



cutting through complexity™

Project Star 2012 Results

16 April 2013

BASIS OF PREPARATION

- This presentation of key findings ('our report') is given in accordance with our agreed written terms of engagement dated 28 November 2012 detailing the scope of our review of the contraband and counterfeit segments of the tobacco market within the 27 EU Member States. We draw your attention to the limitations in scope set out therein.
- Our work has been ongoing since 1 November 2005. Our fieldwork for 2012 results is now complete.
- In preparing our report, we have used a range of sources. Details of our principal information sources are set out throughout the report and we have satisfied ourselves, so far as possible, that the information presented in our report is consistent with other information which was made available to us in the course of our work in accordance with the terms of our engagement letter. We have not, however, sought to establish the reliability of the sources by reference to other evidence. The scope of our work was different from that for an audit and, consequently, no assurance is expressed.
- Our report makes reference to 'KPMG Analysis'; this indicates only that we have (where specified) undertaken certain analytical activities on the underlying data to arrive at the information presented.
- Our report is provided solely for the benefit of the parties identified in our engagement letter and should not be copied, quoted or referred to in whole or in part without our prior written consent. We will not accept responsibility to any other party to whom our report may be shown or who may acquire a copy of our report.

IMPORTANT NOTICE

- This report on tobacco consumption in the EU ("Report") has been prepared by KPMG LLP in accordance with specific terms of reference ("terms of reference") agreed between Philip Morris International Management S.A. ("PMI") and KPMG LLP.
- KPMG LLP has agreed that the Report may be disclosed to any party on the basis set out herein. KPMG LLP wishes all parties to be aware that KPMG LLP's work for PMI was performed to meet specific terms of reference agreed between PMI and KPMG LLP and that there were particular features determined for the purposes of the engagement.
- The Report should not therefore be regarded as suitable to be used or relied on by any other person or for any other purpose.
- The Report is issued to all parties on the basis that it is for information only. Should any party choose to rely on the Report they do so at their own risk. KPMG LLP will accordingly accept no responsibility or liability in respect of the Report to any party other than PMI.

Project Star 2012

Glossary of terms

Cigarette industry

<i>Bootlegging</i>	Also called small-scale smuggling, bootlegging is the purchase of tobacco products in one country for illegal consumption or resale in another country without paying the applicable taxes or duties
<i>Cigarette</i>	Any factory-made product that contains tobacco and is intended to be burned or heated under ordinary conditions of use
<i>Cigarillos</i>	A short, narrow cigar, which, like cigarettes, is often machine-made and sold in packs
<i>Contraband (CB)</i>	Genuine product that has been bought in a low-tax country and which exceeds legal border limits or acquired without taxes for export purposes to be illegally re-sold (for financial profit) in a higher priced market. There are generally two types of contraband: bootlegging and wholesale smuggling/organised crime
<i>Counterfeit (CF)</i>	Cigarettes that are illegally manufactured and sold by a party other than the original trademark owner. For the purposes of this analysis, data relating to Counterfeit is not included within the definition of Contraband. Illicit flows of Philip Morris brands are split into their separate Counterfeit and Contraband components. Illicit volumes of other manufacturer brands are reported as combined Counterfeit and Contraband flows
<i>Duty Free</i>	Purchases made outside the EU that have no state, local or provincial taxes, federal import duties or any other type of taxation added to the cost of the item purchased. Subject to purchase volume restrictions
<i>Green Leaf</i>	Uncut dried tobacco leaf, which smokers cut themselves. Green leaf was not subject to excise tax in Poland until 2013
<i>MPPC</i>	Most popular price category
<i>NMA / TMA</i>	National Manufactures Association / Tobacco Manufacturers Association
<i>OTP</i>	Other Tobacco Products (RYO/MYO, cigarillos, portions, rolls and cigars; excluding smokeless tobacco and water-pipe tobacco)
<i>RYO/MYO</i>	Roll-your-own/Make-your-own - loose tobacco for the purpose of hand rolling / loose tobacco for the purpose of tubing
<i>Smoking prevalence</i>	The percentage of smokers in the total adult population
<i>Smoking incidence</i>	Daily average consumption by the adult population

Cigarette industry cont.

<i>Tobacco taxes</i>	The sum of all types of taxes levied on tobacco products. There are two basic methods of tobacco taxation: <i>Normal or specific taxes</i> are based on a set amount of tax per unit (e.g. cigarette); these taxes are differentiated according to the type of tobacco. <i>Ad valorem taxes</i> 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
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Glossary of terms

Project Star

<i>CAGR</i>	Compound Annual Growth Rate
<i>C&C</i>	Counterfeit and Contraband
<i>Consumption</i>	Actual total consumption of cigarettes in a market, including legal IMS and illicit products as well as those purchased overseas to be brought back and smoked in market
<i>Consumption gap</i>	The difference between total consumption and legal domestic consumption
<i>Country of origin</i>	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 tax stamp is not shown, on the health warning and packaging characteristics
<i>Domestic Whites</i>	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
<i>EU</i>	European Union
<i>EU Flows Model</i>	The primary methodology for measuring consumption in a market. The model details the volume of inflows and outflows of product for a given market by country of origin (the model only specifies flows to EU countries)
<i>Illicit Whites</i>	Cigarette brands manufactured outside the EU and / or in Free Trade Zones, and distributed in such a way that a large share of their volumes is sold at a very low price and consumed in EU countries, although these brands are in general not registered there and not destined to be sold at legitimate retail in such markets
<i>Inflows/Outflows</i>	Inflows of non-domestic product into a market/outflows of product from a market
<i>LDS</i>	Sales of genuine domestic product through legitimate, domestic channels based on In Market Sales (IMS) data
<i>LDC</i>	Legal Domestic Consumption is defined as legal domestic sales net of outflows
<i>ND</i>	Non-Domestic product – product that was not originally intended for the market in which it is consumed
<i>ND(L)</i>	Non-Domestic (Legal) – product that is brought into the market legally by consumers, such as during a cross-border trip

Project Star cont.

<i>Unspecified</i>	Unspecified market variant refers to cigarette packs which do not bear specific market labelling or Duty Free labelling
<i>OLAF</i>	Office Européen de Lutte Anti-Fraude (European Commission Anti-Fraud Office)
<i>PMI</i>	Philip Morris International

PMI data sources

<i>EPS</i>	Empty Pack Survey
<i>GCTS</i>	Global Consumer Tracking Survey
<i>IMS</i>	In Market Sales (the primary source of legal domestic sales volumes)
<i>Retail Panel</i>	Sales measurement at a retail level

Market research

<i>CAPI</i>	Computer-aided personal interviewing
<i>CATI</i>	Computer-aided telephone interviewing

Measurements

<i>Bn</i>	Billion
<i>Mn</i>	Million

- European Market Overview

- Total Consumption
- C&C Levels
- C&C Flows
- Illicit Whites

- Menthol and Slims

- Country Results

- Appendices

Executive summary

Project Star 2012 headlines

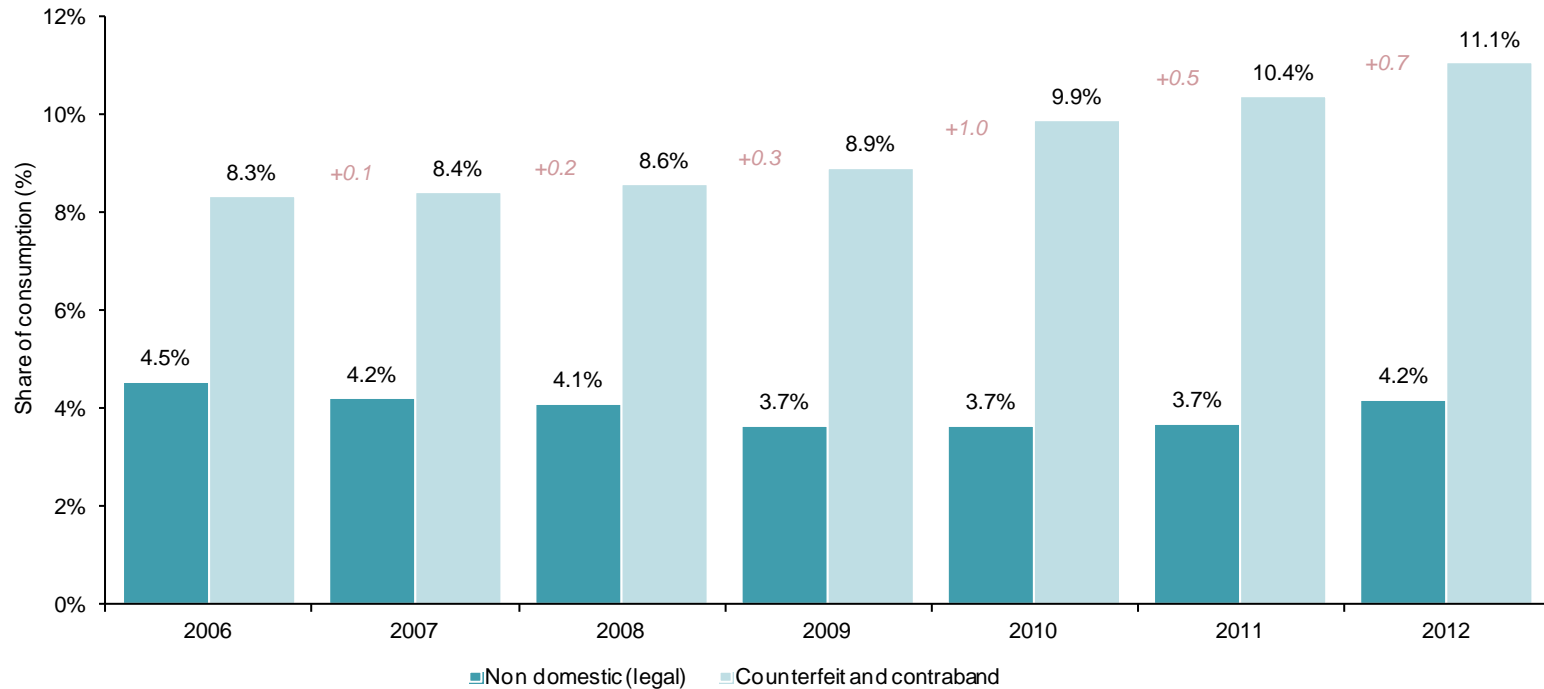
<p>Although manufactured cigarette consumption declined in the EU in 2012, C&C and ND(L) increased</p>	<p>Cigarette consumption declined by 5.7% to 593 billion cigarettes in the EU 27</p> <ul style="list-style-type: none"> Germany and Italy were the largest consumption markets at 103 billion and 86 billion cigarettes respectively The six largest consumption markets in the EU 27 represented over 69% of total consumption <p>C&C and ND(L) both increased in 2012, both in absolute terms and as a proportion of consumption</p> <ul style="list-style-type: none"> C&C increased by 0.4% in 2012 to 65.5 billion cigarettes and grew by 0.7 percentage points as a proportion of total consumption. If these cigarettes had been sold legally in the countries where they were identified, the tax revenue would have been worth approximately €12.5 billion ND(L) increased in 2012 for the first time since the study was initiated, by 6.5% to 24.8 billion cigarettes and grew by 0.5 percentage points as a proportion of total consumption
<p>Prices continued to rise within the EU, whilst Eastern border countries remained significantly cheaper</p>	<p>There continues to be a wide range of prices across the EU 27 countries, although prices generally increased across the majority of markets</p> <ul style="list-style-type: none"> Prices increased in Euro terms in 24 of the 27 Member States in 2012, with increases of over 5% in 13 countries The price of a pack of Marlboro varies widely across the EU, from €2.61 in Bulgaria to €9.54 in the UK; the UK experienced the biggest growth in C&C in 2012 across the EU 27 at 6.4 percentage points Prices in non-EU countries at the Eastern borders remain significantly lower; the price of a pack of premium brand cigarettes in the major source countries of Belarus, Russia and Ukraine are €1.08, €1.71 and €1.31 respectively
<p>OTP sales continued to increase, growing by 6.8% from 2011 to 2012</p>	<p>Legal domestic sales of OTP have increased every year since 2008, offsetting some of the decline in manufactured cigarette consumption</p> <ul style="list-style-type: none"> Legal domestic sales of OTP have grown at an annual growth rate of 11.4% from 2008 to 2012, reaching 145 billion cigarette equivalents, whilst legal domestic sales of manufactured cigarettes declined at an annual growth rate of 4.8% over the same period, to 540 billion sticks Price gaps between OTP and manufactured cigarettes continue to grow and range from €1.05 in Greece to €4.23 in the UK OTP represents the largest share of tobacco consumption in the Benelux markets
<p>Growth in Illicit White brands has predominantly been driven by emerging brands originating in Belarus</p>	<p>Consumption of Illicit White brands increased by 3% to 16 billion sticks in 2012, representing over 24% of total C&C volumes in the EU</p> <ul style="list-style-type: none"> The share of the three major established Illicit White brands of Classic, Jin Ling and American Legend has fallen as a proportion of total Illicit White sales, from 76% in 2009 to 33% in 2012, as the emerging Illicit White brands have gained share The largest source country for emerging Illicit White brands in 2012 was Belarus

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Non-domestic consumption in the EU

C&C has continued to grow since 2006, reaching 11.1% in 2012. ND(L) also increased in 2012, for the first time since 2006

**ND(L) and C&C share of total consumption
2006-2012⁽¹⁾**



ND(L) volume (bn cigarettes)	31.0	30.3	29.0	25.0	23.7	23.3	24.8
C&C volume (bn cigarettes)	56.8	60.6	60.5	61.1	64.2	65.3	65.5

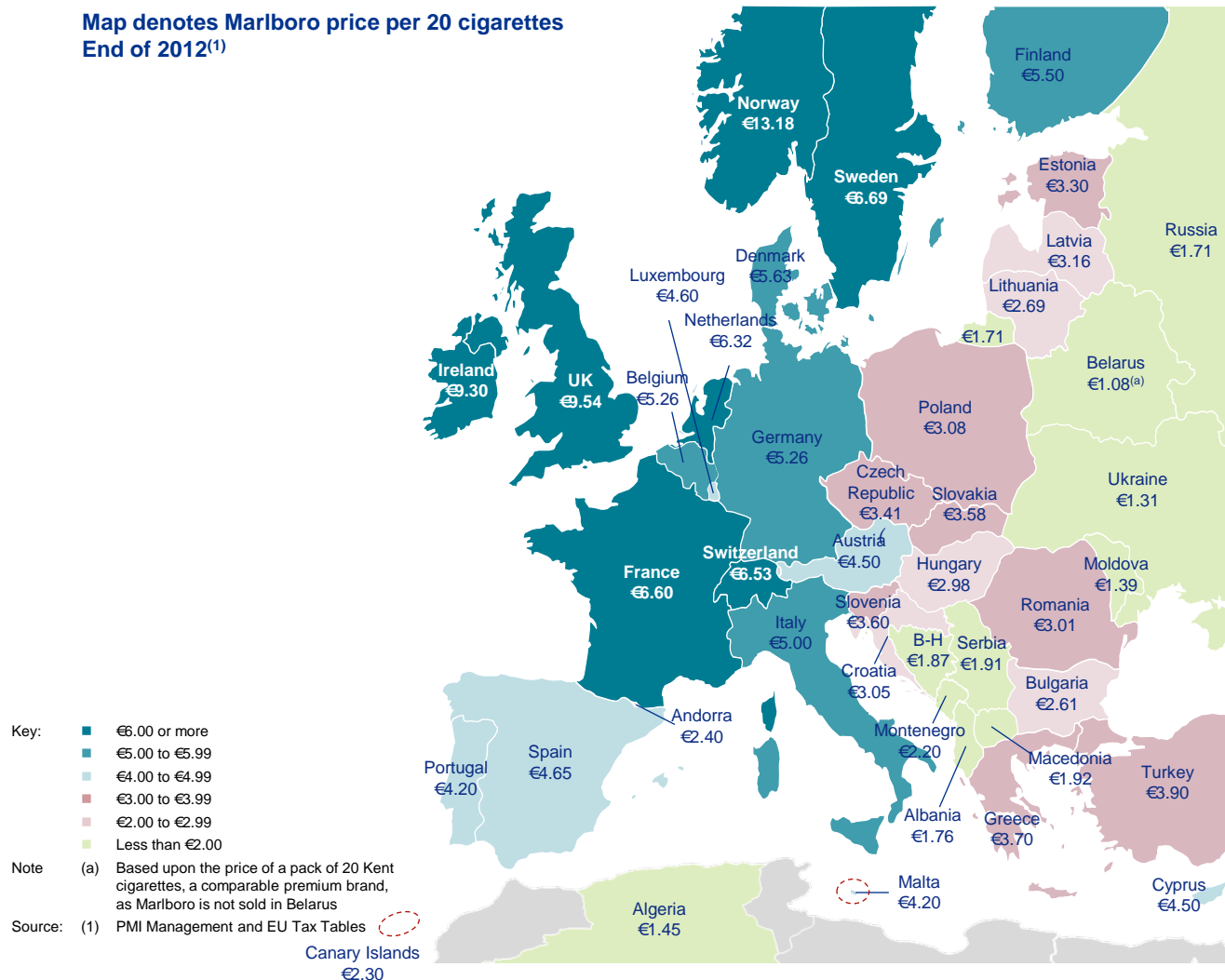
Source: (1) EU Flows Model 2006 – 2012

EU Price differentials

Price gaps have narrowed between EU countries; however, prices in countries on the Eastern border remain up to 8 times lower

Country price comparison - Marlboro pack of 20 (€)			
Country	End of 2011	End of 2012	Price change
Belarus (a)	0.58	1.08	86.4%
Moldova	1.05	1.39	32.4%
Hungary	2.33	2.98	28.0%
Ukraine	1.09	1.31	20.4%
Turkey	3.25	3.90	20.0%
Russia	1.43	1.71	19.8%
Sweden	5.66	6.69	18.2%
Norway	11.21	13.18	17.6%
UK	8.26	9.54	15.4%
Serbia	1.66	1.91	15.4%
Netherlands	5.47	6.32	15.4%
Slovenia	3.20	3.60	12.5%
Finland	5.00	5.50	10.0%
Estonia	3.00	3.30	10.0%
Spain	4.25	4.65	9.4%
Albania	1.62	1.76	8.4%
Poland	2.86	3.08	7.5%
France	6.20	6.60	6.5%
Slovakia	3.37	3.58	6.3%
Greece	3.50	3.70	5.7%
Latvia	2.99	3.16	5.7%
Romania	2.87	3.01	4.9%
Denmark	5.37	5.63	4.8%
Bosnia	1.79	1.87	4.6%
Luxembourg	4.40	4.60	4.5%
Lithuania	2.58	2.69	4.5%
Croatia	2.93	3.05	4.3%
Belgium	5.05	5.26	4.2%
Switzerland	6.34	6.53	3.0%
Czech Republic	3.32	3.41	2.8%
Cyprus	4.40	4.50	2.3%
Ireland	9.10	9.30	2.2%
Italy	4.90	5.00	2.0%
Germany	5.16	5.26	2.0%
Bulgaria	2.56	2.61	2.0%
Montenegro	2.19	2.20	0.5%
Austria	4.50	4.50	0.0%
Malta	4.20	4.20	0.0%
Portugal	4.20	4.20	0.0%
Algeria	1.46	1.45	-0.7%
Macedonia	1.94	1.92	-0.9%
Canary Islands	2.40	2.30	-4.2%

