The following characterizes the competitive environment during 1992 in key tobacco segments.

Overall

ITL's major competitors, RJR and RBH were very aggressive in 1992. We also experienced increased competition from minor players in the market; small tobacco companies and manufacturers who are not members of the CTMC.

Price related activities have been the thrust of opposition initiatives this year. These price activities have taken the form of price/value options in the domestic market and, as well, there has been a growing black market trade in Canada. These products are bought duty-free and on the US duty paid market and are smuggled back into the country. Increasingly these activities have been undertaken by organized crime. Based on current information, the size of this "black" market is estimated at 6 billion cigarettes.

ITL has not participated in the smuggling network by refusing to ship to customers known to participate in illicit activities. Both key competitors have not restricted shipments.

In total tobacco terms, on a 12-month Oct. '92 basis, ITL has a 55.6% share which is off 1.0% versus last year. This is mainly due to our non-participation in smuggling as well as our slow entry into the domestic low-weight fine cut market.. RBH is 26.6%, up 1.6 share. RBH is benefitting from stock availability in illicit channels and a strong share in low-weight fine cut. RJR at 17.8%, is down 0.6 share. RJR has been producing their key trademark, Export, in Puerto Rico which distorts their domestic performance as these sales are not part of the measured industry. We estimate 200 mln sticks in '92 will be produced off-shore.

Tailor-made market

The domestic TM market represents approximately 68% of all tobacco products sold in Canada. This segment has been declining due to the growing duty-free/export business which now represents almost 16% of all industry sales.

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On a 12-month Oct. '92 basis ITL has achieved 65.7% of the domestic tailor-made market, which represents a growth of 3.7 share points. RBH, at 21.1% is down 1.4 share and RJR at 13.3% has declined 2.2%

The share declines by RBH in the domestic market are compensated by stellar growth in the duty-free/export business which is dominated by product smuggled back into Canada. Their 12-month Oct.'92 share is 42.7% which is up 20.1 share points.

RJR has declined in both the duty paid and duty-free/export markets. The decline in the duty-free market is 1.8 share points to 21.4%. The RJR decline is due in large part to the Puerto-Rico production. On a consumer demand basis, the company is declining at a slow rate. ITL has shown good performance in the domestic TM market, but we have declined 18.1 share points in the duty-free/export business to 35.9% since the non-participation in criminal activity has been initiated.

In terms of domestic brand launch activity, ITL launched Player's Light Smooth in test in Alberta in May and after a successful test extended nationally commencing in August. The brand forecasted at 1.3% is achieving over a 2.0% share. This brand is designed to specifically address consumer need for reduced irritation.

RBH has launched Holiday in two small test markets where performance has been unfavourable. Recently they have introduced Holiday in a cylinder for a limited period and are offering 30 for the price of 25.

RJR undertook a re-positioning of the Export trademark through a packaging re-design which has moved the trademark away from its traditional strong, male, harsh position to a less ^Pmasculine, strong, irritating perception. This move has not translated into good short-term performance for the trademark as it has tended to alienate the franchise and it has not succeeded in making the trademark more acceptable to non-users.

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Roll-Your-Own

There has been intense activity in the R-Y-O segment in Canada due to the price savings afforded by these products. The bulk of the activity has been in the low weight segment. The low weight segment is characterized by products at 110g.-135g. which provide 200 cigarettes. These brands are priced at a lower rate than 200g. traditional offerings due to the Canadian tax regime on R-Y-O which is on a per gram basis.

The low weight segment represents a growing 4.3% of total tobacco on a 12-month Oct. '92 basis and traditional R-Y-O has correspondingly declined to 6.4%.

The low-weight category was pioneered by RBH in 1989, but in 1992 has seen entries by RJR and ITL. Consequently, RBH's 100% share of this segment is rapidly declining since the introduction of perceived superior trademarks. RBH's short-term low-weight share has dropped to 47.7% and will continue to erode as new brands, particularly ITL recent entries, extend nationally. In the 4th quarter ITL has introduced 3 Player's products and 2 Matinée products simultaneously in Eastern Canada. The balance of the launches will occur in '93 as soon as diet availability and supply is assured.

RJR launched the Export trademark mid-way through the year and has approximately 20% of the low weight segment.

Shares of the traditional R-Y-O segment are 59.7% for ITL, which is a growth of 2.8%. RBH has 10.1%, a decline of 3.4% versus one year ago. RJR has 30.3% which is up 0.7 share.

A new product category has been introduced in the Quebec market, namely Raw Leaf. The tobacco leaves are placed in plastic bags weighing 200-225g. or are processed into large flakes which are sold at retail. This category is very inexpensive as it benefits from a tax definition of unprocessed leaf. There are a number of entrepreneurs who have entered the category and it is estimated the equivalent of 500 mln sticks will be consumed over a 12-month period.

Sticks

The stick category represents 1.5% of total industry sales and remains dominated by RBH who have a patent on the product. ITL was forced to withdraw from the market following an unsuccessful attempt at challenging the patent in 1991. This is now in appeal with a judgement anticipated in Spring '93.

RJR has recently launched the Export trademark into the stick category in an attempt to challenge the RBH patent. Their short-term share of the category is approximately 20%.

SUMMARY

RBH has been benefitted from availability of their products on the black market in 1992. Their share of the domestic tailor-made market, however, has continued to deteriorate as their trademarks increasingly lose relevance. They were successful in the low weight segment, however as major opposition trademarks participate, their share will decline. We anticipate further pricing initiatives from RBH. Their trademarks are not well positioned to compete in the mainstream of the Canadian market, consequently they will strive to distort market dynamics and will attempt to use price as their key marketing weapon.

RJR has continued to focus on the Export trademark and although the recent re-positioning has not provided short-term gain, they are attempting to widen market access with the re-positioning effort. Their activities continue to be closely monitored.

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