IMPERIAL TOBACCO LTD. - CANADA

REVIEW OF THE COMPETITIVE ENVIRONMENT

Agenda item 8(iii)

TOTAL INDUSTRY PERFORMANCE

The Canadian Industry continues to evolve as smokers seek lower cost alternatives to heavily taxed domestic tailor-made products. The result is a decline in the contribution of domestic tailor-made to the total tobacco industry. Currently, domestic tailor-made now represents 64% of the CTMC reported industry, a decline in contribution of over seventeen percentage points since the beginning of high taxation in 1991.

The primary beneficiary of the decline in domestic tailor-made has been the DFX tailor-made industry. Led by strong growth in smuggling, the DFX tailor-made category now represents 22% of the total CTMC industry.

The increasingly wide accessibility of the smuggled tailor-made to Canadian smokers is providing little incentive for them to adopt RYO alternatives as a means to reduce cost. The result is that the contribution of total fine-cut to the total industry has stabilized at 15% after several years of growth.

Total Industry Volume

As the Canadian industry continues to evolve, its total volume in July (represented within the CTMC industry) on a three month basis now stands at 13.1 billion cigarettes. This represents a decline of 5.0% versus the same period last year. On a twelve month basis, total CTMC volume as of July is 50.5 billion cigarettes, a decline of 4.7% versus July of 1992. This decline in CTMC volume is in fact larger than that of the total industry as a whole as non CTMC member producers have increasingly captured volume. The complete industry as of July is 54.3 billion cigarettes on a twelve month basis, a decline of approximately 3.0 % from the previous year.

Outside the CTMC, small entrepreneurs have capitalized on increased demand for low cost alternatives. In Quebec, the sale of unprocessed raw leaf tobacco at significantly lower prices by small entrepreneurs allowed this category to grow to 900 mln cigarettes in 1992; however, recent changes by the Quebec government to increase the duty on raw leaf have halted this growth of this product. For their part, native indians have captured approximately .2% of the market using their tax exempt status to sell black market imitations of major Canadian brands. As a result outside the CTMC, member companies now represent approximately 94% of total industry volume.

COMPETITOR PERFORMANCE

Through a strategy of maintaining relevant trademarks to consumers, ITL is currently entering all major price sensitive areas of the market. This strategy is aimed at regaining share lost to competitors who have capitalized on growing consumer demand for low cost alternatives.

TOTAL TOBACCO INDUSTRY (CTMC)			
	12 MTHS JULY 92	12 MTHS JULY 93	% Ch.
TOTAL VOLUME	50.5 bln	53.0 bln	- 4.7
ITL SHARE	56.0%	55.3%	- 0.7
RBH SHARE	26.1%	25.2%	- 0.9
RJR SHARE	17.9%	19.5%	+ 1.6

While the twelve month table above does not indicate growth, growth can be seen on a short term basis. On a three months basis, ITL share of total tobacco (CTMC) has grown from a level of 52.0% during July of 1992 to a level of 57.3% during July of 1993. This recent growth has been fuelled by launches of major trademarks in low weight roll-your-own and increased distribution in the general trading component of the DFX market.

RBH, through a strategy aimed directly at price sensitive consumers, has attempted to stabilize their declining share through introduction of low weight fine-cut products and heavy participation in general trading. However, both ITL's and RJR's more recent entry into these markets with stronger trademarks is weakening this strategy. On a three month basis, RBH's share in July is 24.5%, down from the level of 29.3% during July of 1992.

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RJR, whose fortunes are linked to the Export trademark, remains relatively stable at a share of 18.2%. Much of their activity has centred around continued repositioning of the Export trademark, and aggressive participation in general trading. The latter strategy has proven to be a greater success for RJR.

Domestic Tailor-Made

As a result of continued growth in DFX tailor-made markets, the decline in the domestic tailor-made industry continues to exceed the decline within the industry as a whole. As of July, the annual domestic tailor-made industry now stands at 32.1 billion cigarettes, a decline of 11.7% from July of 1992.

Within the domestic-tailor made industry, ITL performance continues to improve at the expense of the other two CTMC competitors.

DOMESTIC TAILOR MADE INDUSTRY (CTMC)			
	12 MTHS JULY 92	12 MTHS JULY 93	% Ch.
TOTAL VOLUME	36.4 bln	32.2 bln	- 11.5
ITL SHARE	64.6%	67.5%	+ 2.9
RBH SHARE	21.5%	20.4%	- 1.1
RJR SHARE	13.9%	12.1%	- 1.8

Much of ITL's success in this market has been the company's strategy of both providing Canadian smokers with meaningful trademarks, and satisfying demonstrated consumer needs. Since its launch, Player's Light Smooth, by addressing a demonstrated need for less irritating products has captured 2.1% of the domestic market; seventeen percent of this being new business to ITL.