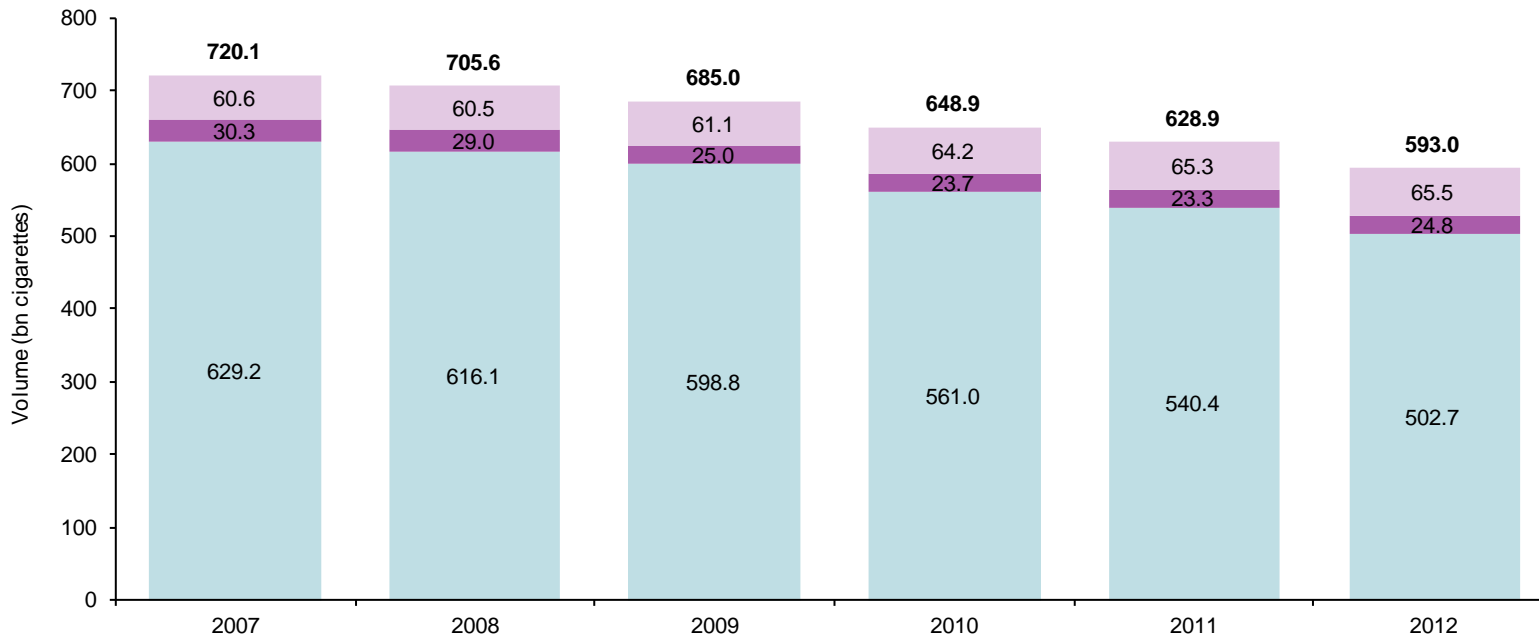
Map denotes Marlboro price per 20 cigarettes End of 2012⁽¹⁾



EU total consumption

Non-domestic volumes increased by 1.9% in 2012, while total cigarette consumption declined by 5.7%

Total cigarette consumption within the EU by type
2007-2012^{(1)(a)}



% Change	2011-2012
C&C	+0.4%
Non-domestic (legal)	+6.5%
Total non-domestic consumption	+1.9%
Legal domestic consumption	-7.0%
Total consumption	-5.7%

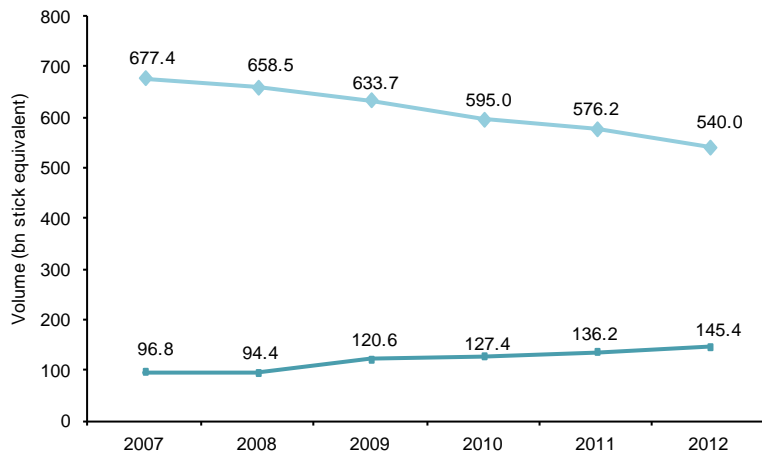
Source: (1) KPMG analysis based on EPS, LDS and ND(L) research

Note: (a) Total cigarette consumption within the EU by type is shown from 2007, as Romania and Bulgaria were not included in the 2006 study.

Total tobacco consumption in the EU

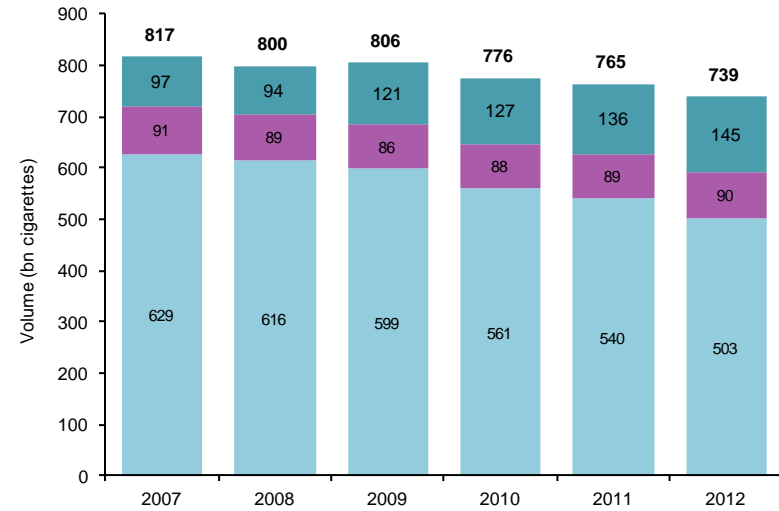
The decline in legal domestic cigarette sales by 6.3% was partly offset by an increase in non-domestic flows and OTP sales

**Legal domestic sales of manufactured cigarettes and OTP
2007-2012^{(1)(a)(b)}**



% Change	2011-2012
◆ Cigarettes (Legal Domestic sales)	-6.3%
■ OTP (Legal Domestic sales)	6.8%

**European Union total cigarette consumption and OTP LDS (bn sticks)
2006-2012^{(1)(a)(b)}**



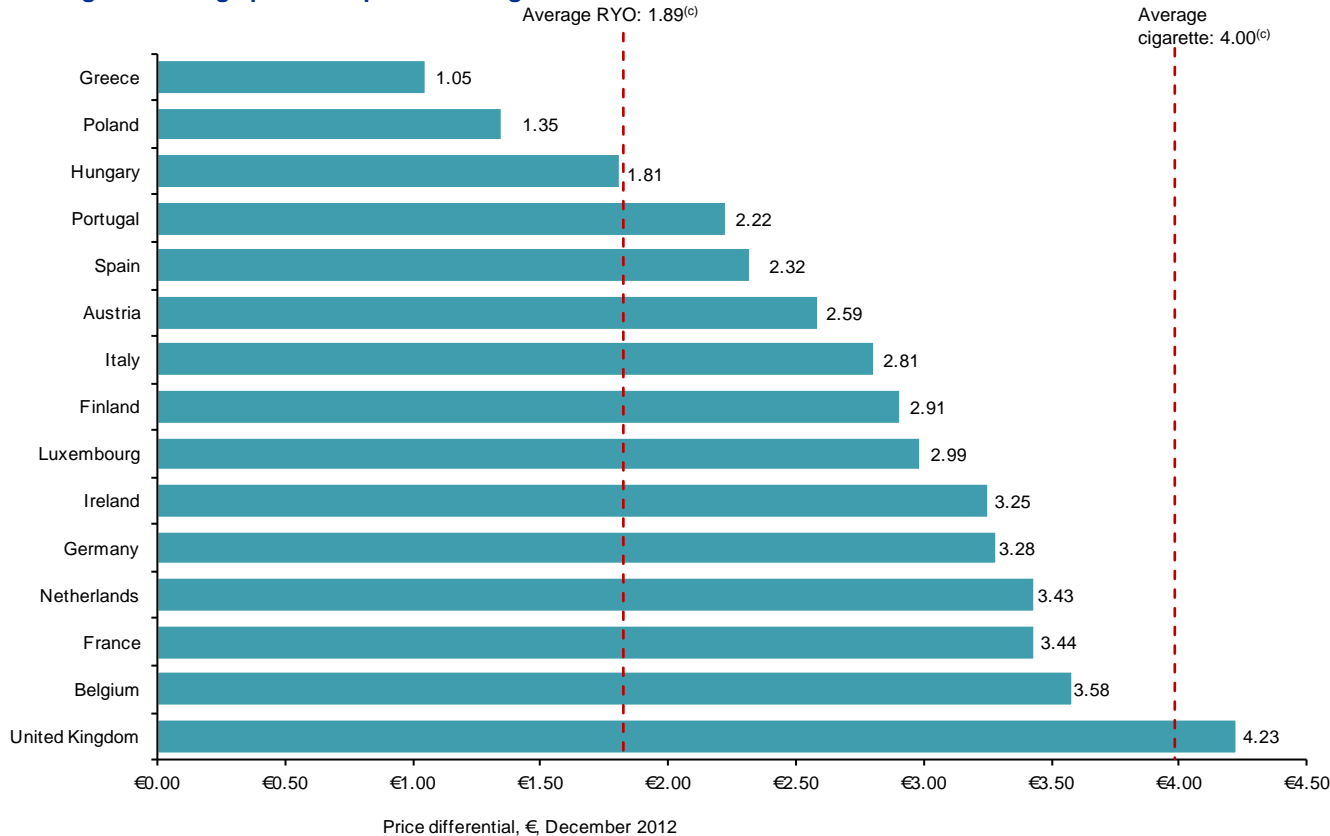
% Change	2011-2012
■ OTP (legal domestic sales)	6.8%
■ Non-domestic consumption	2.0%
■ Legal domestic consumption	-7.0%
Total consumption (including OTP)	-3.4%

Source: (1) KPMG analysis based on EPS, LDS and ND(L) research

Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.
(b) Significant volumes of green leaf are understood to be consumed in Poland, Czech Republic, Hungary and Bulgaria which are not captured in the LDS data above.

In most European markets, the price differential between OTP and manufactured cigarettes is significant

Price differential between weighted average price of RYO 20 cigarette equivalents and weighted average price of a pack of 20 cigarettes^{(1)(2)(3)(a)(b)}



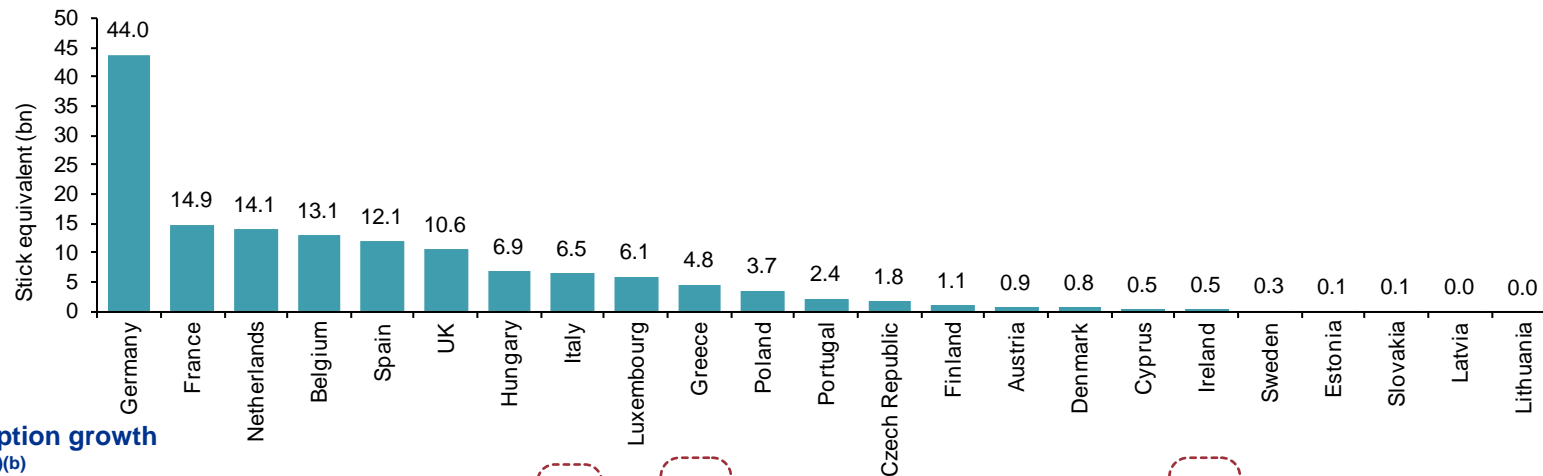
Source: (1) European Commission "Excise Duty tables", January 2013
 (2) Italy, Ireland and Greece – PMI estimates
 (3) UK – KPMG estimate based on Euromonitor sales data

Note: (a) Total tobacco market defined as total legal domestic sales of manufactured cigarettes and RYO cigarette equivalents (0.65 grams cigarette equivalent rate), with the price gap being defined as the cost between the weighted average price of pack of 20 and 20 roll-your-own cigarettes. For Ireland no weighted average price of RYO was available so the cheapest price of 20 cigarettes and cheapest RYO cigarette equivalent was used.
 (b) Weighted average of European Commission excise duty tables.
 (c) Simple average across each country

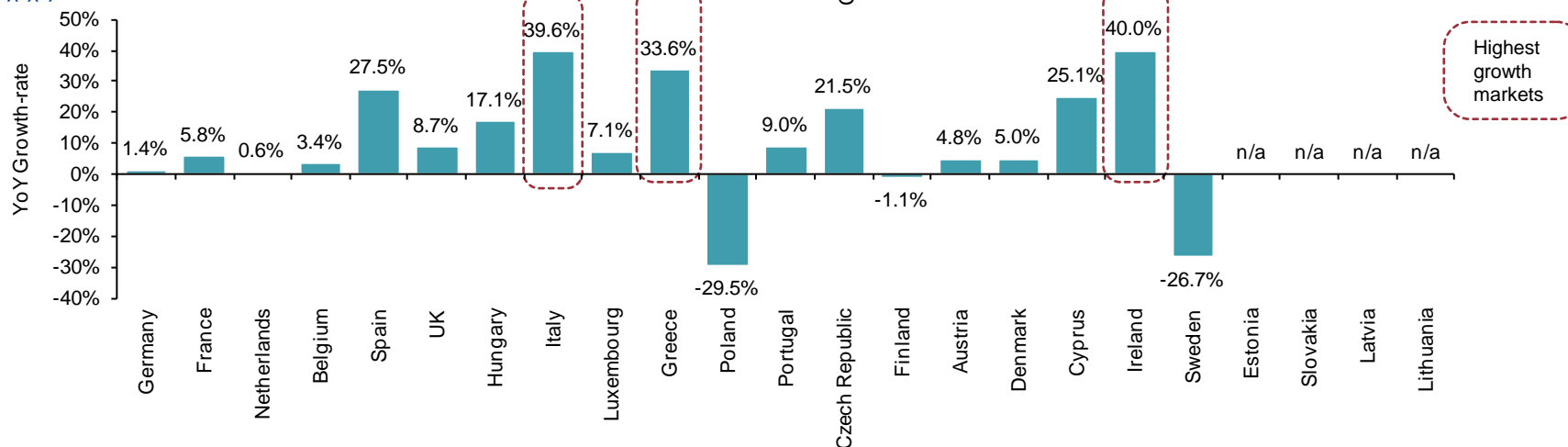
OTP consumption and growth in the EU

Countries with the largest growth vs 2011 were Ireland, Italy and Greece

OTP consumption, cigarette equivalent volumes
2012^{(1)(a)(b)}



OTP consumption growth
2011-2012^{(1)(a)(b)}



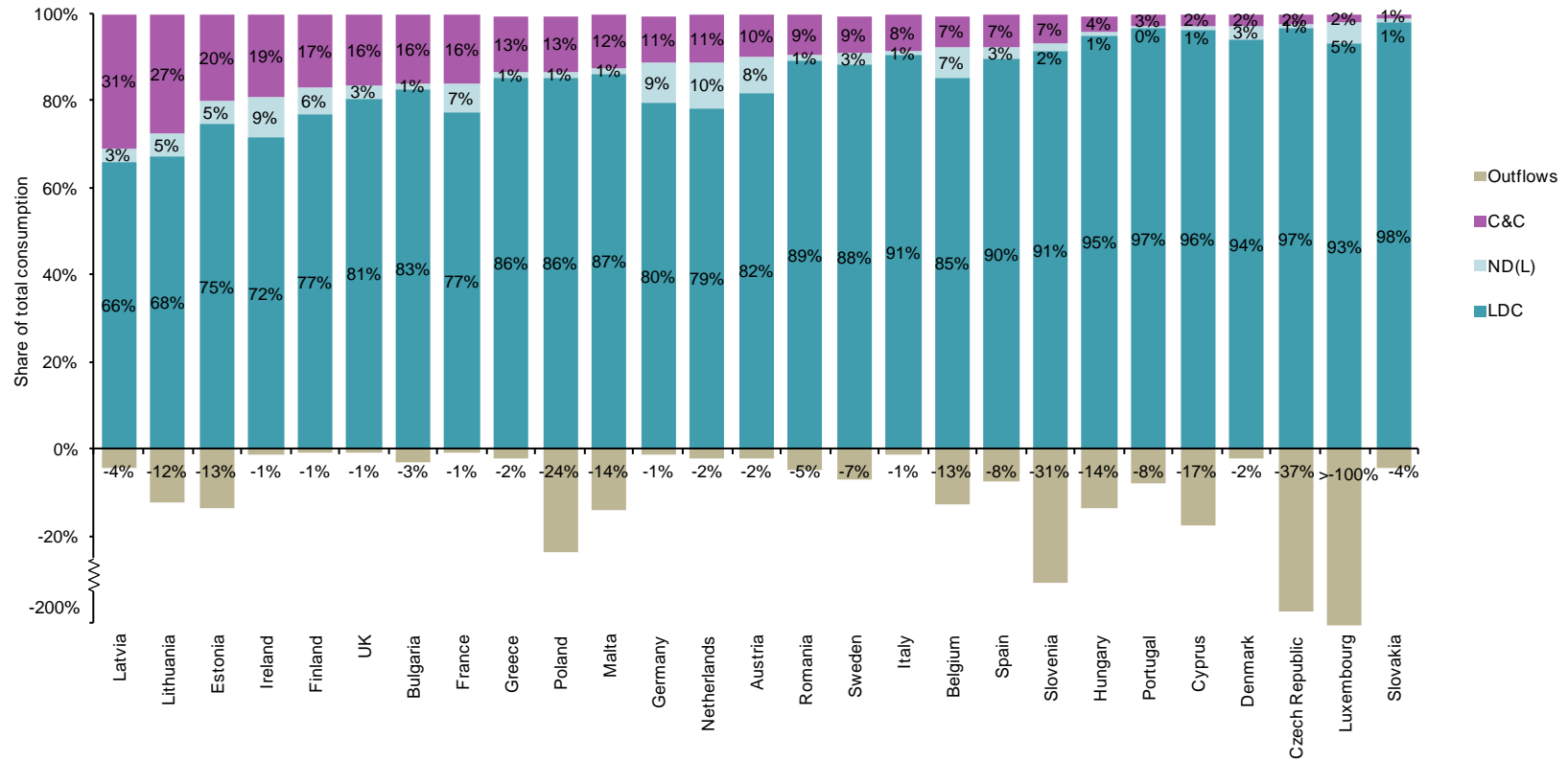
Source: (1) KPMG analysis based on EPS, LDS and ND(L) research. Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports. (b) Significant volumes of green leaf are understood to be consumed in Poland, Czech Republic, Hungary and Bulgaria which are not captured in the LDS data above.

