  
 EU countries ■  
 Non-EU countries ■

Note: (a) Manufacturer estimates based on the price of the most sold brand used for countries not included in the EU Tax Tables  
 Sources: (1) EU Tax Tables and pricing information on most sold brands outside of EU (2) Data provided by manufacturers for Canary Islands, Norway, Switzerland, Belarus, Ukraine, Russia and Albania

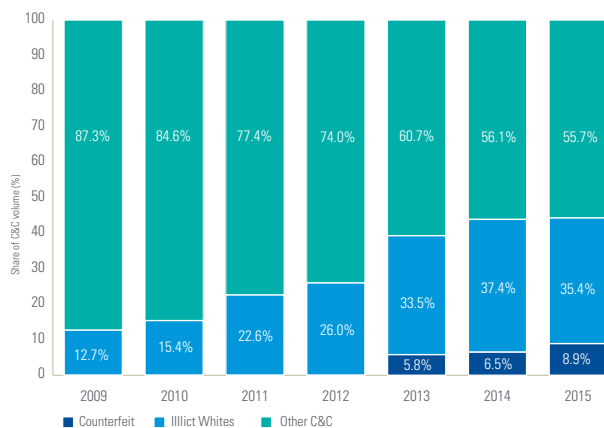
# Illicit Whites brand flows continued to represent over one third of C&C in the EU, equating to 3.5% of total cigarette consumption

- Illicit Whites brand flows have grown as a proportion of total C&C from 7.8 billion in 2009 to 18.8 billion in 2015
- 57% of Illicit Whites brand flows were either misleadingly labelled as Duty Free (as they are unavailable in Duty Free outlets) or had no country specific labelling, resulting in limited identification of the country of origin or trademark owner<sup>(a)</sup>
- 28% of Illicit Whites brand flows had Belarusian labelling, including the brands Fest, NZ and Minsk; all trademark-owned by Grodno Tobacco Company<sup>(1)</sup>
- 1.3 billion cigarettes are thought to originate from the Jebel Ali Free Trade Zone in the United Arab Emirates<sup>(2)(b)</sup>
- The number of Illicit Whites brands increased by 12% with many identified in small volumes; this may further complicate identification of the source and nature of the product

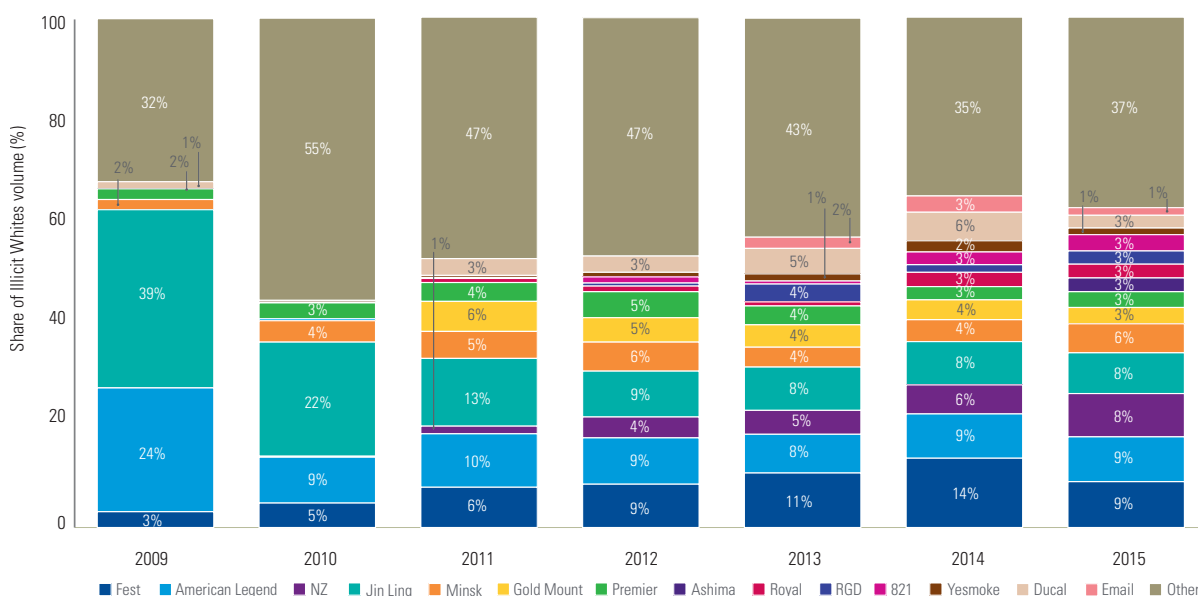
**Illicit Whites labelling – 2015<sup>(1)(a)</sup>**