In spite of package design changes and new price value innovations, ITL's CTMC competitors have failed to regain share lost to ITL trademarks. RJR's sole major trademark, Export, continues to decline in market share while RBH's recent price/value introduction, Oxford, did not generate sales despite high awareness in test markets where it was launched. Oxford offered consumers a reusable filtered cigarette which could be relit and smoked.

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DFX Tailor-Made

In response to the weak domestic performance of the Export trademark, RJR has attempted to capitalize on the tremendous growth in smuggling by making their products fully available in general trading at highly competitive prices. As shown below, the result has been a significant increase on a twelve month basis in RJR's share of the fast growing DFX Tailor Made market.

DFX TAILOR MADE INDUSTRY (CTMC)			
	12 MTHS JULY 92	12 MTHS JULY 93	% Ch.
TOTAL VOLUME	7.9 bln	11.2 bln	+ 41.6
ITL SHARE	43.3%	34.3%	- 9.0
RBH SHARE	36.2%	34.3%	- 1.9
RJR SHARE	20.5%	31.4%	+ 10.9

ITL's performance has been hindered by the March 1992 decision to restrain shipments to the general trading portion of the DFX market. However, since ITL's decision to reenter this market in March of 1993, ITL's three month share of the DFX market has increased by over 10 share points to a July level of 43.9%, while RBH and RJR's share have declined by 3.3 and 7.4 share points respectively. On a three month basis, RJR's July share stands at 25.7% while RBH now is at 30.3%.

As a means to help supply general trading markets, RJR, since mid 1992, has been manufacturing product in Puerto Rico. Although not reported within the CTMC industry, consumer tracking studies estimate this volume represents approximately 600 mln cigarettes per year.

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Domestic Fine - Cut

As the legitimate domestic low cost alternative for Canadian smokers, the domestic fine-cut market continues to experience an extensive amount of competitive activity. Through reduction in the per-cigarette weight of fine-cut tobacco, all major Canadian competitors in 1993 now have their major trademarks fully competing in price/value portion of the RYO market.

As shown below, both ITL has regained market share in 1993 from both RBH and RJR. This is mainly due to the national launch of the Player's trademark in the low weight RYO category, and ITL's initial domination of the newly emerging bonus category. Both price/value RYO options comprise over 50% of total domestic fine-cut industry volume.

DOMESTIC FINE CUT INDUSTRY (CTMC)			
	12 MTHS JULY 92	12 MTHS JULY 93	% Ch.
TOTAL VOLUME	5.7 bln	4.7 bln	- 17.2
ITL SHARE	40.5%	43.7%	+ 3.2
RBH SHARE	35.8%	33.6%	- 2.2
RJR SHARE	23.7%	22.7%	- 1.0

During June of 1993, RJR launched a bonus version of the Export trademark. Through a product which offers 25% more cigarettes from a 200g tin of RYO tobacco, RJR hopes to compete against ITL's highly successful Player's Light Special Cut. Since its national introduction in November, Player's Light Special cut has captured 9.2% of the domestic fine cut market. Through off-pricing at the time of launch in June, Export Extra has generated good levels of awareness and trail among RYO smokers.

Activity on the part of both ITL and RJR in 1992 and 1993 has been aimed at ending RBH's dominance of the low weight RYO category. In response, RBH has re-launched their Superoll product to now be the lowest priced fine-cut product on the market. Although performing well, much of the generated business has been a cannibalization of the Superoll I version. The total RBH Superoll family currently holds 29.5% of the domestic fine cut market.

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DFX Fine-Cut

With the full availability of competitive priced DFX tailor-made available in smuggled channels, DFX fine-cut has not experienced the same stellar growth as its tailor made counterpart.

DFX FINE CUT INDUSTRY (CTMC)			
	12 MTHS JULY 92	12 MTHS JULY 93	% Ch.
TOTAL VOLUME	2.2 bln	1.9 bln	- 15.4
ITL SHARE	19.6%	17.9%	- 1.7
RBH SHARE	15.1%	16.2%	+ 1.1
RJR SHARE	65.3%	65.9%	+ 0.6

As shown above, continued full distribution and competitive pricing, has allowed RJR's domination of the DFX fine-cut market to continue in 1993.

However, in spite of traditional weakness in DFX fine-cut, ITL's December agreement with Philip Morris to distribute the Player's trademark in the United States combined with the company's commitment to full distribution in general trading is facilitating growth in ITL's share. As a of July, ITL's three month share is 26.1%, an increase of over twelve share points since March of this year.

SUMMARY

In summary, the desire of Canadian consumers to seek low cost tobacco products continues during 1993. Much of the competitor activity during that same period has focused on satisfying the demand for reasonably priced tobacco products. The entry of relevant trademarks into lower priced categories have allowed those companies who posses them to regain share lost to the original pioneers of the categories who have less relevant trademarks. With this in mind, competitive activities will continue to be closely monitored to see if this trend continues into the future.

September 3, 1993