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EU total consumption

The Baltic countries had the highest non-domestic and C&C incidence as a proportion of total cigarette consumption

Total cigarette consumption by type 2012⁽¹⁾

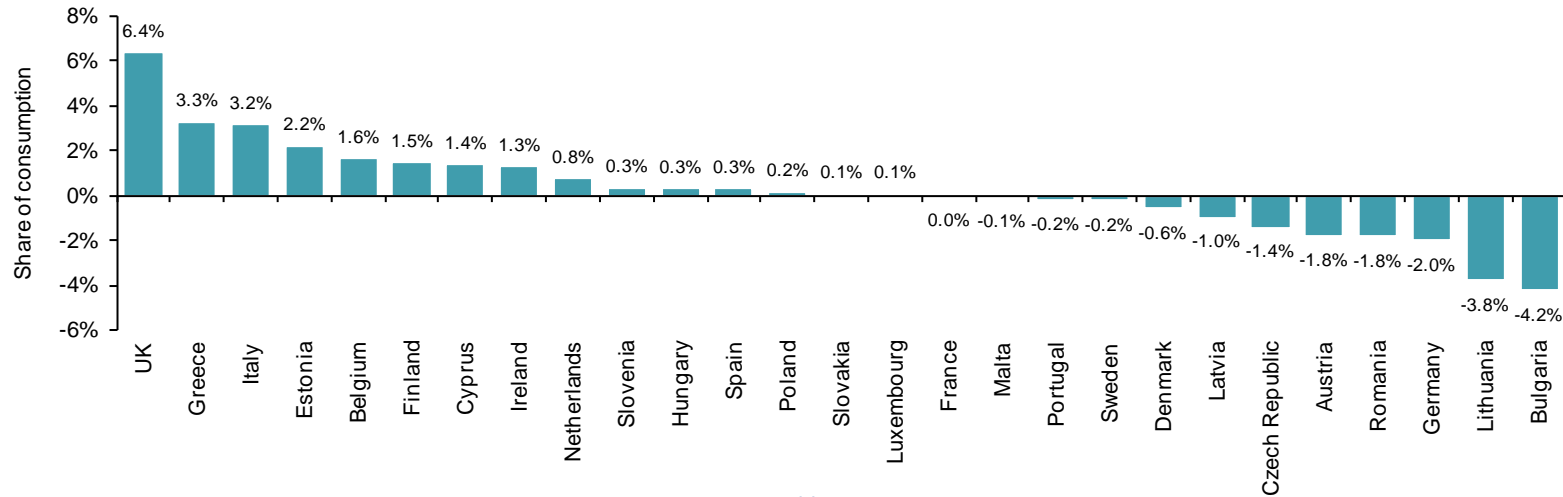


Source: (1) KPMG analysis based on EPS, LDS and ND(L) research

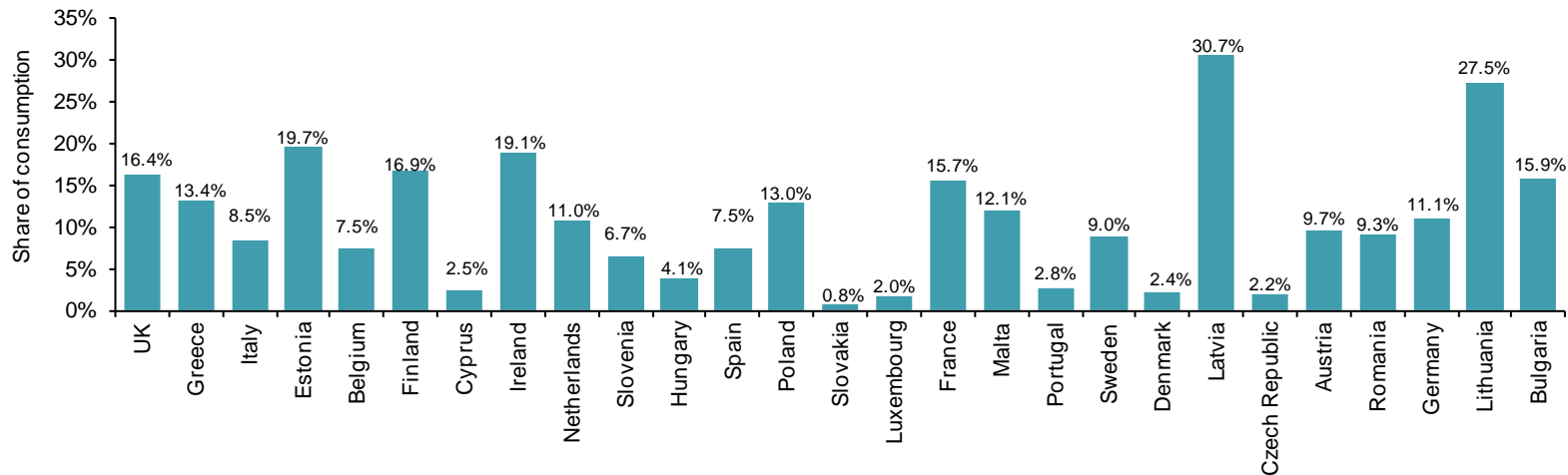
Non-domestic C&C consumption in the EU

The UK experienced the highest increase of C&C at 6.4 percentage points, followed by Greece and Italy at +3.3 and +3.2 points respectively

Percentage point change in counterfeit and contraband consumption incidence by country, 2011 vs 2012⁽¹⁾



Counterfeit and Contraband consumption incidence by country, 2012⁽¹⁾



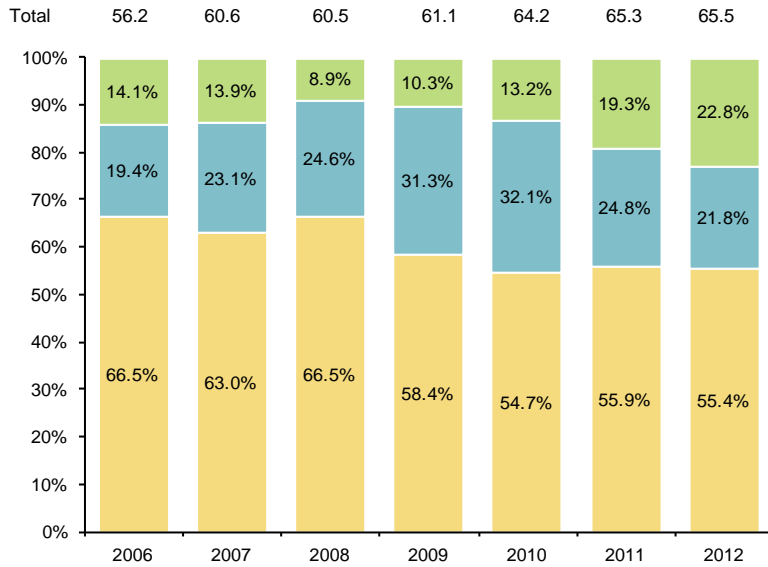
Source: (1) KPMG analysis based on EPS, LDS and ND(L) research

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C&C inflows by destination regions

The share of EU illicit cigarette consumption accounted for by the Southern European countries continued to rise in 2012

Share of total EU C&C inflows by destination regions
2006-2012⁽¹⁾



Key:

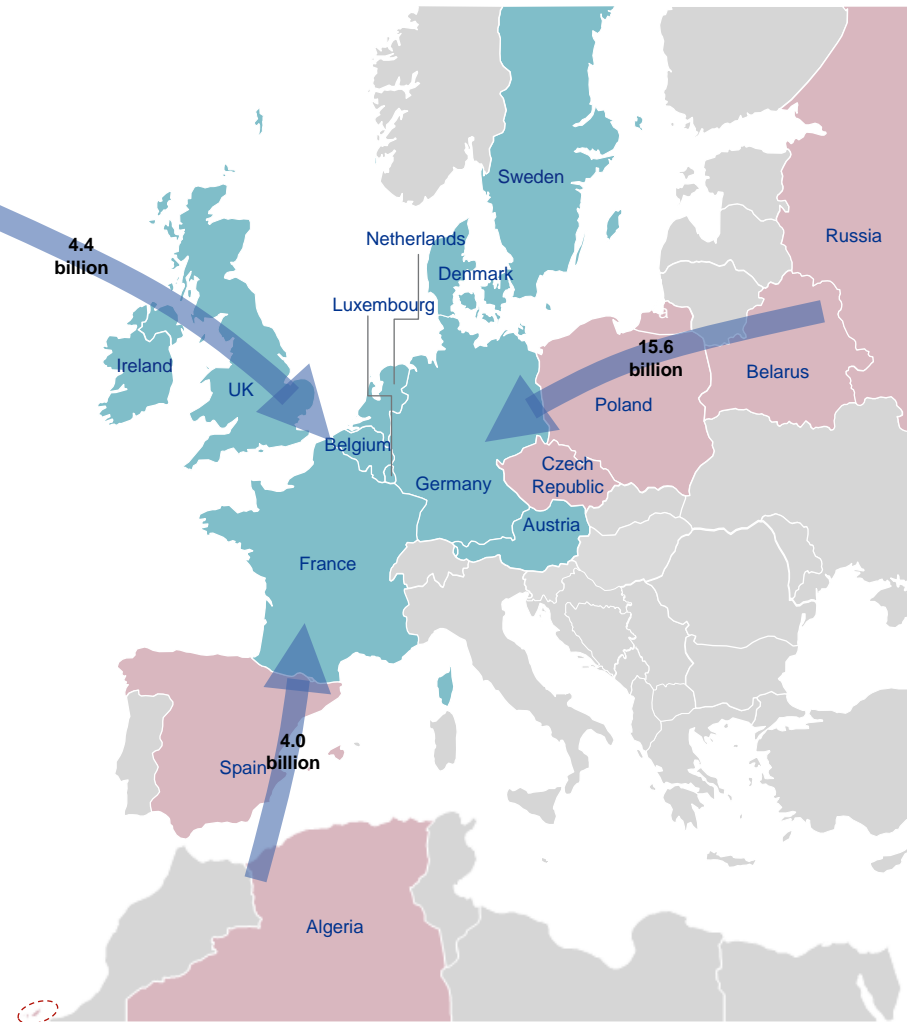
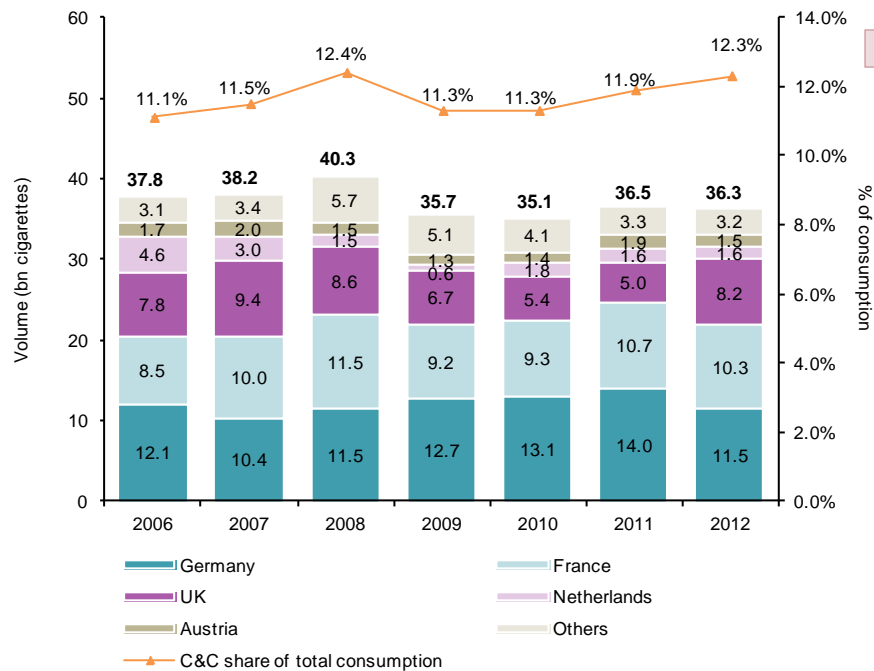
- Southern EU countries – Cyprus, Greece, Italy, Malta, Portugal and Spain
- Eastern border EU countries – Bulgaria, Estonia, Finland, Hungary, Latvia, Lithuania, Poland, Romania and Slovakia
- Western and Central EU countries – Austria, Belgium, Czech Republic, Denmark, France, Germany, Ireland, Luxembourg, Netherlands, Slovenia, Sweden and UK

Source: (1) KPMG analysis based on EPS, LDS and ND(L) research

C&C inflows by destination regions: Western EU countries

C&C flows to Western EU countries remained stable in volume; however, there was an increase to the UK from Eastern Europe and Spain

C&C inflows to Western EU countries 2006-2012⁽¹⁾



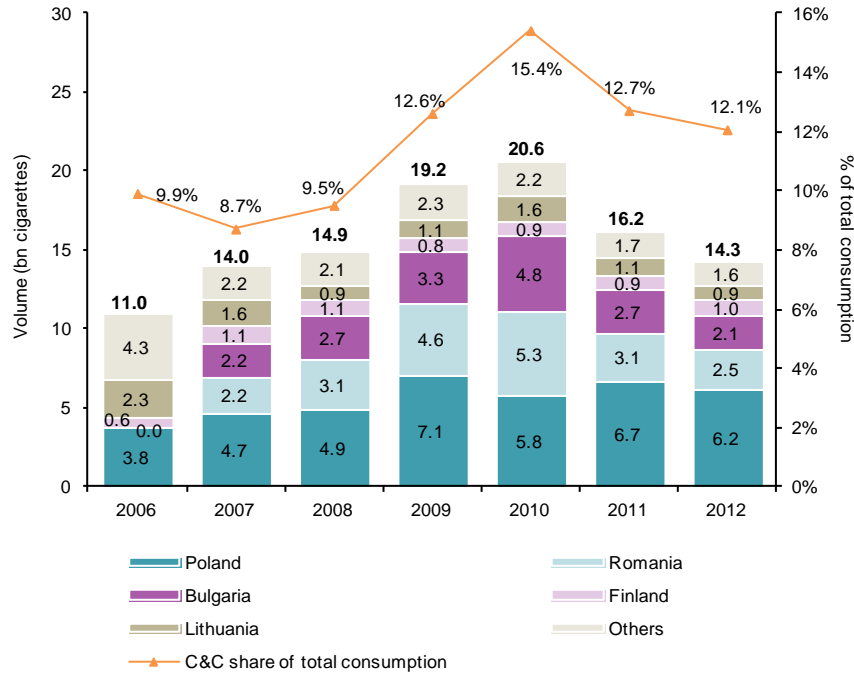
Key:
■ Western EU countries
■ Source countries with inflows of >0.5 billion cigarettes in 2012 – total flows from highlighted source countries to Western Europe

Source: (1) KPMG analysis based on EPS, LDS and ND(L) research

C&C inflows by destination regions: Eastern EU countries

Eastern European countries' C&C inflows declined, mainly as a result of lower flows into Bulgaria and Romania

C&C inflows to Eastern EU countries 2006-2012⁽¹⁾



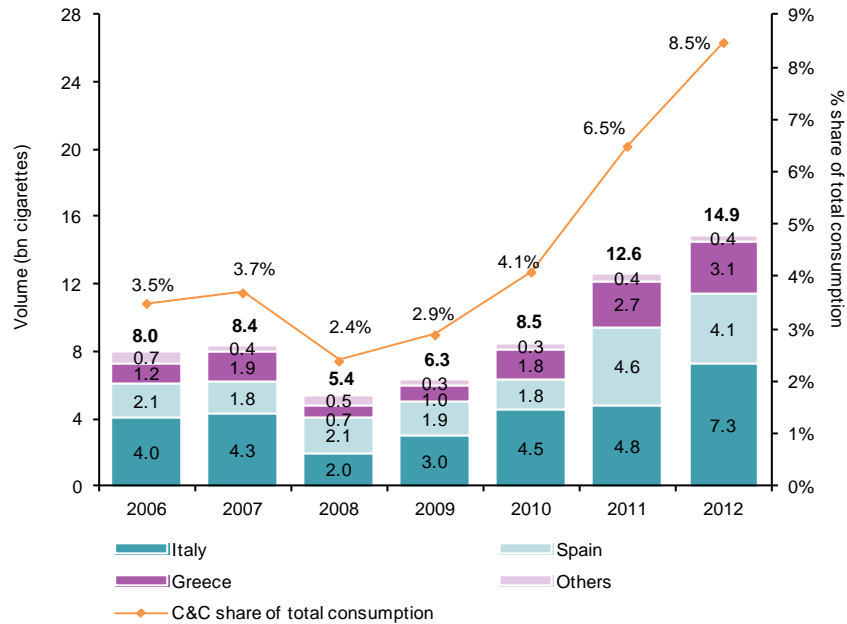
Key: ■ Eastern EU countries
■ Source countries with inflows of >0.5 billion cigarettes in 2012 - total flows from highlighted source countries to Eastern Europe

Source: (1) KPMG analysis based on EPS, LDS and ND(L) research

C&C inflows by destination regions: Southern EU countries

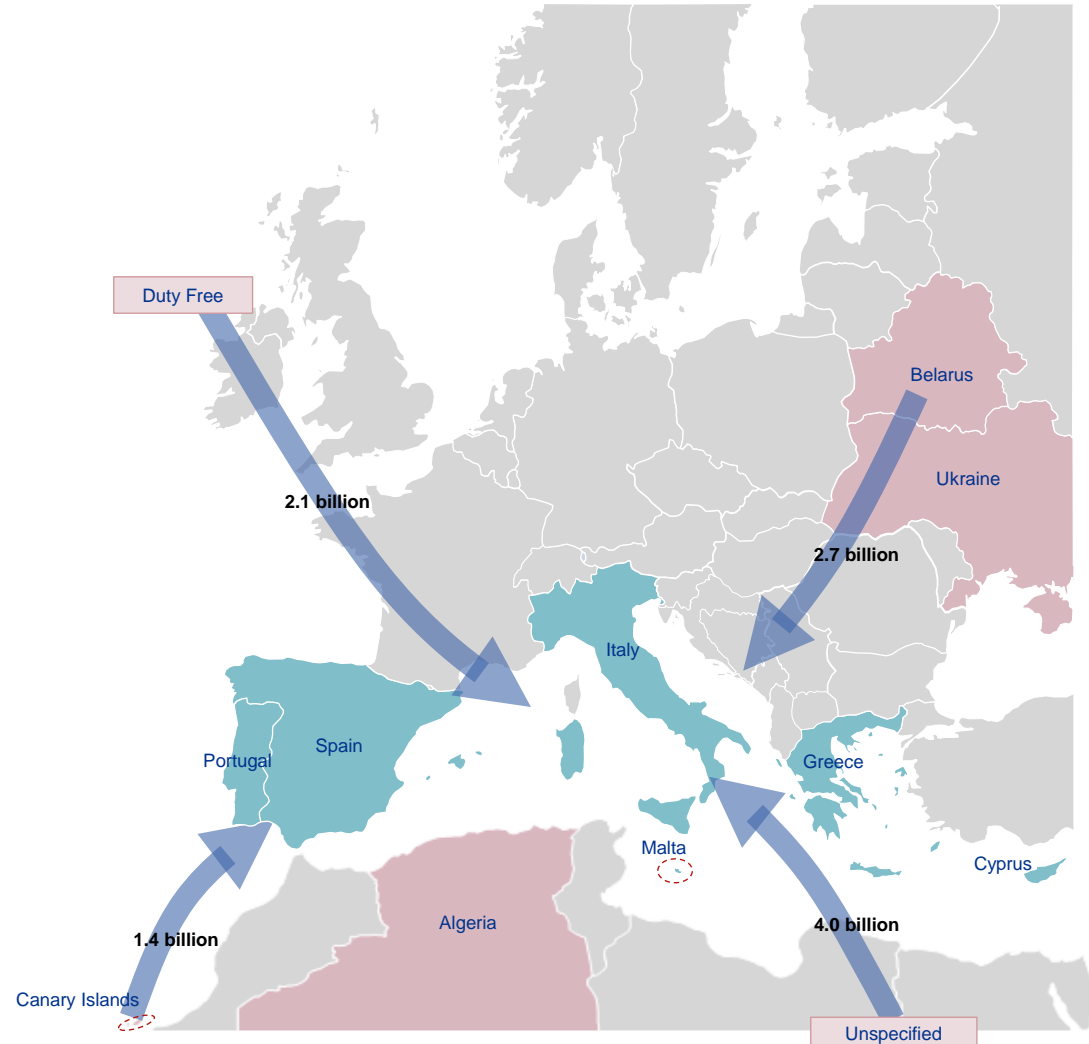
Southern European countries' C&C inflows continued to increase, mainly as a result of a 50% increase in Italy between 2011 and 2012

C&C inflows to Southern EU countries 2006-2012⁽¹⁾



Key:
■ Southern EU countries
■ Source countries with inflows of > 0.5 billion cigarettes in 2012 - total flows from highlighted source countries to Southern Europe