**Illicit Whites as a percentage of total C&C<sup>(1)(c)</sup>**



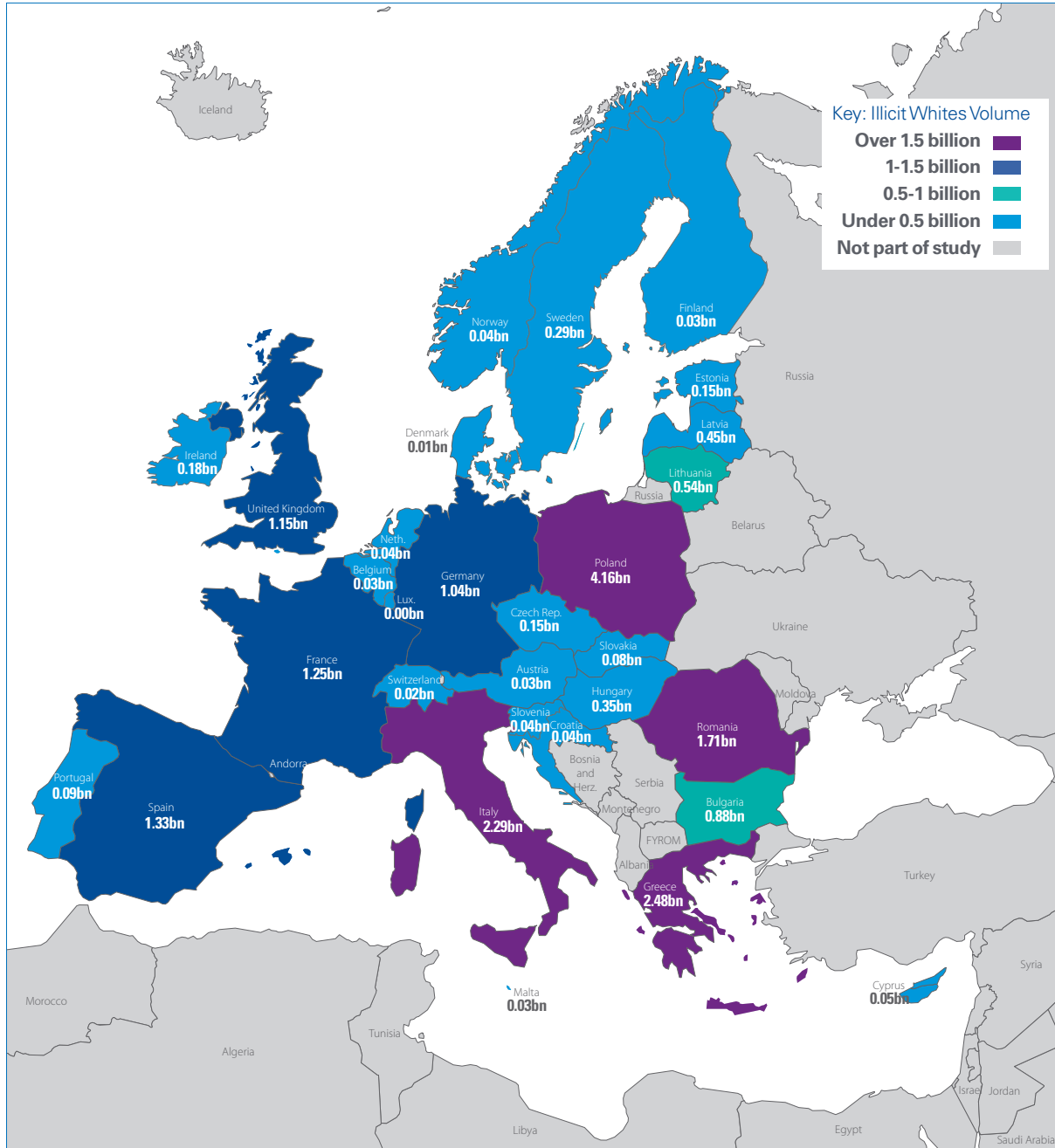
**Illicit Whites by brand – 2009-2015<sup>(1)(a)</sup>**



