



June 18, 2018

Contact Information

Research Analyst: Rouba Chbeir

rouba.chbeir@blominvestbank.com

Head of Research: Marwan Mikhael

marwan.mikhael@blominvestbank.com

Abstract

The report aims to explore the existing market for tobacco-based products in Lebanon. It focuses on the contribution of the “cigarettes” industry to the economy and does not tackle “smoking” or tobacco-consumption from a “public health” viewpoint. The main findings highlight the market size of the cigarettes industry, the key market players, their challenges, competition, modern industry trends, top products, and strategies set by distributors and manufacturers of tobacco-products to ensure sustainability of their businesses amidst changing customer preferences and the smoking environment.

Nonetheless, the research also identifies a data gap on the large portion of tobacco-based products (cigarettes, cigars, cigarillos, and mouassal) due to “illicit trade” channels in Lebanon. The study therefore touches lightly on the cigars, cigarillos, and shisha markets, while it focuses on “cigarettes” as more comprehensive data and inferences on the latter can be shared by the Regie Libanaise Des Tabacs et Tombacs (Regie), the national tobacco state-run monopoly actively combatting cross-border smuggling.

The First Cigarette: A Historical Snapshot

The first “cigarette” known to mankind was manufactured by the French in the 19th century. It had arrived to Europe after Christopher Columbus discovered the American continent at the end of the 15th century, where the aboriginal inhabitants used tobacco leaves for some religious rituals and for inhibiting pain (utilizing its medicinal properties). With the conquests and expansion of the Ottoman Empire, the cigarette traveled east, as Ottoman trade pushed the propagation and sales of cigarettes across the region and smoking became more popular.

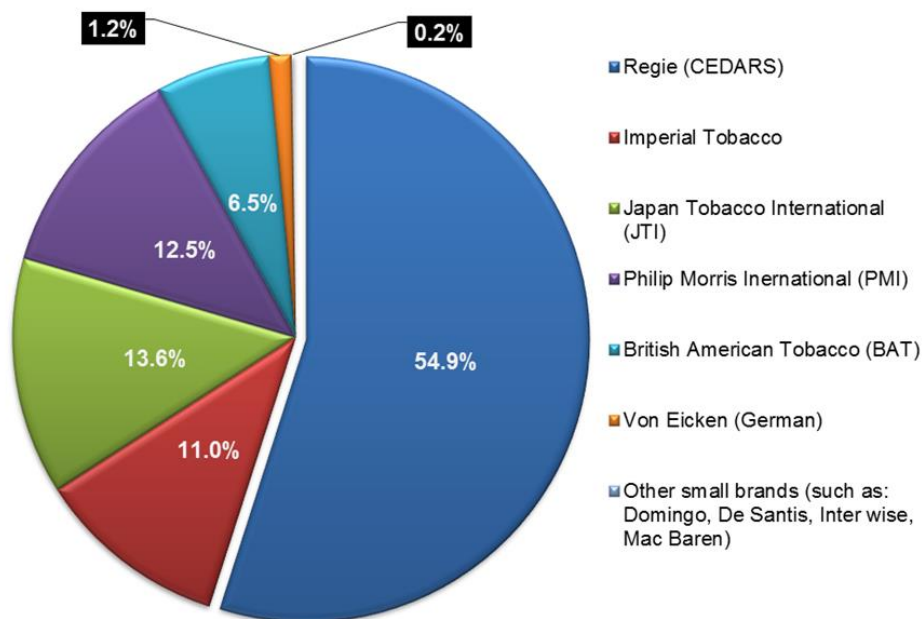
Today, it seems a cigarette is an “international good”. It is available, sold across borders and is utilized by people from all walks of life (ideally providers target adults over 21, but violations to the official consumer age occur worldwide). Nowadays, even cigarette substitutes and cigarettes’ impacts on consumers are on the shared agendas of different nations and societies. For instance,

the consumption of tobacco products, which contain the main addictive substance ‘nicotine’, widened rifts that exist worldwide between pro-smoking bodies (like governments who rely on tobacco-products to prop-up fiscal imbalances and nurture economic growth) v/s humanitarian, health-oriented global entities aiming to nurture “social wellbeing”, namely the World Health Organization (WHO) that partners with health ministries to reduce treatment (medication) costs.

Smokers around the world also include niche markets. Some clientele prefer to consume a cigar or a lighter (smaller) version of it known as a cigarillo, rather than a cigarette. Many tobacco consumers particularly in the Arab world further developed affinity towards the shisha (also known as hookah, nargileh, or argileh), which uses water pipe tobacco (flavor-infused tobacco blends).