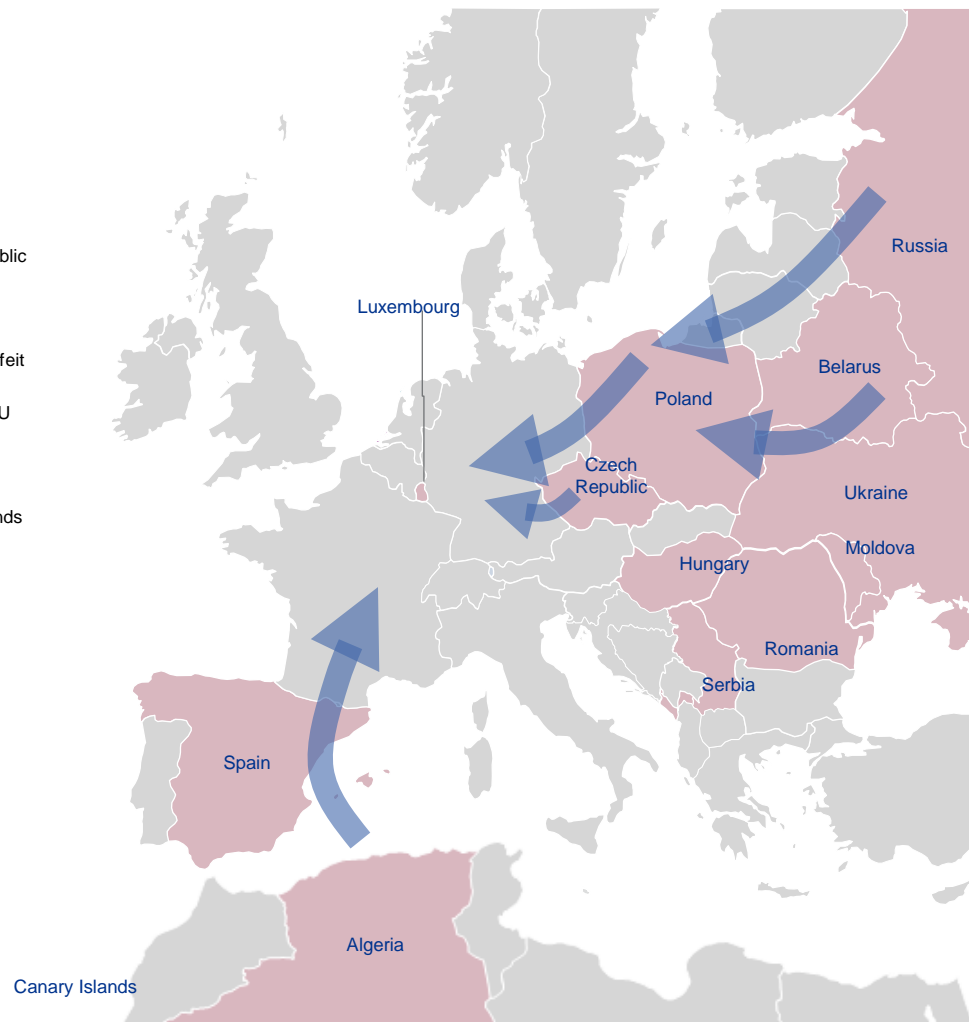
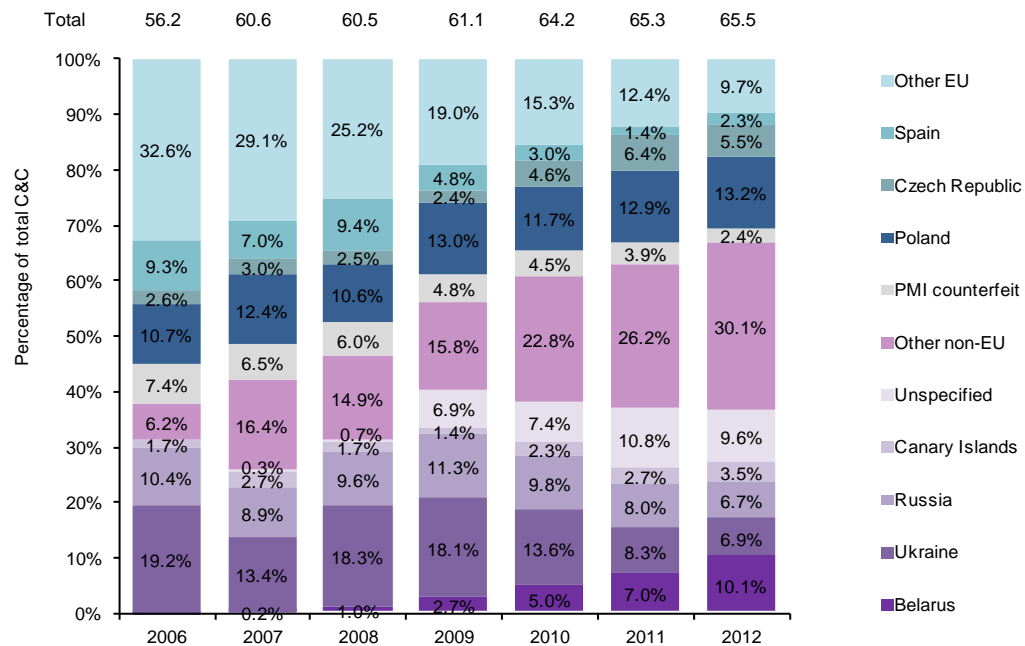
Source: (1) KPMG analysis based on EPS, LDS and ND(L) research



C&C source countries

The largest source countries of C&C are from outside the EU, predominantly Belarus, which grew by 3.1 percentage points vs 2011. Within the EU Poland, the Czech Republic and Spain continue to be major source countries

Main non-domestic outflow countries and outflows 2012⁽¹⁾



Key: ■ Source countries with outflows of > 0.5 billion cigarettes in 2012

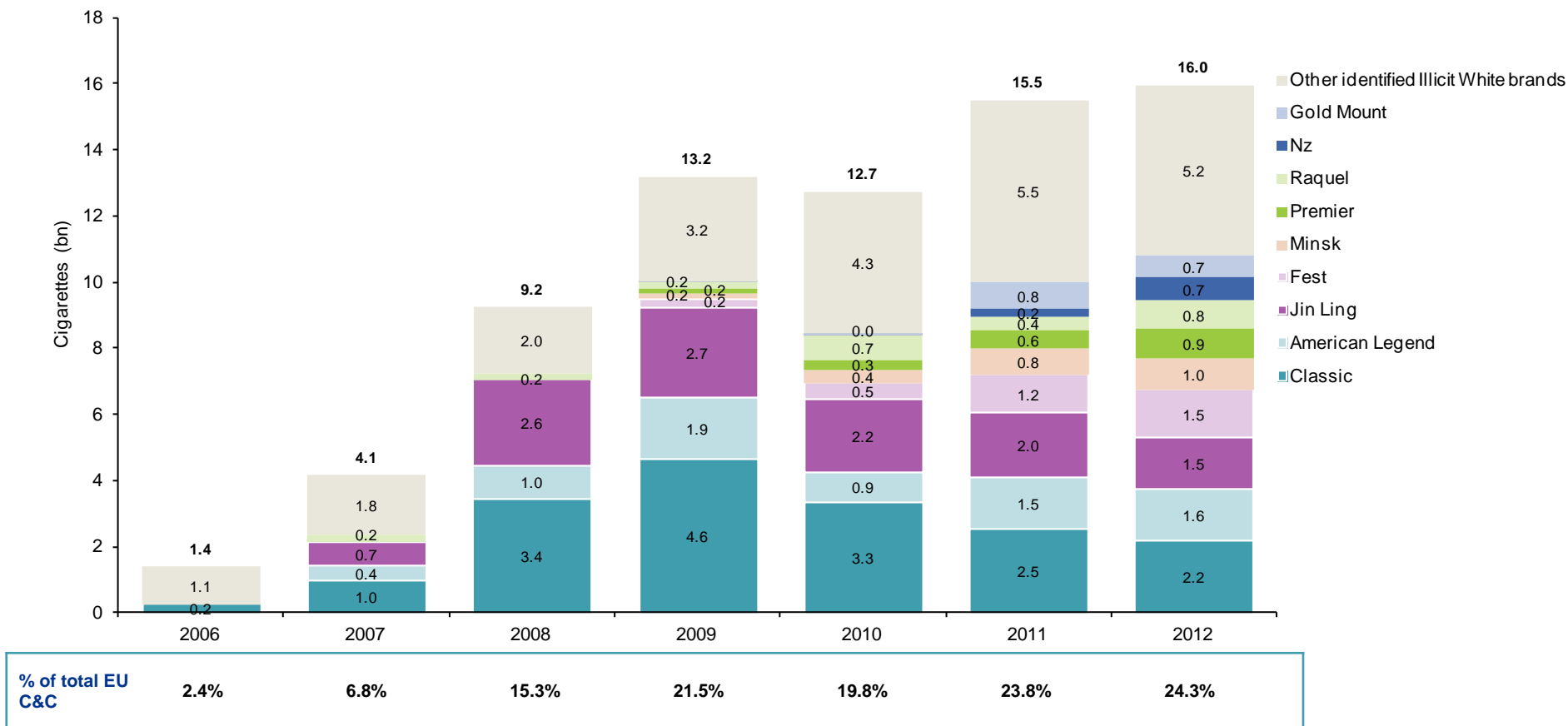
Source: (1) KPMG analysis based on EPS, LDS and ND(L) research

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Illicit Whites

Consumption of Illicit Whites increased by 3% in 2012, representing over 24% of total C&C volumes in the EU

Consumption of Illicit White brands
2006-2012^{(1)(a)}

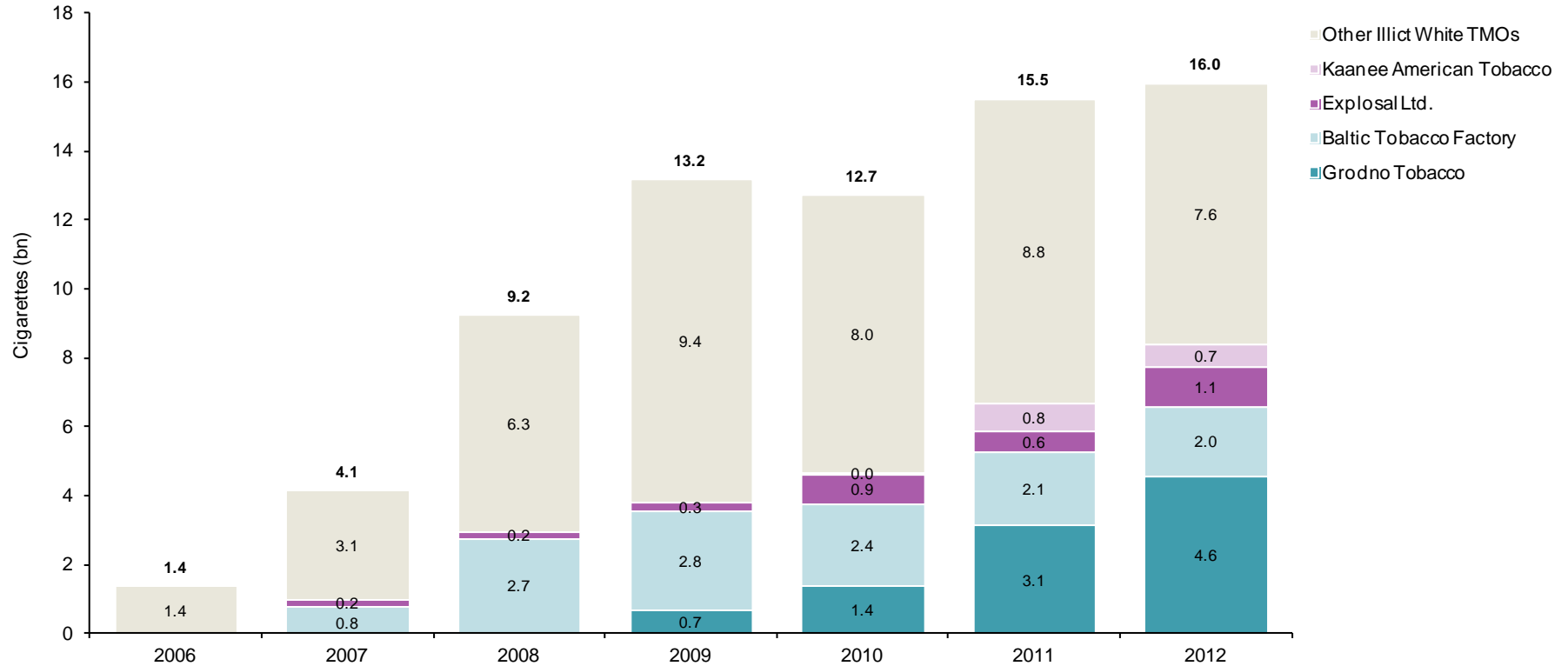


Note: (a) The analysis covers Illicit Whites brands as defined by PMI with at least 10 packs found in 2012.

Source: (1) KPMG analysis based on Empty Pack Surveys, legal domestic sales and non-domestic (legal) research.

Grodno tobacco is the fastest growing Illicit White manufacturer, with volumes increasing by 47% in 2012

Consumption of Illicit White brands by manufacturer
2006-2012^{(1)(a)(b)(c)}

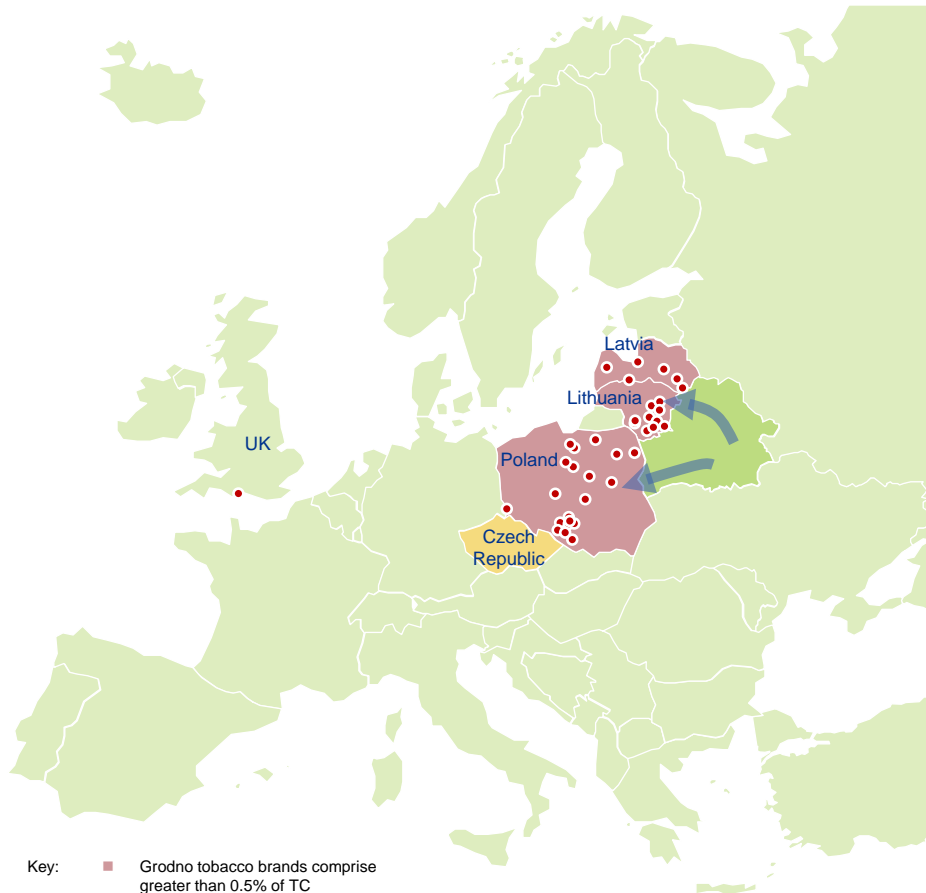


Note: (a) The analysis covers Illicit Whites brands as defined by PMI with at least 10 packs found in 2012.
 (b) Consumption represents the total consumption of each of the company's main brands, which may include packs labelled as Unspecified or immaterial volumes from packs labelled with another TMO.
 (c) Illicit White Manufacturers represent manufacturers of Illicit White brands as indicated by PMI.
 Source: (1) KPMG analysis based on Empty Pack Surveys, legal domestic sales and non-domestic (legal) research.

Illicit Whites

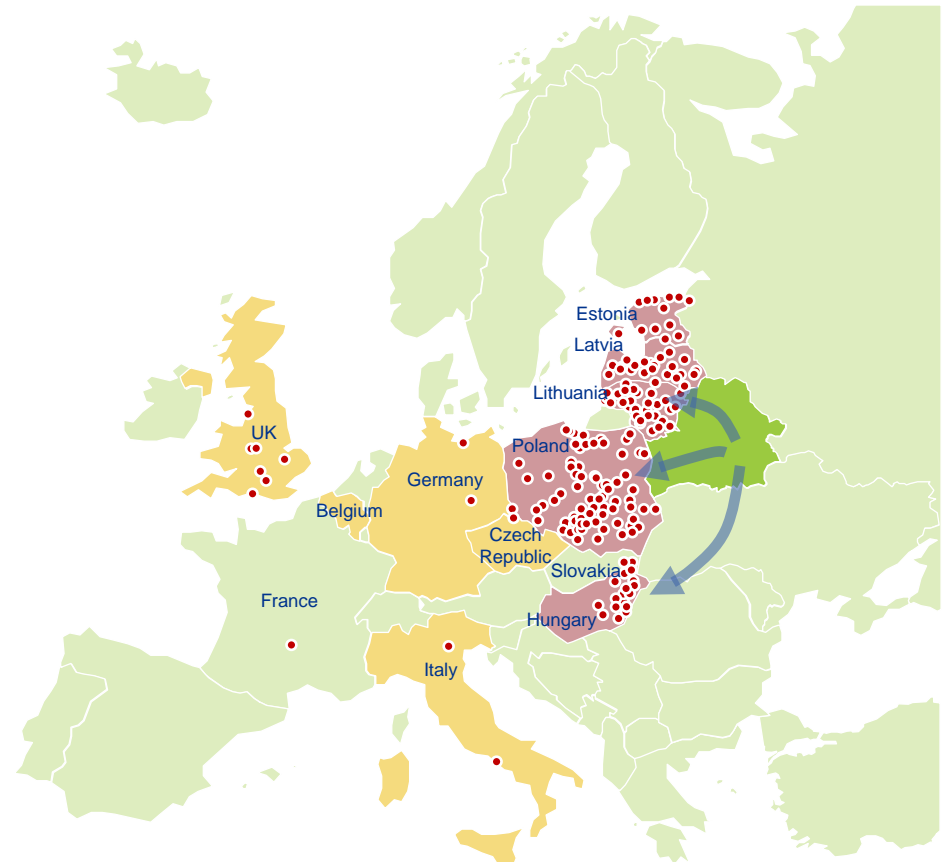
While Grodno Tobacco brands were present in 4 countries in 2009, they have become prevalent in 10 countries in 2012

Consumption of Grodno Tobacco brands 2009^{(1)(a)(b)}



- Key:
- Grodno tobacco brands comprise greater than 0.5% of TC
 - Grodno tobacco brands comprise between 0.1% and 0.5% of TC