Notes: (a) KPMG's approach to identifying Illicit Whites is explained in the appendix. When determining Illicit Whites brand flows, KPMG is not able to distinguish between genuine and counterfeit product as counterfeit can only be identified from brands trademark-owned by the four participating companies in the study (b) Free Trade Zone: an area within which goods may be landed, handled, manufactured or reconfigured, and re-exported without the intervention of the customs authorities. However, in many countries products illegally pass through the free-zone border without duty being paid (c) Counterfeit reported from 2013 only due to all 4 manufacturers' participation

Sources: (1) EU Flows Model 2009 – 2015 (2) KPMG analysis of manufacturers operating in Free Trade Zone

**Illicit Whites Volume – 2015<sup>(1)</sup>**

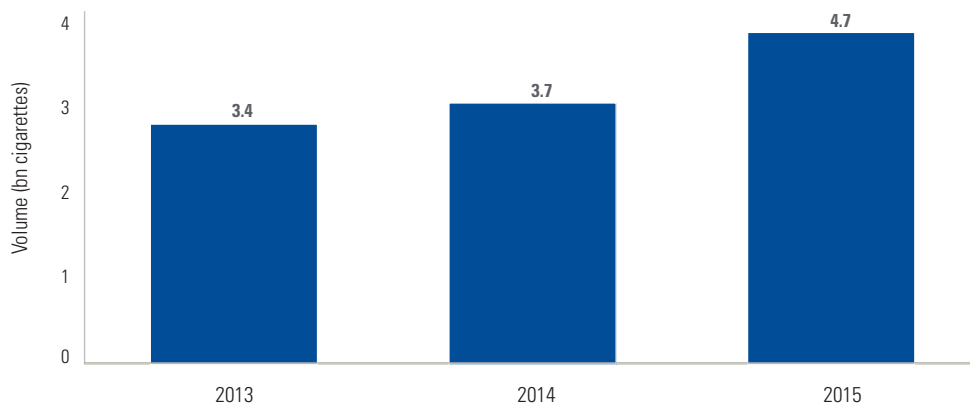


Sources: (1) EU Flows Model 2009 – 2015

# Counterfeit experienced a 28% increase in volume, representing 9% of C&C consumption

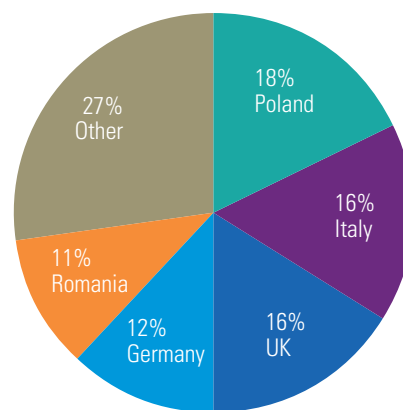
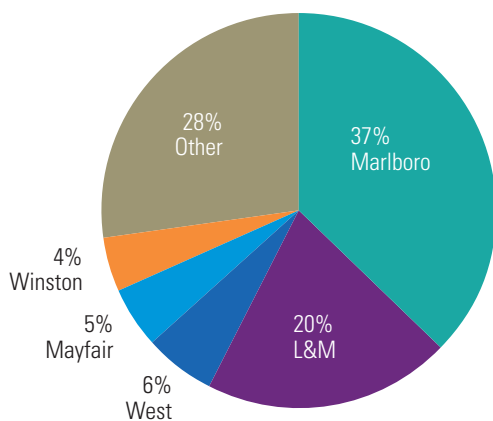
- Counterfeit identified in the study was most common in brands with high levels of legal domestic sales in the country identified<sup>(a)</sup>
- The increase in counterfeit may have offset contraband flows from genuine major international brands originating from lower priced countries
- Counterfeit was mainly identified in markets where there was also high overall flows of C&C (Poland, UK and Italy accounted for 50% of total counterfeit identified)<sup>(1)</sup>
- The majority of counterfeit had Duty Free, Ukrainian and Russian labelling
- Unlike contraband, counterfeit is often seized in large volumes relative to legitimate international brands<sup>(a)(b)</sup>

## Total volume of counterfeit cigarettes consumed in Europe - 2013-2015<sup>(1)</sup>



## Counterfeit brands identified - 2015<sup>(1)</sup>

## Consumption of counterfeit - 2015<sup>(1)</sup>



Notes: (a) Counterfeit was only identified from manufacturers participating in the study (JT International SA, Philip Morris International Management SA, Imperial Tobacco Ltd and British American Tobacco Plc) (b) Explanation of seizures data and its usage provided in appendix

Source: (1) EU Flows Model 2013 - 2015





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