Lebanese Market Players: The Commercial Dynamics

Distribution of Market Shares in Lebanon’s Cigarette Sales for 2017



Source: Regie, BLOMInvest Bank

The Regie Libanaise Des Tabacs et Tombacs (Regie) is the monopoly in Lebanon’s tobacco industry and acts as the intermediary among the other top players. In accordance with Law 151, “Regie is the exclusive agent for all imported tobacco products and the sole agency that has the authority to grant permits for the sale of tobacco”. It also oversees the efforts to fight illicit trade. As such, Regie grasps the lion’s share of the tobacco-products market owing it to the 2015 successful repositioning of the Lebanese cigarettes: “Cedars”, which uses a distinctive blend of imported tobacco alongside other products that enter in its making. The Regie also imports a variety of multinational brands. As it is not a direct seller itself, the Regie makes both, local and imported cigarettes available to the

market through four international players as well as numerous, licensed “heads of sales” (wholesalers or retailers). In details, the Regie imports tobacco products from foreign tobacco companies according to agreed specifications. Foreign products are then stored in regional warehouses across Lebanon, where the goods become easily available to the licensed local distributors and multinational players. It’s essential to note that the Regie imports under an “exchange” principle, such that national tobacco is exported for sale abroad, thereby safeguarding the national agriculture and tobacco industry while meeting the local demand of the market on foreign brands.

The top 4 international players grasping the remaining market shares independently market, advertise, and sell their own foreign brands. *Japan Tobacco International* (or JTI) grasped 13.6% of total cigarette sales selling its main brands: Winston and Camel. Meanwhile, *Philip Morris International’s* (PMI) share stood at 12.5% of the total, via its premium brand Marlboro and *Imperial Tobacco* followed with 11% of the total, selling Davidoff, West, Gauloises, and Gitanes. Lastly, *British American Tobacco’s* (or BAT’s) market share totaled 6.5%, via its key brands: Kent (premium) and its lower to mid-end brands of Viceroy, Lucky Strike, and Dunhill. Allure cigarettes are also imported through the smaller German player Von Eicken as per the chart. These players import their brands through the state-owned monopoly, Regie. However, they are in charge of the sale, advertising, and distribution of their multinational brands albeit abiding by “Law No. 174, Tobacco Control and Regulation of Tobacco Products’ Manufacturing, Packaging and Advertising”, which was mainly followed by Decree No 7473 and No 8991 regulating advertising signs and the health warnings (starting 2012) posted on the packs of tobacco products.

As for the licensed heads of sales, they are spread across Lebanon and sell both local and foreign cigarette brands. There is no estimate for the market size of these wholesalers or retailers largely because they sell all brands made available in the country through the Regie. According to Mr. Aoun, owner of Rigali Souhad Aoun & Co. in tobacco wholesale, “*Heads of sales in the Lebanese market are regionally stratified, with one or two players dominating sales in Beirut or Greater Beirut area, while others focus their distribution in the North, South, Bekaa, Metn, and so forth.*”

On his end, Mr. Jabak, owner at Jabak Bros. wholesaler of tobacco products, similarly confirms his firm’s sales are concentrated in Beirut, while other large players include: Fadi Mansour in Beirut, Abi Ramia, Joseph Akiki, and Raymond Sarkis in Keserwan. Meanwhile, Aoun also highlights Ziad Al Kaii and Awad Co. in the South. Regie confirms Laoun Trading Co sal in Metn is one of the biggest players, Ziad Tahsh in the North region, Simon Wadih in Ashrafieh, Ali Zeineddine in the Bekaa, among others.

Heads of sales favour smaller groceries over large retailers. Mr. Jabak complements Mr. Aoun’s words as he explains how, “*we distributors prefer to serve the smaller groceries and around-the-corner shops because big supermarkets bare greater payment risks.*” Hypermarkets may request payment facilities for their big orders, which may jeopardize the cash and liquidity of the wholesalers if clients delay their payments or default on them.

Moreover, the relationship between the Regie, national distributors, and international players has its peculiarities. The Regie has confirmed total licenses reached 1,100 heads of sales by 2017, up from 665 in 2014. However, unlike the international players, domestic licensees do not carry advertising or marketing costs nor favor a brand over the other, and they are in fact directly in touch with consumers' buying habits which they capture through their top (least) sold brands. Nevertheless, a manager at the Regie explains that multinational players may sometimes approach heads of sales asking them to display a particular foreign brand more than another, or agree on a seasonal offer to boost a certain brand.