Consumption of Grodno Tobacco brands 2012^{(1)(a)(b)}



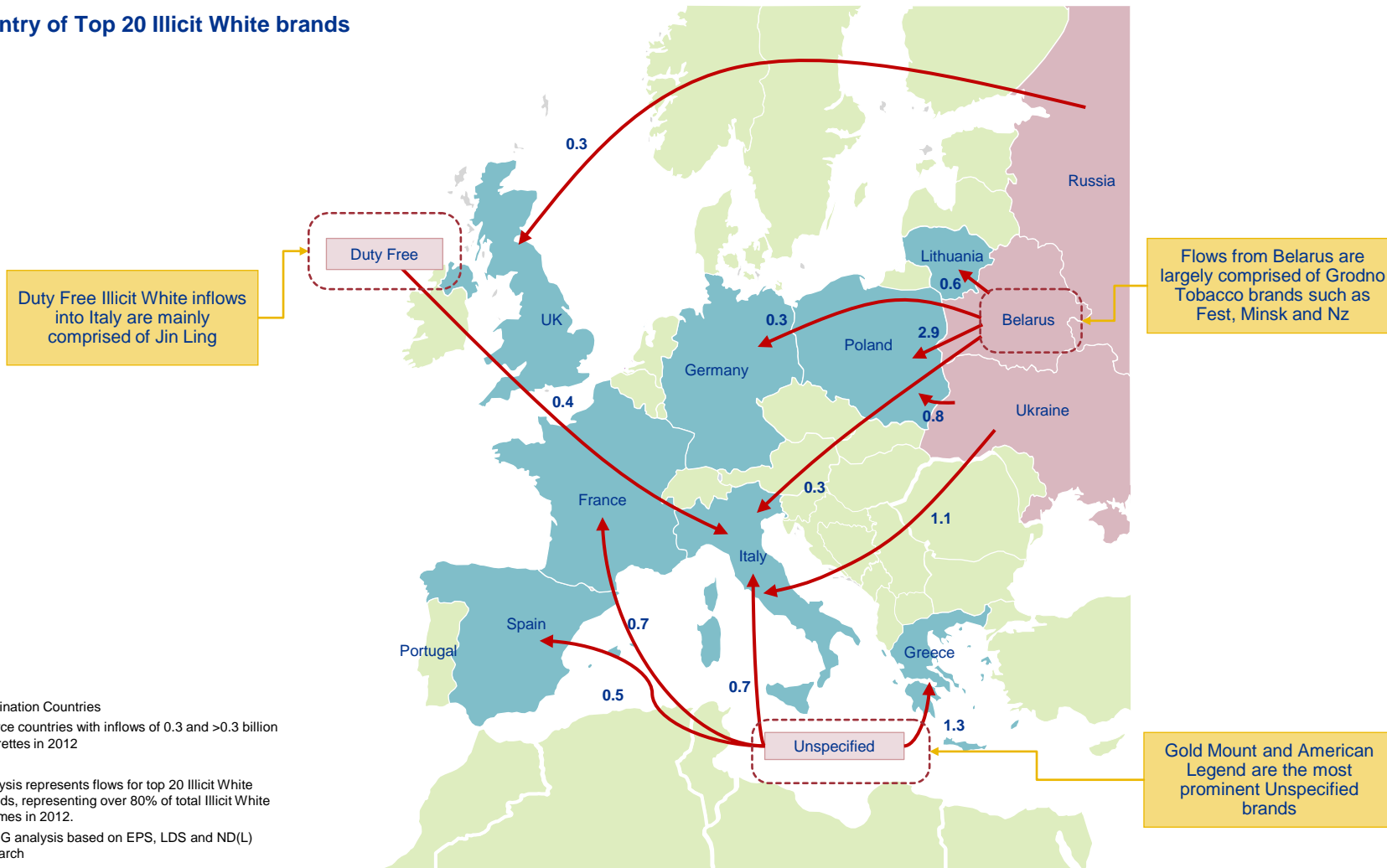
- Note:
- (a) The analysis covers Illicit Whites brands with at least 10 packs found in 2012.
 - (b) Cities marked in these maps represent locations where Grodno Tobacco brands represented at least 1% of packs collected in that city.

Source: (1) KPMG analysis based on Empty Pack Surveys, legal domestic sales and non-domestic (legal) research.

Illicit Whites

Belarus has become the largest source of Illicit White brands, particularly in Eastern Europe; Unspecified brands remain significant in Southern Europe

Source country of Top 20 Illicit White brands 2012^{(1)(a)}



Key:
■ Destination Countries
■ Source countries with inflows of 0.3 and >0.3 billion cigarettes in 2012

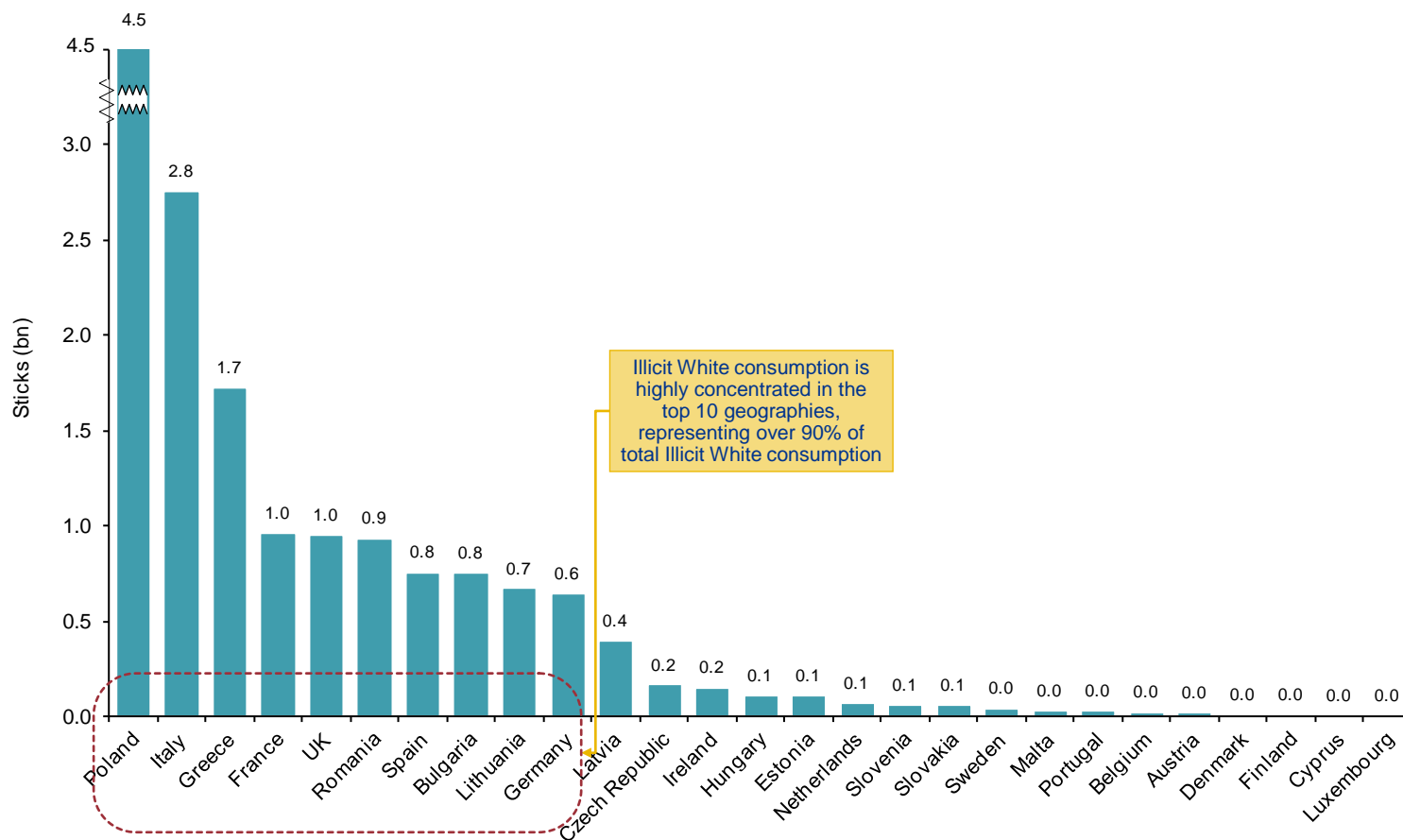
Note: (a) Analysis represents flows for top 20 Illicit White Brands, representing over 80% of total Illicit White volumes in 2012.

Source: (1) KPMG analysis based on EPS, LDS and ND(L) research

Illicit Whites

Poland has the largest Illicit White consumption levels in Europe at 4.5 bn cigarettes; Italy and Greece have the next highest levels at 2.8 bn cigarettes and 1.7 bn cigarettes respectively

Illicit White consumption by country
2012^{(1)(a)}



Note: (a) The analysis covers Illicit Whites brands as defined by PMI with at least 10 packs found in 2012.

Source: (1) KPMG analysis based on Empty Pack Surveys, legal domestic sales and non-domestic (legal) research.

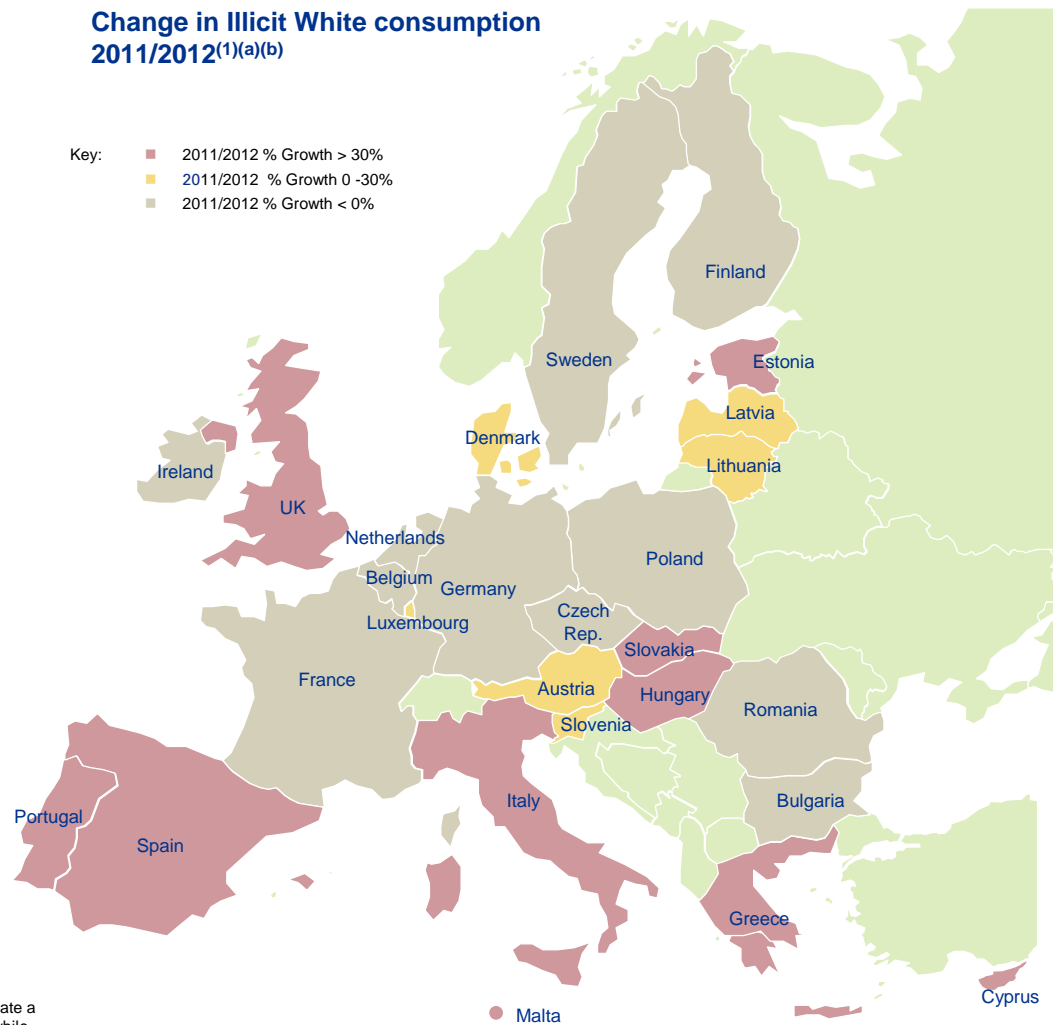
Italy and Greece have seen among the fastest growth rates of Illicit White volumes in 2012

Volume and growth of illicit white brands by country			
Country	2011	2012	Change 11/12 %
Hungary	0.01	0.11	>100%
Slovakia	0.01	0.07	>100%
Italy	1.58	2.76	75%
Malta	0.02	0.03	61%
Greece	1.09	1.73	59%
Spain	0.49	0.76	54%
UK	0.64	0.95	49%
Estonia	0.07	0.11	48%
Slovenia	0.05	0.06	24%
Latvia	0.35	0.40	13%
Austria	0.02	0.02	8%
Finland	0.01	0.01	5%
Lithuania	0.66	0.67	2%
Portugal	0.00	0.03	-
Cyprus	0.00	0.01	-
Luxembourg	0.00	0.00	-
Poland	4.62	4.48	(3)%
Belgium	0.02	0.02	(6)%
Ireland	0.17	0.15	(9)%
Denmark	0.01	0.01	(12)%
Netherlands	0.08	0.07	(14)%
Sweden	0.06	0.04	(21)%
Bulgaria	1.02	0.76	(26)%
Romania	1.29	0.93	(27)%
France	1.58	0.96	(39)%
Czech Republic	0.30	0.17	(44)%
Germany	1.36	0.64	(53)%
Total	15.50	15.95	3%

Note: (a) The analysis covers Illicit Whites brands as defined by PMI with at least 10 packs found in 2012.
 (b) Illicit White volumes in Portugal, Cyprus and Luxembourg were zero in 2011, therefore it is not possible to calculate a percentage change year on year; countries where volumes have increased from zero have been coloured red, while countries which remained at zero have been coloured yellow.

Source: (1) KPMG analysis based on Empty Pack Surveys, legal domestic sales and non-domestic (legal) research.

Change in Illicit White consumption 2011/2012^{(1)(a)(b)}

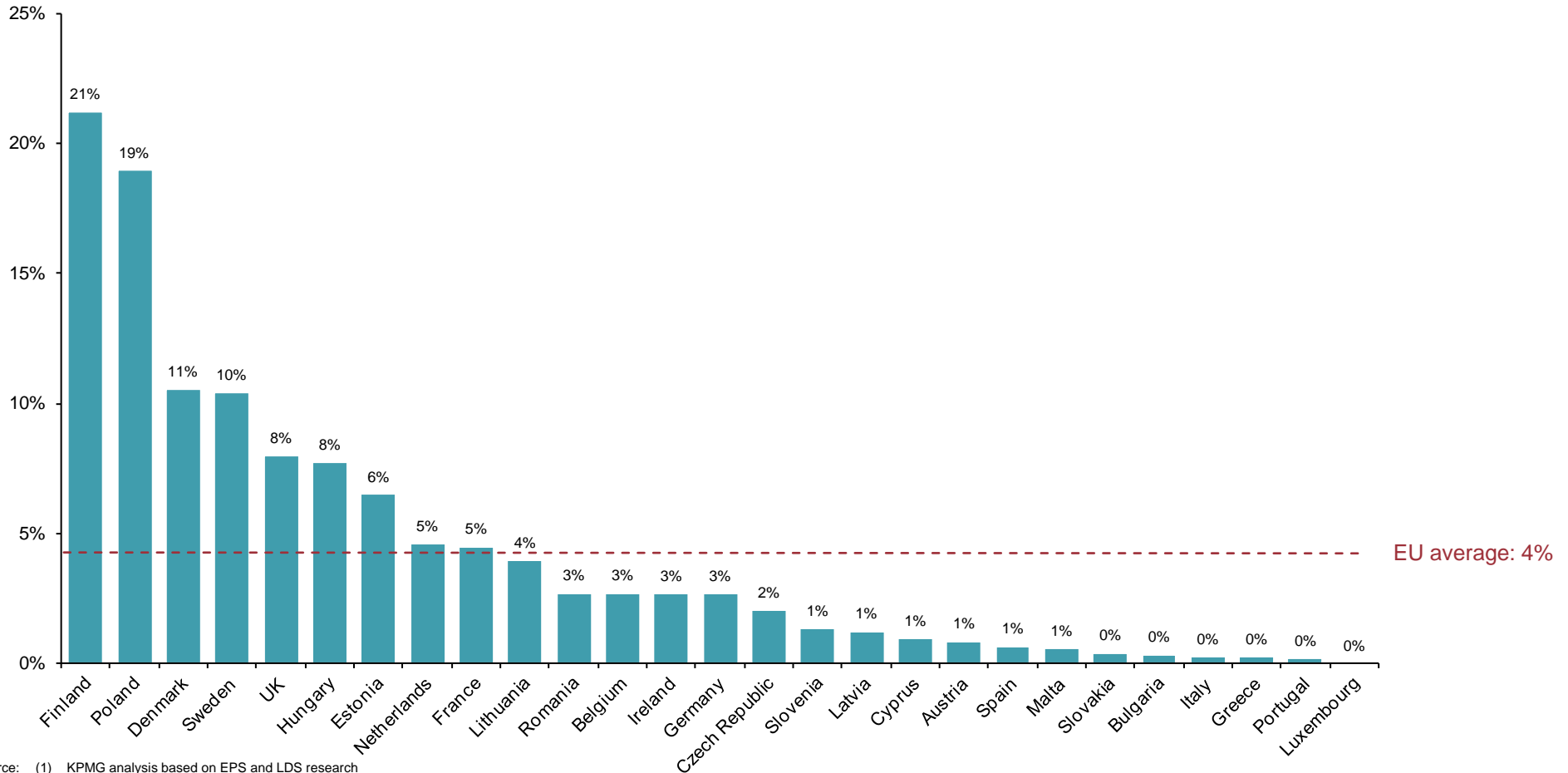


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Menthol analysis

Finland has the highest consumption of menthol cigarettes as a proportion of total consumption at 21%, versus an EU average of 4%

Menthol cigarettes as a proportion of total cigarette consumption
2012^{(1)(a)}



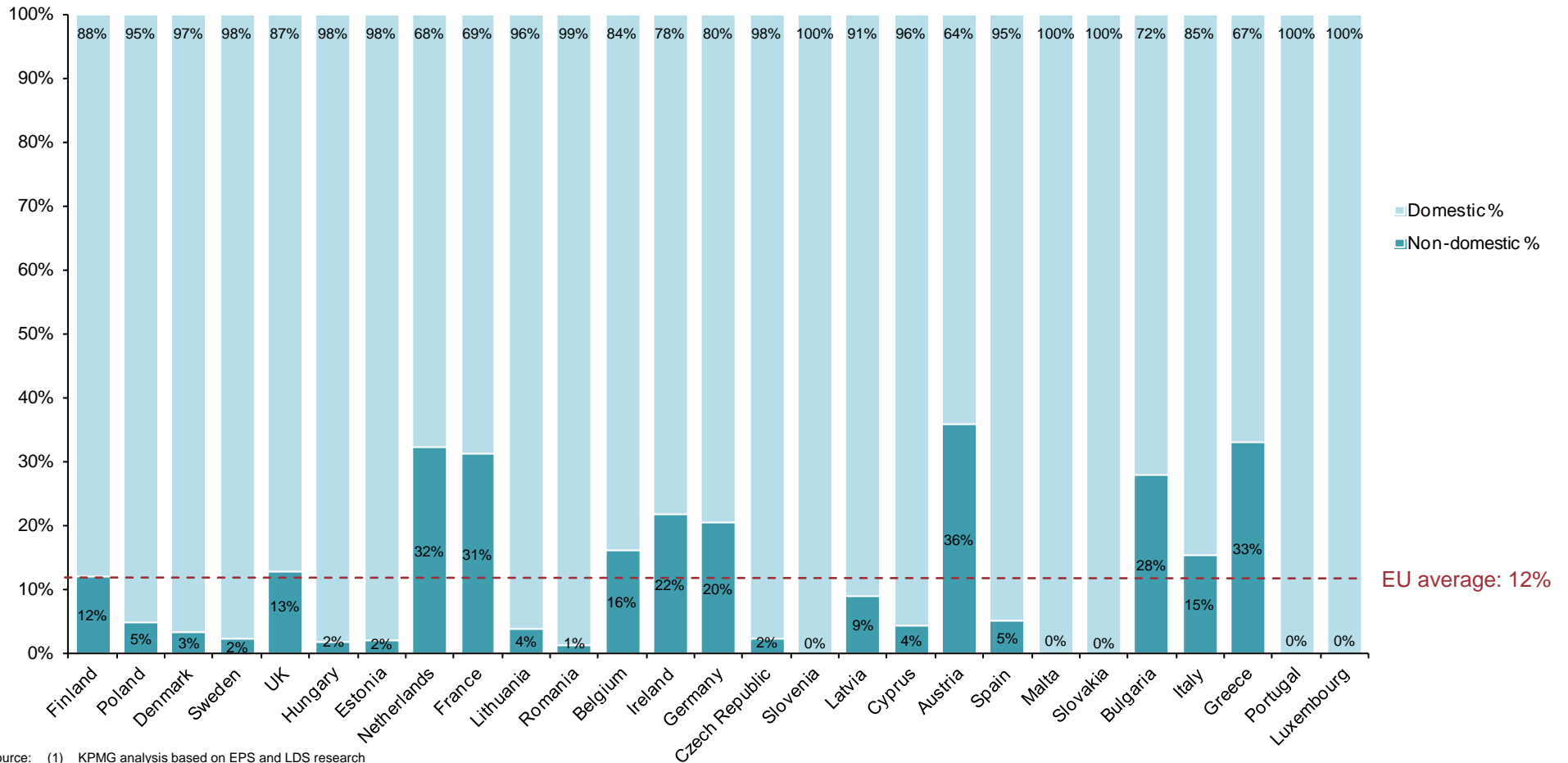
Source: (1) KPMG analysis based on EPS and LDS research

Note: (a) Separate menthol and slim EPS data was not available for Germany. As a result it has been assumed that non-domestic incidence for menthol and slim cigarettes is the same as non-domestic incidence for all cigarettes in Germany

Menthol analysis

The non-domestic incidence of menthol cigarettes is over 30% for Austria, Greece, Netherlands and France; the EU average is 12%

Non-domestic incidence of menthol cigarettes in the EU, out of total menthol cigarette consumption 2012^{(1)(a)}



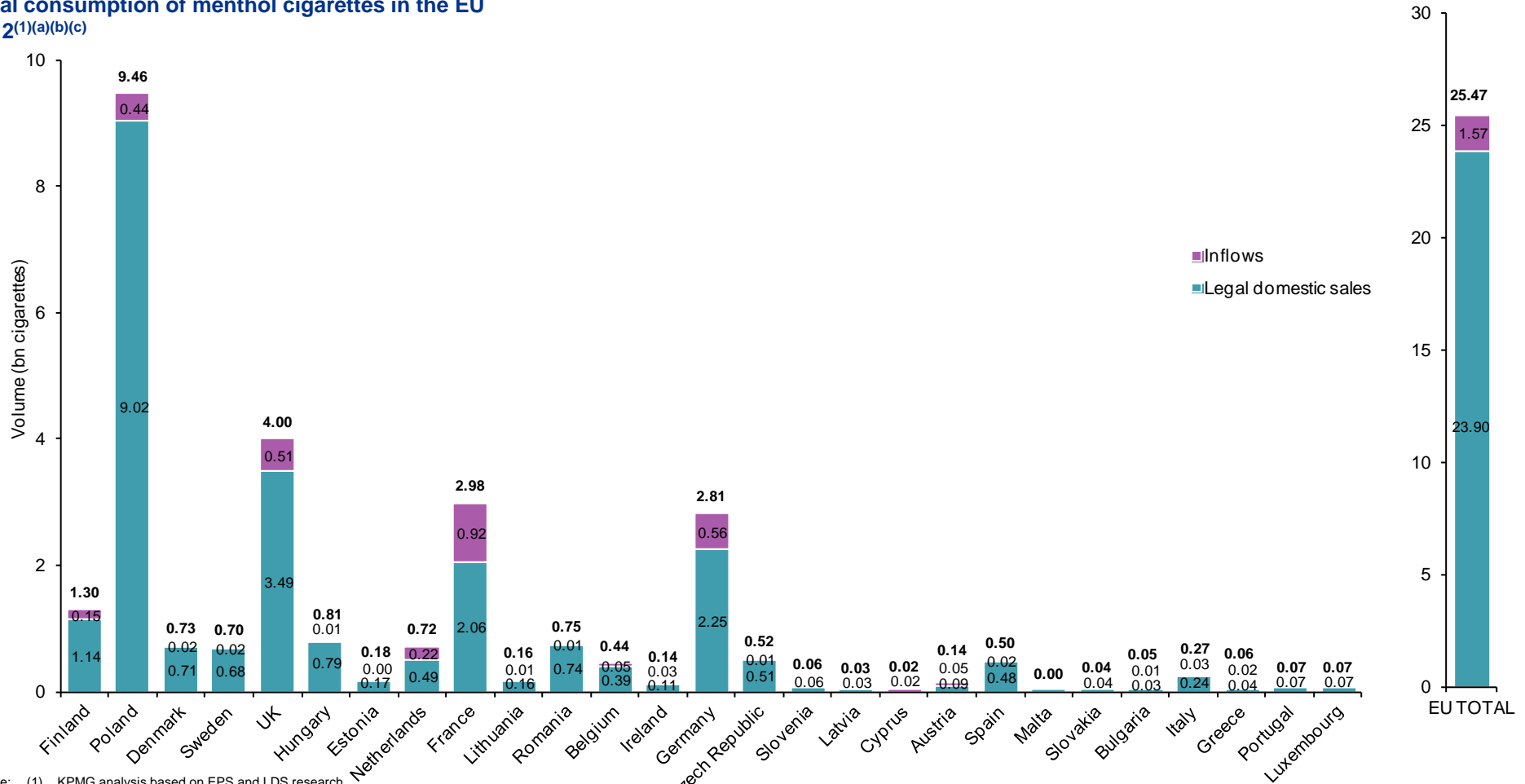
Source: (1) KPMG analysis based on EPS and LDS research

Note: (a) Separate menthol and slim EPS data was not available for Germany. As a result it has been assumed that non-domestic incidence for menthol and slim cigarettes is the same as non-domestic incidence for all cigarettes in Germany

Menthol analysis

The EU has a total consumption of 25.5 bn menthol cigarettes. Poland has the highest level of menthol cigarette consumption, followed by the UK and France. France has the largest menthol inflows of 0.9 bn cigarettes

Total consumption of menthol cigarettes in the EU
2012^{(1)(a)(b)(c)}



Source: (1) KPMG analysis based on EPS and LDS research

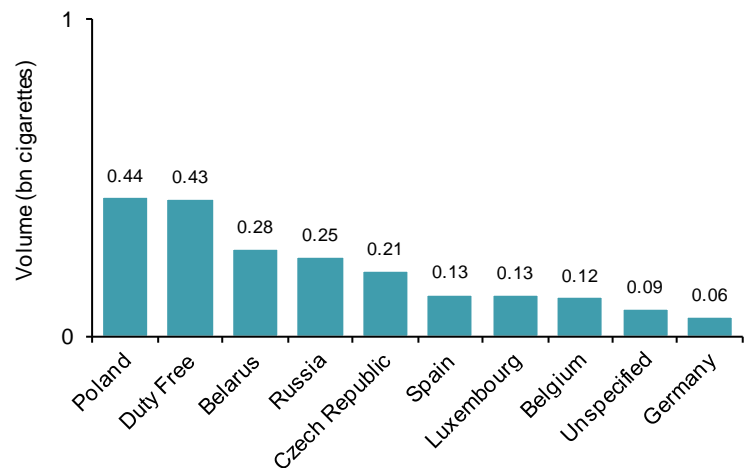
Note: (a) Separate menthol and slim EPS data was not available for Germany. As a result it has been assumed that non-domestic incidence for menthol and slim cigarettes is the same as non-domestic incidence for all cigarettes in Germany

(b) Total consumption refers to inflows and legal domestic sales only. Outflows are not included in total consumption figure

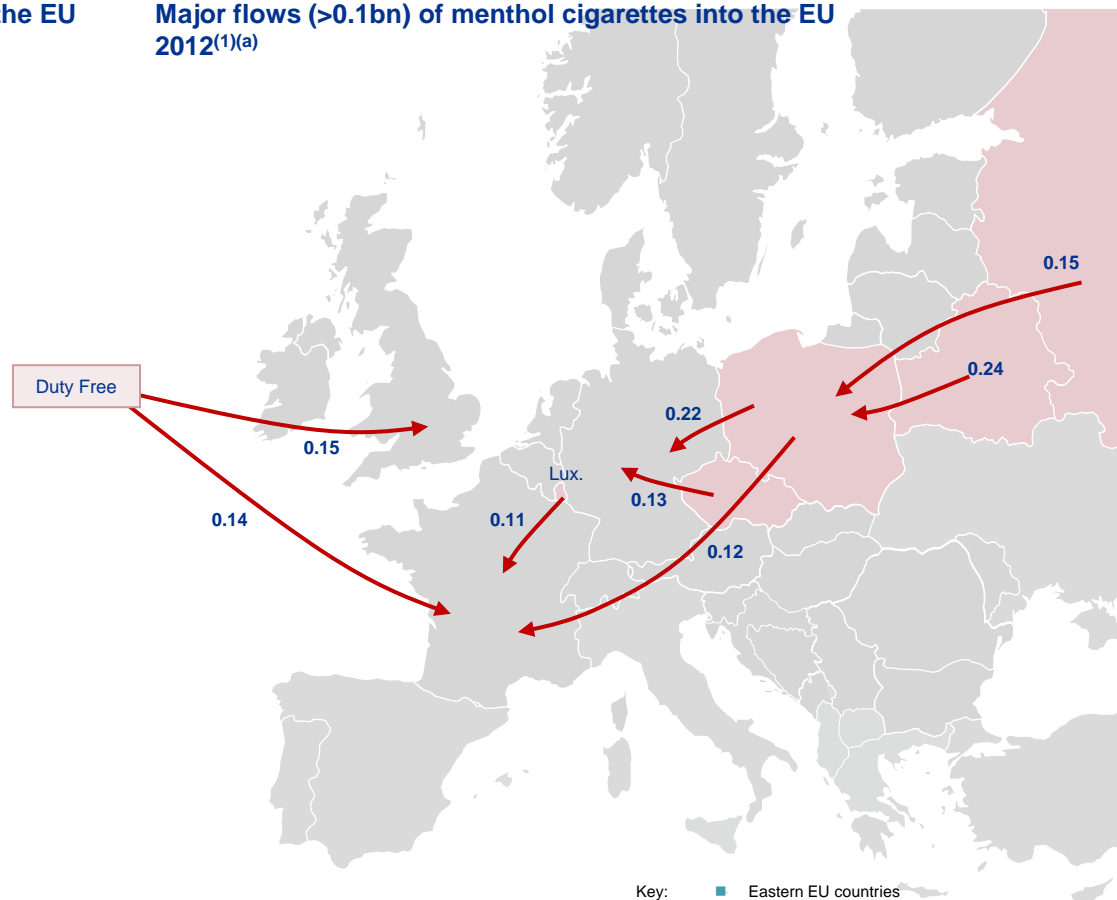
(c) The EU Total consumption figure given is calculated net of intra-EU outflows. These have not been excluded at a country level

Eastern Europe, the Eastern border countries and Duty Free account for the majority of major EU menthol flows

Top 10 source countries of non-domestic menthol cigarettes in the EU 2012^{(1)(a)}



Major flows (>0.1bn) of menthol cigarettes into the EU 2012^{(1)(a)}



Key:
■ Eastern EU countries
■ Source countries with inflows of >0.2 billion cigarettes in 2012

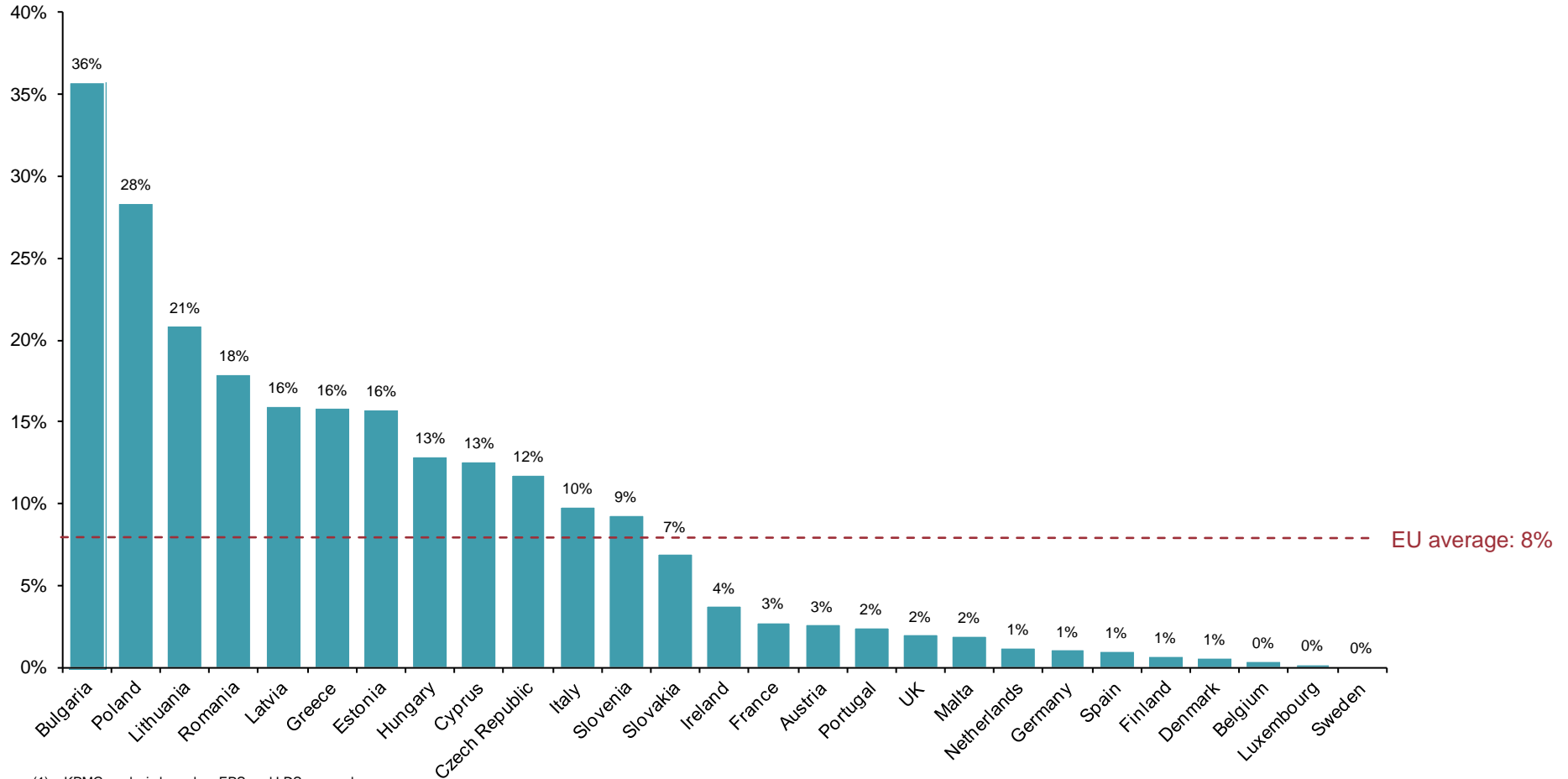
Source: (1) KPMG analysis based on EPS and LDS research

Note: (a) Separate menthol and slim EPS data was not available for Germany. As a result it has been assumed that non-domestic incidence for menthol and slim cigarettes is the same as non-domestic incidence for all cigarettes in Germany

Slim analysis

Bulgaria has the highest consumption of slim cigarettes as a proportion of total consumption at 36%, versus an EU average of 8%

Slim cigarettes as a proportion of total cigarette consumption 2012^{(1)(a)}



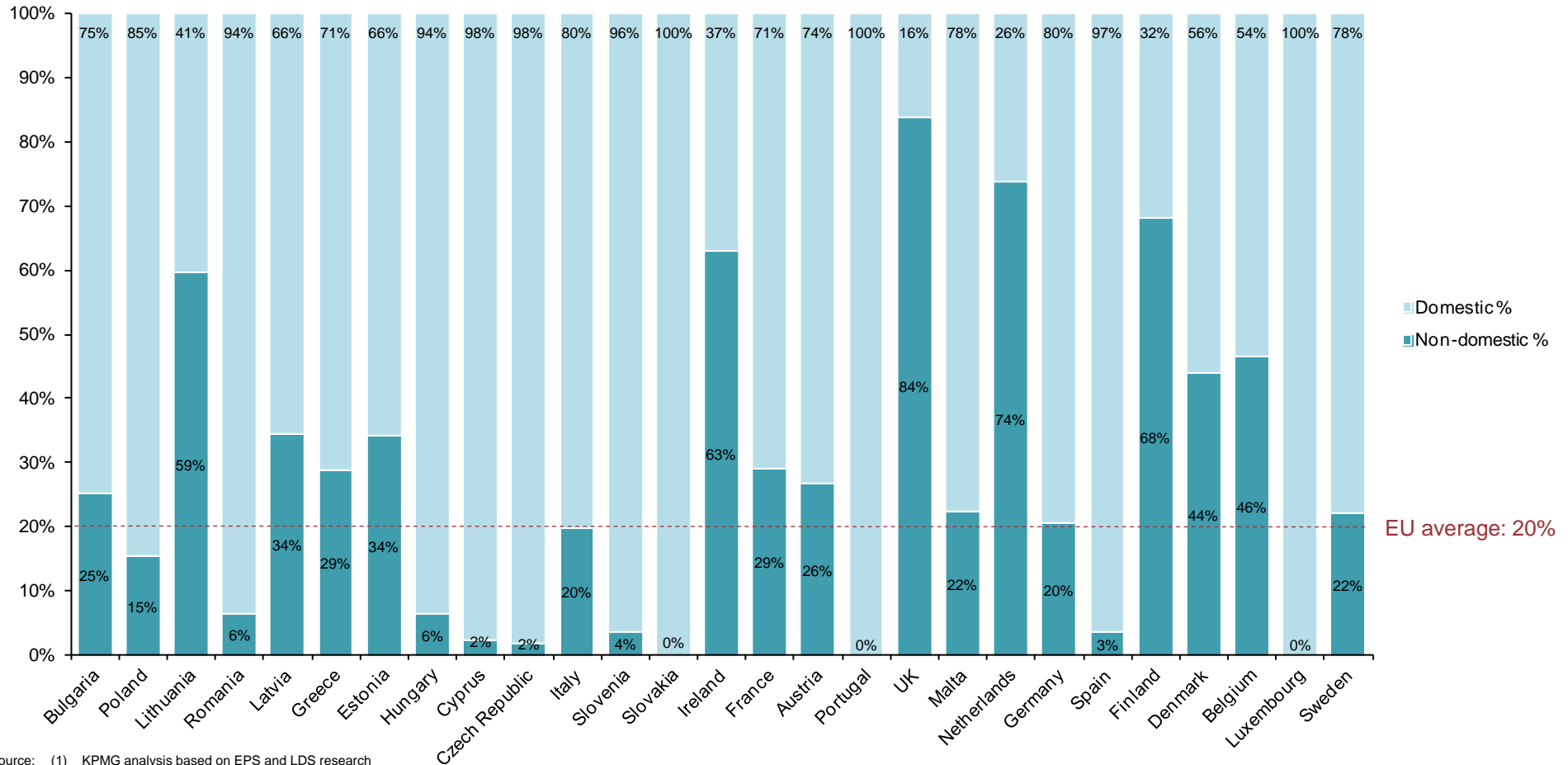
Source: (1) KPMG analysis based on EPS and LDS research

Note: (a) Separate menthol and slim EPS data was not available for Germany. As a result it has been assumed that non-domestic incidence for menthol and slim cigarettes is the same as non-domestic incidence for all cigarettes in Germany

Slim analysis

Non-domestic incidence of slims is over 50% for the UK, Netherlands, Finland, Ireland and Lithuania, with the UK having the highest non-domestic inflows of 84%; the EU average is 20%

Non-domestic incidence of slim cigarettes in the EU, out of total slim cigarette consumption 2012^{(1)(a)}