Therefore, the main competition lies between heads of sales and illicit traders. Knowing that the prices of tobacco products (molasses, cigars, cigarillos, pipe tobacco and cigarettes) are assigned as per the Ministry of Finance resolution 1/1141 dated November 10th, 2014, it follows that the main competition lies between the national heads of sales and the illicit traders. The cigarettes market is price sensitive which magnifies the threat imposed by illicit traders on national licensees as the former do not abide by the Regie's policies and channels nor the ministry's pricing, leaving distributors at a loss.

Market Size and Revenue-Sharing

The formal market size of cigarettes in Lebanon has reached 926,236 cigarette cases¹. Statistics provided by the state-run monopoly revealed that 926,236 cases of cigarettes (46M cartons or 9.3B sticks) worth \$426.82M were sold in 2017 of which 508, 867 were "Cedars" cases, the national brand that was revamped in 2015. Nonetheless, Lebanese consumers of tobacco-based products include smokers of cigarettes, cigars, cigarillos, as well as Shisha. As such, the total sales value of all tobacco-based products mentioned amounted to \$512.13M in 2017, which naturally exclude tobacco products sold in informal channels. Nonetheless, illicit trade, a common phenomenon among Lebanon's tobacco-based products presents a number of challenges driven by the unmonitored (smuggled, tax free) products made available in the local market.

The size of the cigarettes market is estimated to stand at 1.2 cigarette cases or 12B sticks including illicit trade estimations. According to a manager at the state-run monopoly Regie, *"Estimating the size of the cigarettes market is based on two parameters: the sales of cigarettes through Regie, but also the sales estimate of illicitly-traded cigarettes which may reach 20 to 30% of the total market size."* Similarly, four other market players surveyed agreed that illicit trade has been on the rise in the past few years, climbing from the lower bracket of 15-20%, to reach the 20-40% range of the market size today.

The Regie realizes large profits from the sales of cigarettes and transfers millions of dollars to the Treasury each year. The income generated from the sale of cigarettes alone constitutes 85% of

¹ In terms of cigarette packaging, each "case" of cigarettes contains 50 "cartons" of cigarettes (or 10,000 cigarettes). Also, each carton has 10 "packs" ; each cigarette pack frequently contains 20 cigarettes.

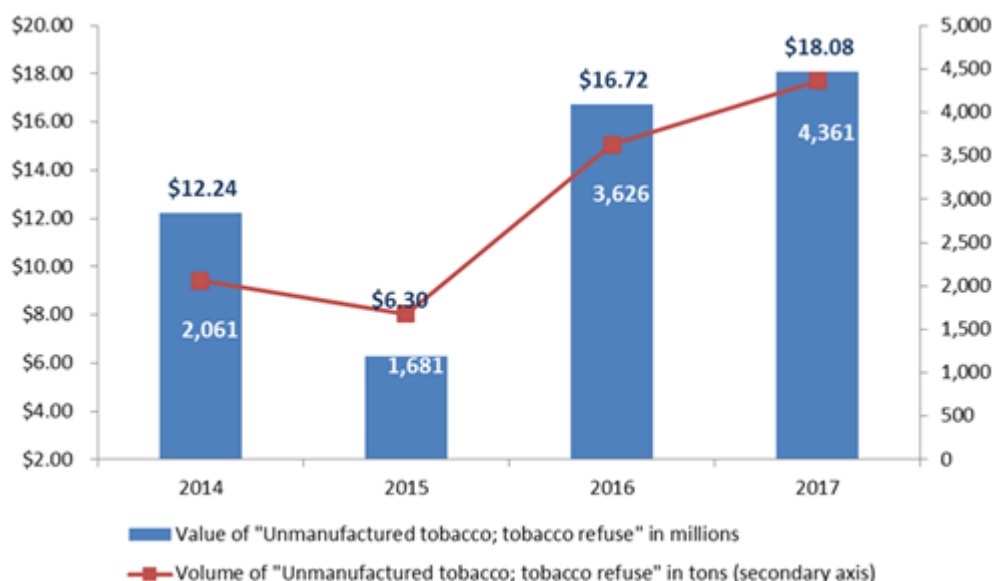
Regie’s total income today, while roughly 14% is generated from cigars (imported through Regie, excluding the duty free sales) and 1% from Moassals (not accounting for the illicitly traded tombac). This renders cigarettes, under the Regie’s monopoly, among the largest sources of revenue for the Lebanese government.