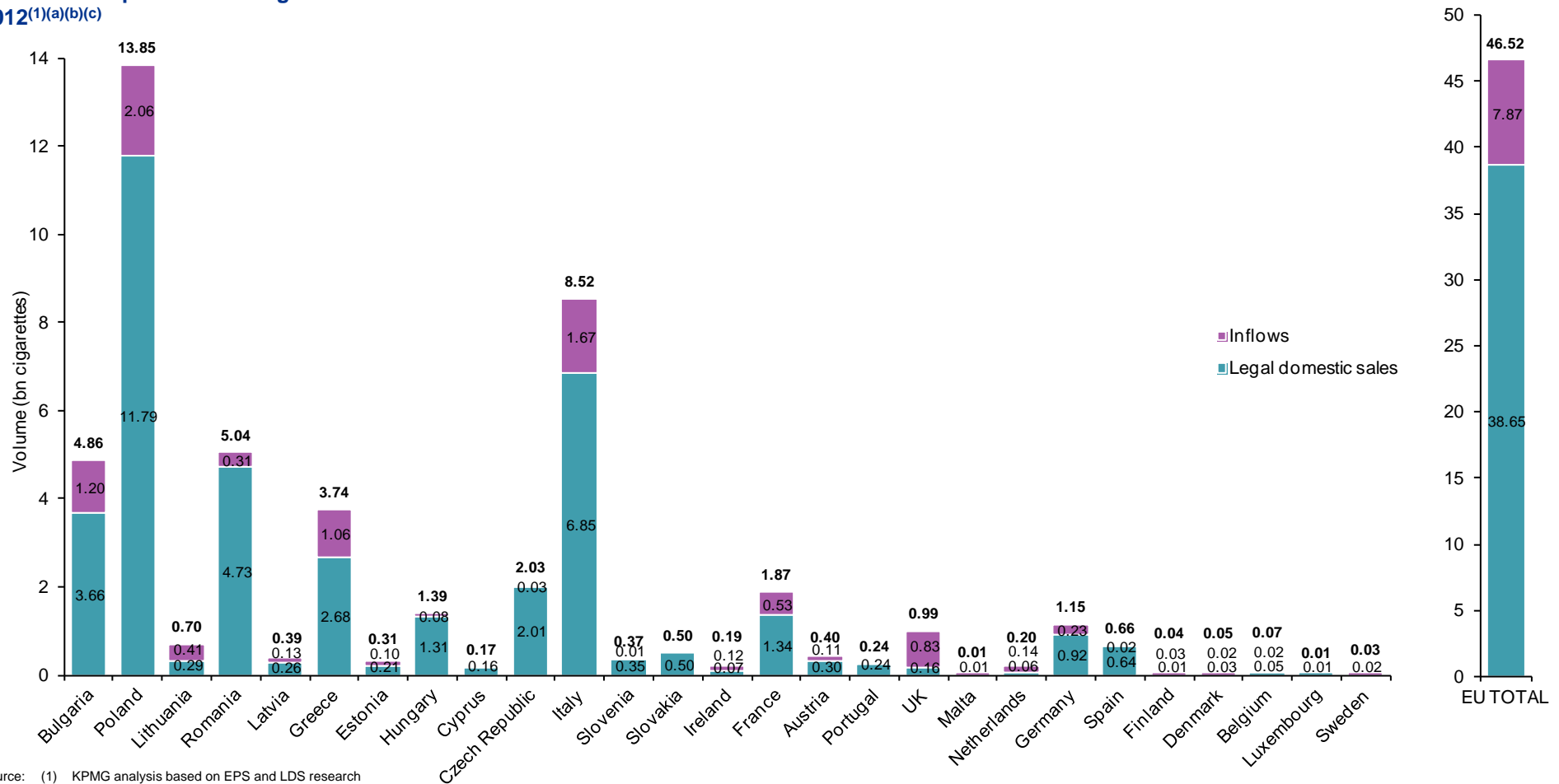
Source: (1) KPMG analysis based on EPS and LDS research

Note: (a) Separate menthol and slim EPS data was not available for Germany. As a result it has been assumed that non-domestic incidence for menthol and slim cigarettes is the same as non-domestic incidence for all cigarettes in Germany

Slim analysis

The EU has a total consumption of 46.5 bn slim cigarettes. Poland has both the largest consumption and the largest inflows of slims in the EU, followed by Italy

Total consumption of slim cigarettes in the EU
2012^{(1)(a)(b)(c)}



Source: (1) KPMG analysis based on EPS and LDS research

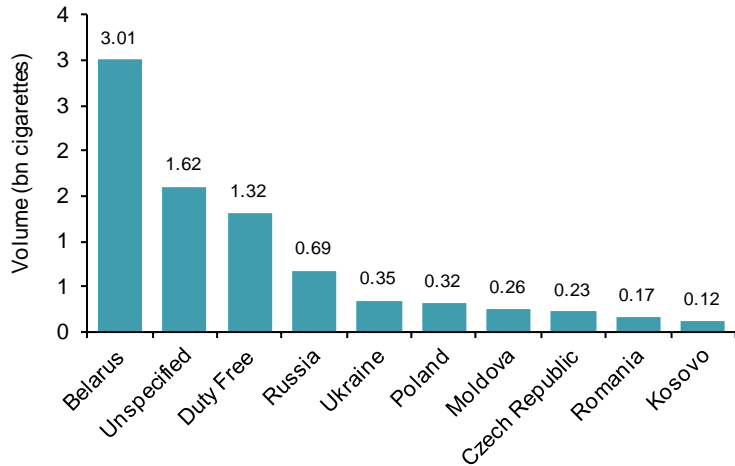
Note: (a) Separate menthol and slim EPS data was not available for Germany. As a result it has been assumed that non-domestic incidence for menthol and slim cigarettes is the same as non-domestic incidence for all cigarettes in Germany

(b) Total consumption refers to inflows and legal domestic sales only. Outflows are not included in total consumption figure

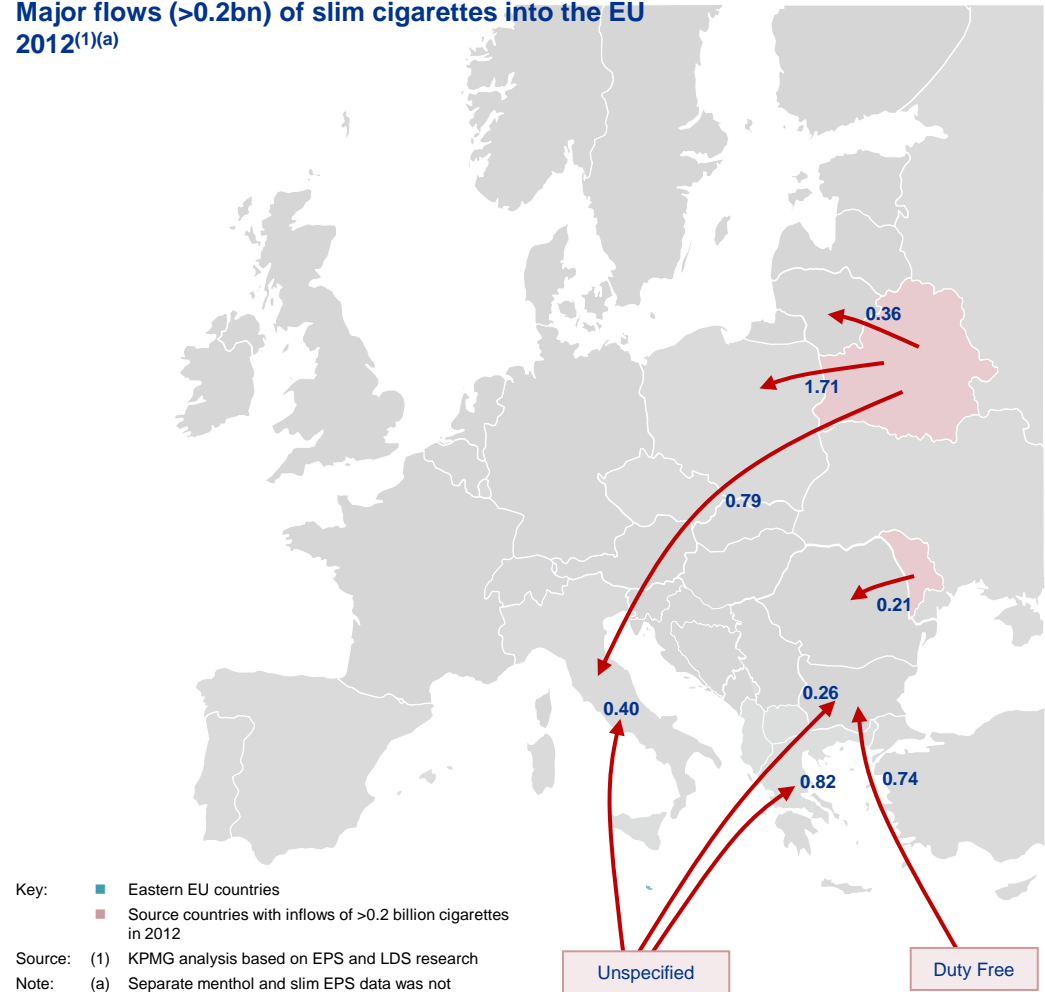
(c) The EU Total consumption figure given is calculated net of intra-EU outflows. These have not been excluded at a country level

Belarusian and Unspecified flows account for the majority of EU slim inflows

Top 10 source countries of non-domestic slim cigarettes in the EU 2012^{(1)(a)}



Major flows (>0.2bn) of slim cigarettes into the EU 2012^{(1)(a)}



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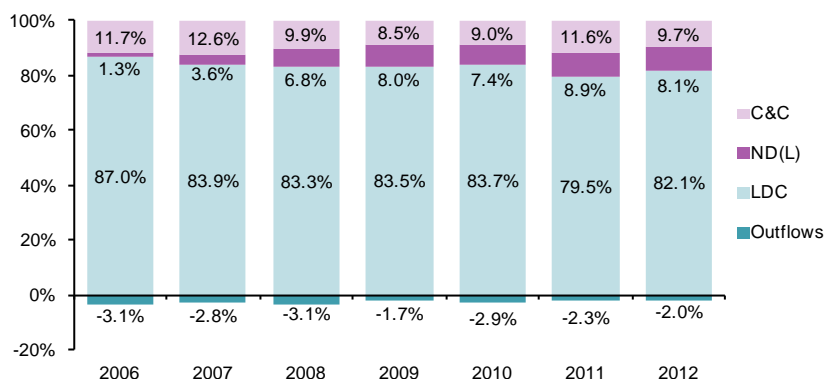
- Austria
- Belgium
- Bulgaria
- Cyprus
- Czech Republic
- Denmark
- Estonia
- Finland
- France
- Germany
- Greece
- Hungary
- Ireland
- Italy
- Latvia
- Lithuania
- Luxembourg
- Malta
- Netherlands
- Poland
- Portugal
- Romania
- Slovakia
- Slovenia
- Spain
- Sweden
- United Kingdom

Consumption of manufactured cigarettes declined by 4%, driven by falling non-domestic inflows; OTP consumption is becoming more significant in Austria and increased by 5% in 2012

Total Austria consumption (1)(2)(3)								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarettes								
Legal domestic sales (LDS)	13.40	13.66	13.20	13.39	13.54	13.09	12.96	(1)%
Outflows	-0.46	-0.45	-0.48	-0.27	-0.45	-0.36	-0.31	(14)%
Legal domestic consumption (LDC)	12.94	13.22	12.72	13.12	13.09	12.72	12.65	(1)%
Non-domestic legal (ND(L))	0.20	0.56	1.04	1.25	1.15	1.43	1.25	(12)%
Counterfeit and contraband (C&C)	1.74	1.98	1.51	1.34	1.41	1.85	1.50	(19)%
Total non-domestic	1.94	2.54	2.55	2.59	2.56	3.28	2.76	(16)%
Total consumption	14.87	15.76	15.27	15.71	15.65	16.00	15.41	(4)%

Austria Other Tobacco Product market (3)(a)								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarette equivalent								
OTP (LDS)	-	0.56	0.63	0.70	0.77	0.83	0.87	5%

Share of Austria cigarette consumption by type 2006-2012(1)(2)



Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)

(3) LDS/IMS data provided by PMI

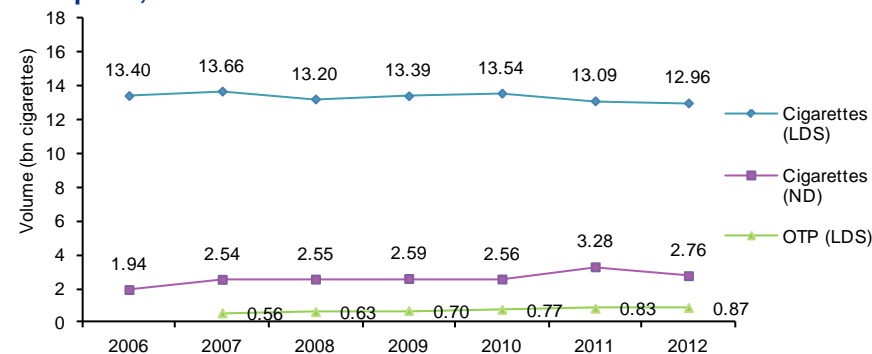
The decline in total consumption was mainly caused by a decrease in inflows

- The decrease in inflows appears to have been caused by lower price differential between Austria and surrounding markets
- The decline was caused by a reduction in both non-domestic (legal) purchases and C&C

A growing OTP sector now accounts for 5% of the total tobacco market

- Taking combined total manufactured cigarette consumption and OTP legal domestic sales, total tobacco consumption has decreased by 2%

Austria legal domestic sales (cigarettes and OTP) and non-domestic consumption, 2006-2012(1)(2)(3)(a)



Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports..

Non-domestic inflows have declined by 16% as the price differential with neighbouring countries has narrowed

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Inflows to Austria								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Hungary	0.13	0.32	0.45	0.48	0.48	0.99	0.86	(13)%
Slovenia	0.23	0.53	0.73	0.79	0.85	1.04	0.83	(21)%
Czech Republic	0.17	0.16	0.20	0.23	0.25	0.47	0.41	(12)%
Other countries	1.41	1.53	1.17	1.09	0.98	0.78	0.66	(15)%
Total inflows	1.94	2.54	2.55	2.59	2.56	3.28	2.76	(16)%

Outflows from Austria								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Germany	0.23	0.17	0.20	0.18	0.33	0.28	0.18	(33)%
Netherlands	0.03	0.03	0.07	0.00	0.05	0.02	0.03	8%
Italy	0.04	0.03	0.00	0.00	0.00	0.02	0.01	(28)%
Other countries	0.16	0.23	0.21	0.08	0.07	0.04	0.09	104%
Total outflows	0.46	0.45	0.48	0.27	0.45	0.36	0.31	(14)%

Austria experienced a 16% decline in inflows in 2012

- Austria experienced a significant decline in inflows from all neighbour countries due to a reduction in price gaps
 - Prices increased by 28% in Hungary and 12% in Slovenia, whilst remaining the same in Austria⁽³⁾

Outflows also declined by 14% as a result of significantly lower outflows to Germany

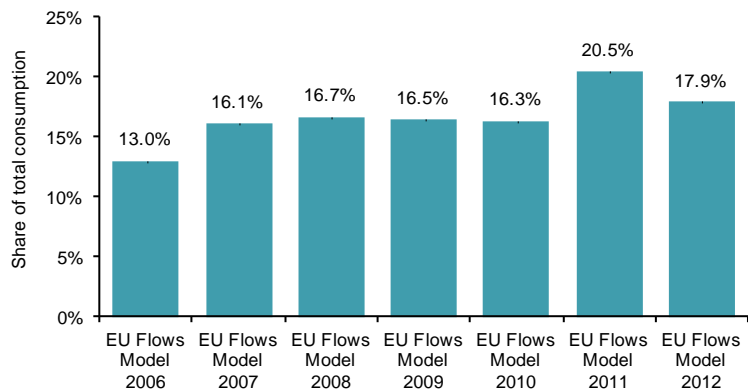
- Outflows remain small in proportion to total consumption

Notes: (a) Map shows flows over 1% of consumption, or top flow if none are greater than 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)
 (3) PMI management discussions and tax tables

Non-domestic incidence in Austria fell by 2.6 percentage points in 2012 from 20.5% to 17.9%

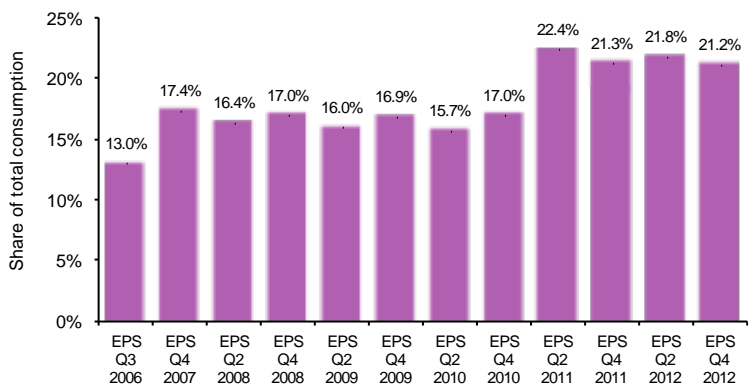
Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The EU flows model calculates non-domestic incidence by inputting the empty pack surveys results from each quarter

- Austria had two quarterly surveys conducted by the National Manufacturer's Association which were weighted equally
- An adjustment was made to the weighting of the packs, which were weighted according to the population of each region to reduce the impact of the extra samples collected in areas with high levels of non-domestic incidence
 - Kärnten was both the most over-sampled region, and had the highest level of non-domestic incidence; as a result, the difference between the EPS and EU flows model is 3.3 percentage points

Other non-domestic market estimates 2006-2012^{(2)(a)}



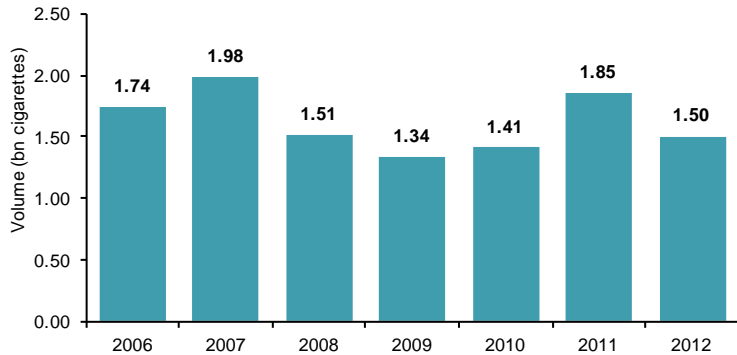
Sources: (1) KPMG EU Flows Model 2007 - 2012
(2) Chamber of Commerce Empty Pack Survey, 2012

Sources: (1) KPMG EU Flows Model 2006 - 2012
(2) PMI Empty Pack Surveys 2006 - 2012

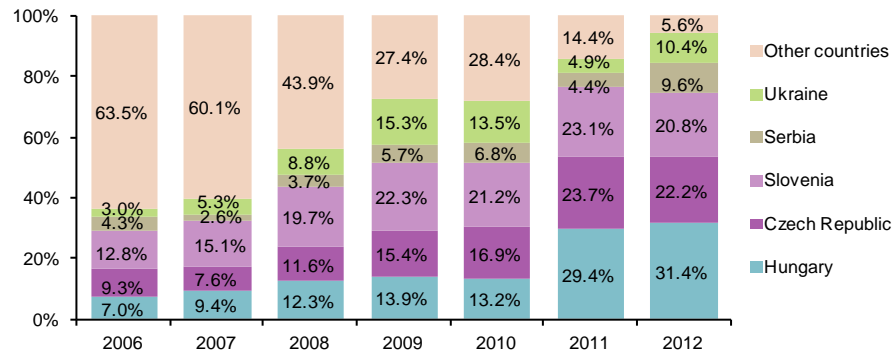
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

C&C declined by 19% in 2012 but remains significant at 9.7% of consumption

Total inflows of C&C
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(a)}



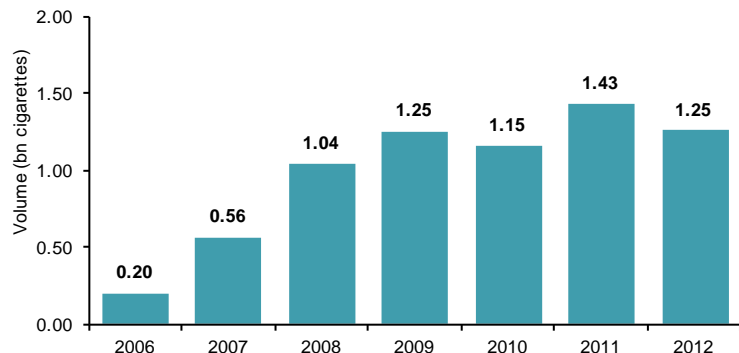
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