Besides the income from Regie, the Ministry of Finance receives revenues from the tax on imports and excises on tobacco. The tax structure on imported “cigarettes” is composed of a 5% Custom charge coupled with a 108% internal excise fee (113% on imported finished tobacco products), while that on “all other manufactured tobacco: including cigars and cigarillos and water pipe tobacco (or *moassel* used for shisha)” totals 40%. The VAT in its turn is set at 10% on all tobacco-based products. According to a manager at Regie, *“The entity adopts a specific price formula through which it sets the retail and wholesale prices for heads of sales and profit margins of local players, taking into account: the government’s share of custom fees, VAT revenue, and Regie’s profits and costs.”*

Trends in the Lebanese Cigarettes Industry & Top Products

Cigarettes sold in Lebanon are of three classes: premium, mid- and low-end products, but Cedars competed across all categories. According to interviewed market players, the top sold products today in terms of quantity sold are: Cedars, Marlboro, and Winston. Since 2015, the Regie decided to give Cedars a product upgrade. The new plan also became evident when observed in the value and volume of imported “unmanufactured tobacco” as per the Lebanese customs. Both parameters surged from 1,681 tons worth \$6.3M in 2015 to 3,626 tons worth \$16.72M in 2016 and continued rising as the brand continues to take off.

Unmanufactured Tobacco Used for the Production of the Upgraded “Cedars”



Source: Lebanese Customs; BLOMInvest Bank

In fact, Cedars emerged as a leading cigarette with a reasonable price and meeting international standards. The two main features that defined the success of the product “upgrade” according to market players were: the selection and import of a new blend of tobacco that gives the cigarette its good quality and taste, and the improved pack appearance and design. Cedars successfully snatched a share of the market from premium and mid-brands, and it accounts today for more than 65 – 70% of distributors’ sales.

BAT country manager - Jordan, Lebanon, Syria, Palestine, and Yemen Mr. Khalifeh emphasizes that, *“Foreign brands used to constitute almost 40% of total sales in the Lebanese cigarettes market, while today they capture 10 to 15%, losing market share to Cedars.”* He goes on to commend how, *“The repositioning of Lebanon’s Cedars brand was a game changer. It shifted the market dynamics and boosted the consumers’ pride in carrying a neat, practical appealing pack and in smoking a national cigarette”.*

Moreover, Lebanon’s top market players identified 3 major trends governing the Lebanese cigarettes industry in the past 5 years. The modern trends include: the shifting consumers’ preferences for “cheaper-priced” products; the rise of ‘secondary manufacturing’ whereby foreign brands are being locally produced; and lastly, modern smokers are now opting for less harmful, more hygienic smokes (such as vaping, e-cigarettes, tobacco heating).

A. The Dynamic Shift to Cheaper-priced Products

The consumption of cigarettes in Lebanon shifted to “cheaper-priced products”. According to Mr. Aoun in tobacco wholesale and Mr. Khalifeh from BAT, the economic headwinds facing Lebanon in the past 5 years had weighed down on household’s purchasing power. As a result, the loyalty of a large chunk of smokers to a premium or medium-level brand was outweighed by the financial restriction in their choice of cigarettes. In parallel, the spillovers of the Syrian crisis had also added the number of low-end tobacco consumers. Both these drivers rendered Cedars a favoured brand selling at a very affordable price, whilst offering the quality taste of a unique tobacco blend wrapped in an appealing pack. This naturally came at the expense of foreign brands that had to readapt to serve the changing market.

B. Secondary manufacturing (Foreign players collaborate with Regie)

Cedars grasped the largest share of the cigarettes market since 2015, which ‘crowded out’ the more expensive foreign brands. The international players operating in the Lebanese market lost cigarette sales in value and volume. Some market sources even admit these were forced to restructure to cope with the new industry dynamics. This triggered the trend of secondary manufacturing whereby the Regie - whose monopoly largely serves to support the local economy and agriculture – intervened in late 2016 offering the alternative of locally producing foreign brands through state-of-the-art, European advanced machinery it provides.

Locally producing foreign cigarette brands met the local demand, albeit restoring a healthy and fair competition to the market. The Regie’s initiative actually reaped multiple benefits to the players and to the economy. For instance, the price of foreign cigarettes regained some

competitiveness; the custom fees imposed on foreign players' finished goods dropped from the 113% fee, and transport fees from the ports to the Regie, to the players' premises were also slashed. *Imperial tobacco* was the first foreign player to produce its brands of: *West*, *Gauloises*, and *Gitanes* in Lebanon starting early 2017 and by early 2018, PMI started its *Marlboro medium* production at Regie's facilities. In its turn, the state-run monopoly created new job opportunities for nationals as it also supports the plastic, paper, and carton produce of local businesses.

The indirect tax incentive encouraged other foreign brands to follow suit. In fact, the customs charges on importing finished tobacco goods, namely foreign brands of cigarettes, is 113% compared to the low 35-40% charge imposed on raw materials (unmanufactured tobacco, plastic, and others) to be used in local production processes, which was appealing to international players desiring to attract their target segments. However, it is worthy to note that the tobacco excise is not applicable on domestically-produced cigarettes.

C. New Generation Products (following the global trend)

Vaping, e-cigarettes, and electronic delivery systems (ENDS) constitute a key international trend gradually impacting the Lebanese and regional markets. Industry experts refer to these as "cigarette-substitutes", "new generation products" or "lower-risk products" generally made up of an "e-liquid"- mainly nicotine, added substances like flavourings, propylene glycol, vegetable glycerin, and other chemicals, atomizers, batteries, glass or plastic container of e-liquid, programmable software, and cartridges among others. They surfaced as smokers began to demand more 'hygienic' smoking and less harmful health impacts. The *Kent* premium brand for instance owned by BAT recently introduced a "special feature" to its cigarettes: less residual smell on hands and mouth when smoked. Such products are also a form of the modern consumer and smoker turning more "health-conscious".

Philip Morris International seems to be the strongest advocate of switching from traditional cigarettes to "heating" tobacco-based products, namely the "IQOS". PMI's corporate affairs manager Mr. Naouss corroborates that, "*PMI's IQOS has grasped an impressive 20% share of the market in Japan, along with a promising increasing figure in neighboring South Korea, where the consumers are simultaneously health-conscious and tech-driven.*" The IQOS is a modern, noncombustible tobacco product. When switched on by the user, sophisticated electronics trigger the tobacco to be heated (instead of burned), which will release a vapor of nicotine flavor.

Ways Forward

In summary, Lebanese market players in the industry of tobacco-based products, especially cigarettes trade, face three main challenges. These are: the magnified portion of illicit trade particularly from Syria, the down trade (price gap) that emerged between the national cigarette and the foreign brands, and lastly, the growing rifts and tensions among public or global health entities v/s governments seeking to protect farmers and fiscal revenues generated from tobacco trade.

Nonetheless, the industry is a dynamic one. Innovation, research, and the development of extensions of existing products and new products is always ongoing as players realize the intensity of the health conscious trend propagating across countries and therefore the need to develop new strategies to preserve the sustainability of their businesses.

On ways forward, the multiple parties already have sustainability strategies in place. For instance, **the Regie** has already launched the first international conference to fight illicit trade last month. The event was a milestone through which the entity emphasized on the collaboration among Lebanon's government entities: the internal security forces, members of the army, customs agents, ministry of economy to join forces. Moreover, the state-run monopoly has also begun pairing up and cooperating with similar tobacco monopolies (in Egypt, Syria, Sudan, Iraq, and Tunis) to jointly call for the protection of farmers, local employment, and to safeguard the income generated to the government from tobacco trading.

The Regie is also expecting modern machinery from Europe in the coming month to jump-start the production of Cedars, given that the current production meets exactly the demand of the brand in the Lebanese market with no stock left for export. However, the plan is to increase production and export the national brand to countries like the UAE, Syria, Iraq & other neighboring countries. New production lines introduced will also accommodate for new production deals with the foreign brands' market players.

In their turn, **Japan Tobacco International and British American Tobacco** are expected to start locally producing some of their brands with the Regie around the second half of 2018. This will allow the pricing of their products to match the market and to be available at the right price attracting the right segment.

Philip Morris International ultimately aims to replace traditional cigarettes with lower risk products as it believes this is where the future lies. In fact, a breakthrough on a regional level was launching the cigarette-substitute, "IQOS", in Palestine in October 2017. This made the country the first Arab nation that introduces any form of new generation products. In Lebanon however, it seems the legal and commercial framework is still not ready to allow the trade and exchange of these products in the country.

For your Queries:

BLOMINVEST BANK s.a.l.

Research Department Bab Idriss,
Weygand Str. POBOX 11-1540
Riad El Soloh Beirut 1107 2080
Lebanon

Rouba Chbeir, Research Analyst
rouba.chbeir@blominvestbank.com

+961 1 991 784

Marwan Mikhael, Head of Research
marwan.mikhael@blominvestbank.com

+961 1 991 782

research@blominvestbank.com

Disclaimer

This report is published for information purposes only. The information herein has been compiled from, or based upon sources we believe to be reliable, but we do not guarantee or accept responsibility for its completeness or accuracy. This document should not be construed as a solicitation to take part in any investment, or as constituting any representation or warranty on our part. The consequences of any action taken on the basis of information contained herein are solely the responsibility of the recipient.