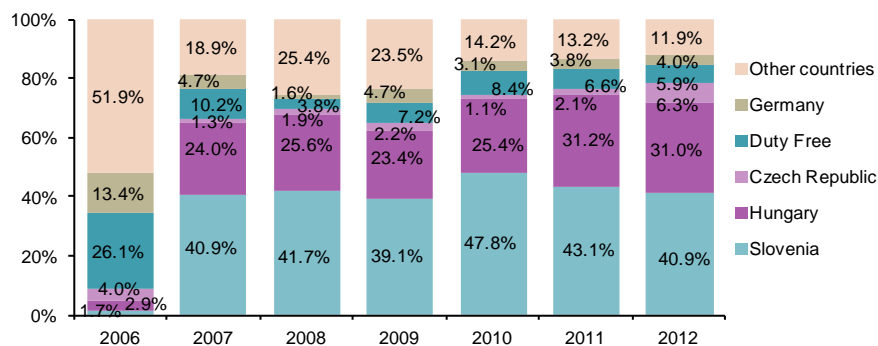
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

Whilst ND(L) volumes declined by 12%, the share of ND(L) from different countries remained broadly stable, with most ND(L) flows coming from countries with lower prices on the border. Marlboro and Camel significantly increased ND(L) brand share in 2012

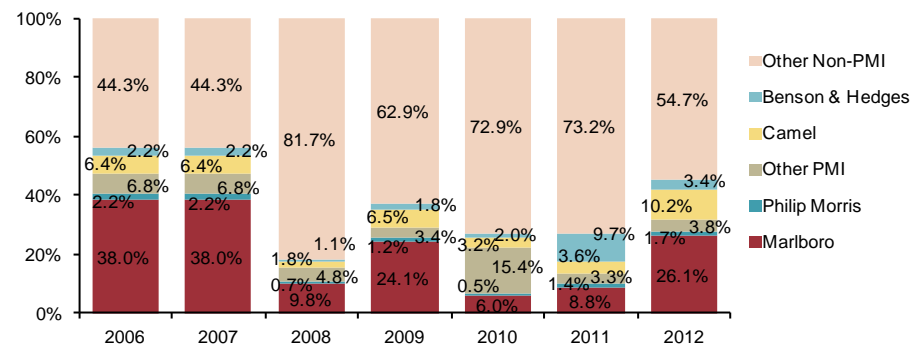
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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- Sweden
- United Kingdom

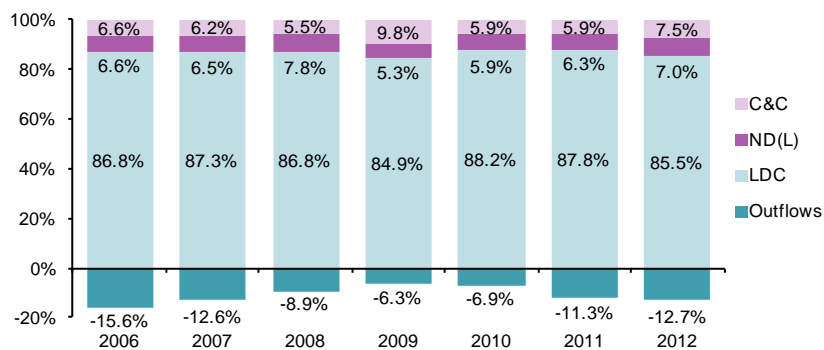
Belgium – Consumption summary

Total non-domestic consumption in Belgium increased by 16% in 2012, driven largely by increased levels of C&C, which grew to 7.5% of total consumption during the year

Total Belgium consumption ⁽¹⁾⁽²⁾⁽³⁾								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	13.39	12.49	11.89	11.74	11.73	11.86	11.44	(4)%
Outflows	-2.04	-1.58	-1.10	-0.81	-0.85	-1.35	-1.48	9%
Legal domestic consumption (LDC)	11.35	10.92	10.78	10.93	10.89	10.50	9.96	(5)%
Non-domestic legal (ND(L))	0.86	0.81	0.96	0.68	0.73	0.76	0.81	7%
Counterfeit and contraband (C&C)	0.86	0.77	0.68	1.27	0.73	0.71	0.88	24%
Total non-domestic	1.73	1.58	1.64	1.95	1.46	1.46	1.69	16%
Total consumption	13.07	12.50	12.42	12.88	12.35	11.97	11.65	(3)%

Belgium Other Tobacco Product market ^{(3)(a)}								
Billion cigarette equivalent	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
OTP (LDS)	12.22	9.97	8.03	11.58	12.23	12.70	13.14	3%

Share of Belgium cigarettes consumption by type 2006-2012⁽¹⁾⁽²⁾

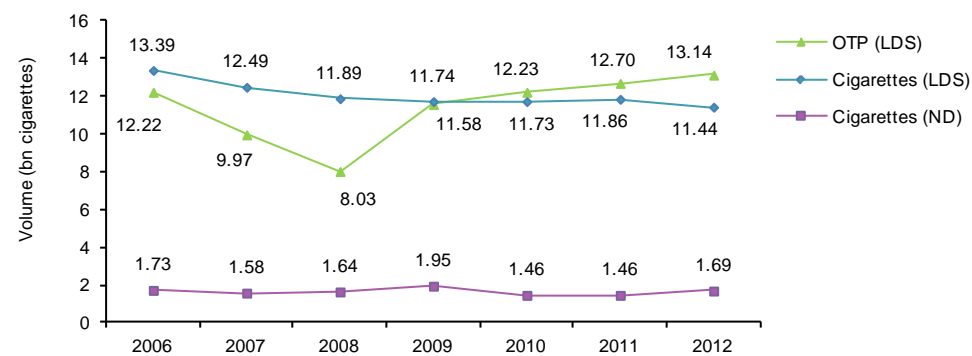


Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) PMI Empty Pack Surveys 2006 – 2012
 (3) LDS/IMS data provided by PMI
 (4) Global Consumer Tracking Survey provided by PMII

Legal domestic sales in Belgium declined by 4% in 2012, partly offset by increasing non-domestic consumption and an increase in legal domestic OTP sales

- Increased non-domestic consumption was driven by growth in both ND(L) and C&C, which increased by 7% and 24% respectively during the year
- Overall cigarette consumption dropped by 3% in 2011
 - This was reflected by GCTS survey results which showed a decline in cigarette smoking rates from 13% in 2011 to 11% in 2012⁽⁴⁾
- OTP represents a significant segment of the tobacco market, with legal domestic sales of OTP surpassing legal domestic sales of cigarettes for the past three years, growing by 3% in 2012

Belgium legal domestic sales (cigarettes and OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

Belgium – Country flows summary

Total non-domestic inflows to Belgium increased in 2012, largely driven by increased volumes from Poland and Luxembourg; outflows increased by 9% during the year

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Inflows to Belgium								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Luxembourg	0.47	0.25	0.31	0.12	0.23	0.47	0.51	10%
Duty Free	0.45	0.21	0.47	0.37	0.27	0.18	0.20	10%
Poland	0.08	0.04	0.05	0.07	0.08	0.10	0.17	65%
Russia	0.08	0.07	0.14	0.08	0.09	0.17	0.12	(27)%
Other countries	0.64	1.02	0.68	1.31	0.79	0.55	0.69	26%
Total inflows	1.73	1.58	1.64	1.95	1.46	1.46	1.69	16%

Outflows from Belgium								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
France	0.53	0.73	0.71	0.48	0.43	0.90	1.01	12%
Netherlands	0.54	0.73	0.13	0.15	0.24	0.29	0.32	8%
UK	0.36	0.00	0.14	0.09	0.04	0.08	0.08	(2)%
Other countries	0.59	0.12	0.13	0.09	0.15	0.08	0.08	(5)%
Total outflows	2.04	1.58	1.10	0.81	0.85	1.35	1.48	9%

Inflows to Belgium increased by 16% in 2012; the two largest inflows were from Luxembourg and Poland, which increased by 10% and 65%, respectively

- The price differential between Poland and Belgium widened in 2012, particularly for higher price brands, driving the significant increase in volumes
- Outflows from Belgium also increased, with the largest flow being from Belgium into Northern France
 - The price differential between these two markets grew to €1.84 in 2012 for the cheapest brands

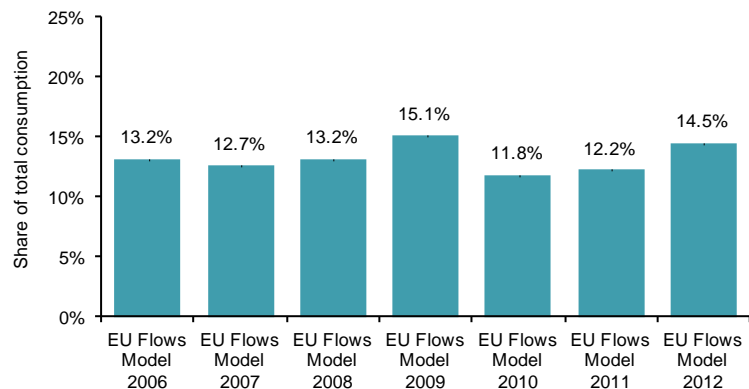
Notes: (a) Map shows flows over 1% of consumption, or top flow if none are greater than 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)

Estimated non-domestic incidence in Belgium increased from 12.2% in 2011 to 14.5% in 2012

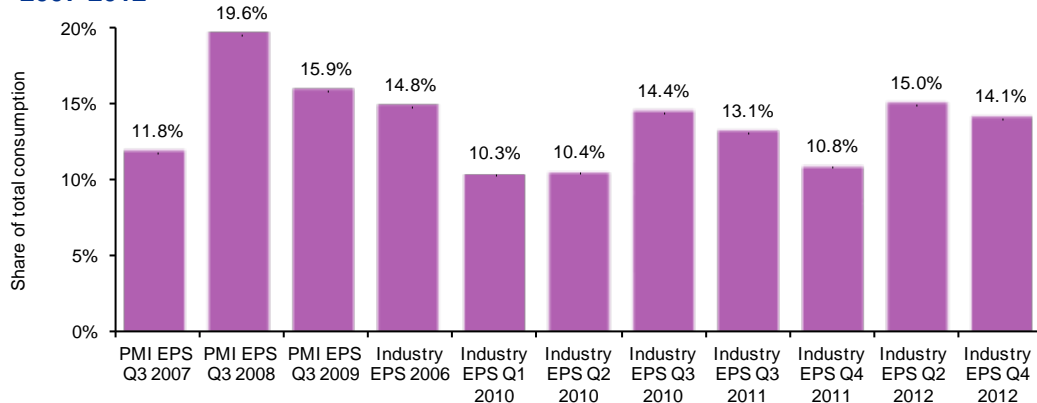
Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The EU Flows Model estimate for non-domestic consumption in 2012 is based on the results of the Empty Pack Surveys undertaken in the second and fourth quarters of 2012

- The EU flows model estimate is based on the arithmetic average results of the Q2 and Q4 EPS surveys, with no further adjustments made to the survey results

Other non-domestic market estimates 2007-2012^{(2)(a)}



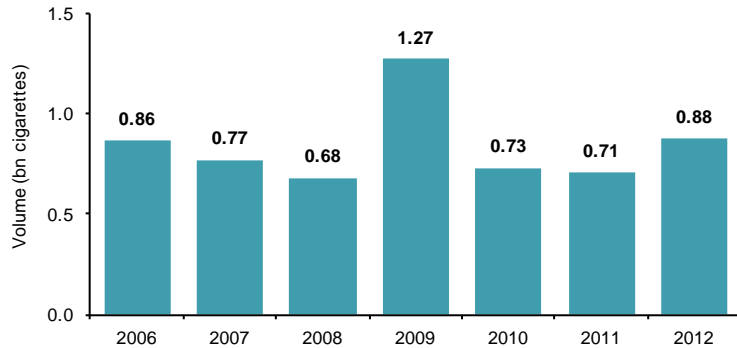
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI and Industry Empty Pack Surveys 2006 – 2012

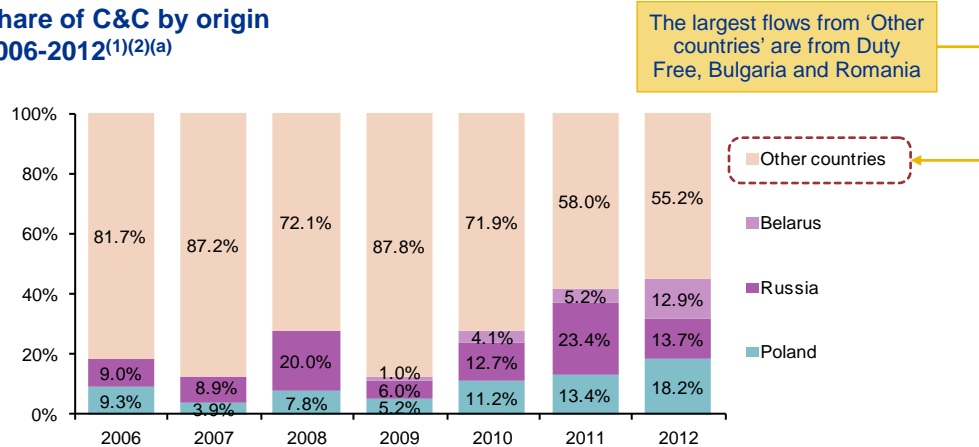
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

C&C volumes increased by 24% in 2012, driven by increasing inflows from Poland and Belarus

Total inflows of C&C
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(2)(a)}

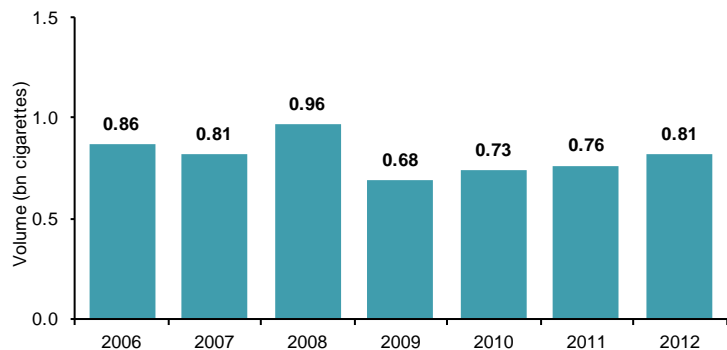


Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

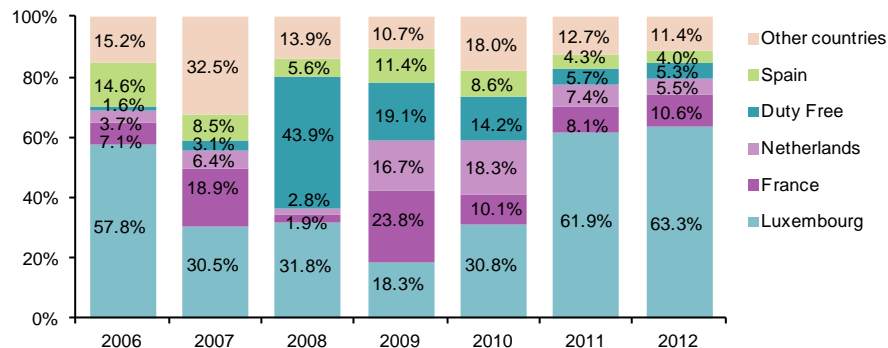
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Non-domestic legal flows increased by 7% in 2012, with over 63% of inflows coming from Luxembourg; brand shares remained stable in 2012, with Camel and Marlboro being the most frequently purchased brands

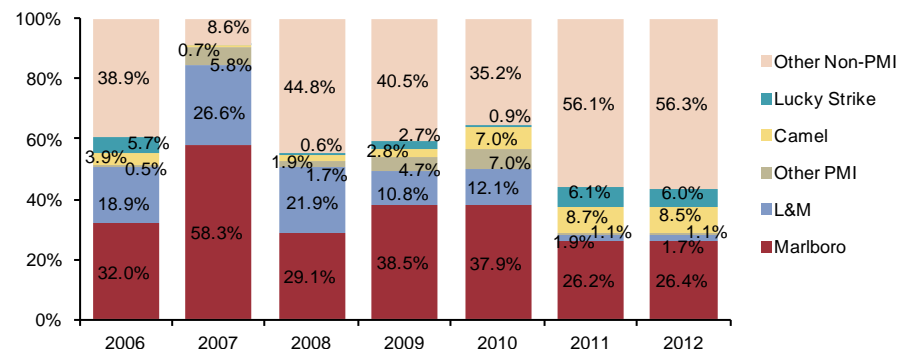
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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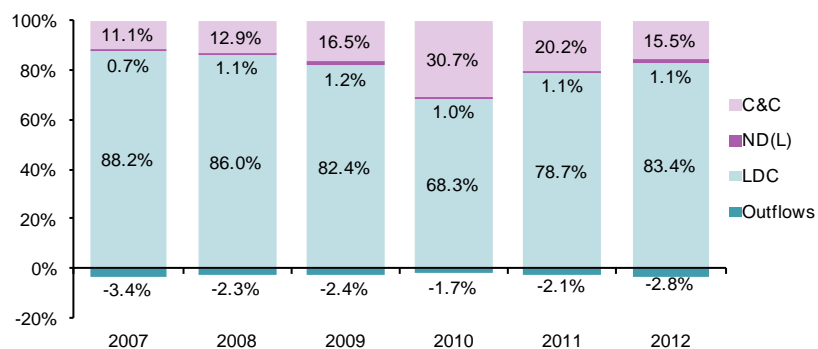
Due to improved border controls and anti-illicit trade measures, non-domestic incidence decreased for the second year running; in particular, C&C decreased by 23% in 2012

Total Bulgaria consumption (1)(2)(3)							
Billion cigarettes	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	18.06	18.77	16.80	10.91	10.80	11.57	7%
Outflows	-0.67	-0.49	-0.47	-0.27	-0.29	-0.38	34%
Legal domestic consumption (LDC)	17.38	18.28	16.33	10.64	10.51	11.19	6%
Non-domestic legal (ND(L))	0.14	0.22	0.23	0.15	0.15	0.15	0%
Counterfeit and contraband (C&C)	2.19	2.75	3.26	4.78	2.69	2.08	(23)%
Total non-domestic	2.33	2.97	3.50	4.93	2.84	2.23	(22)%
Total consumption	19.71	21.25	19.83	15.57	13.36	13.42	0%

Whilst non-domestic incidence declined during the year, legal domestic sales increased by 7%

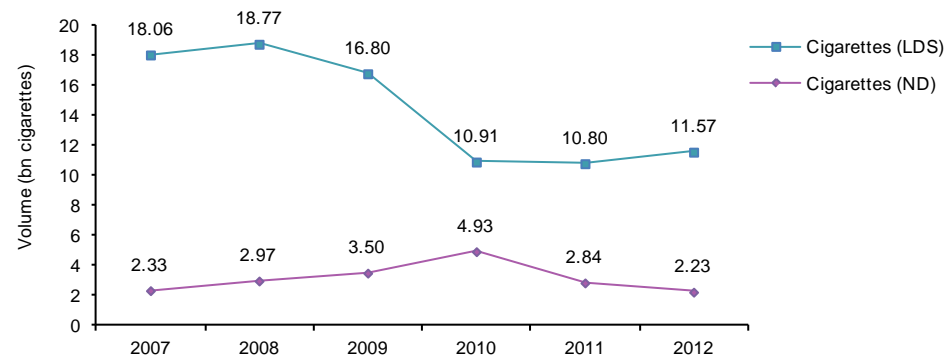
- Total cigarette consumption remained flat during the year, mainly driven by increased outflows
 - Outflows increased by 34% in 2012, largely due to increased outflows to the UK
- ND(L) remained stable at 1.1% of total consumption in 2012, while C&C decreased from 20.2% to 15.5%
- Bulgaria continues to have one of the highest smoking rates in Europe; however, GCTS data shows that the level of regular smokers has declined slightly from 49.5% in 2011 to 47.3% in 2012⁽⁴⁾

Share of Bulgarian cigarette consumption by type 2007-2012⁽¹⁾⁽²⁾



Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) PMI Empty Pack Surveys 2006 - 2012
 (3) LDS/IMS data provided by PMI
 (4) Global Consumer Tracking Survey provided by PMI

Bulgaria legal domestic sales and non-domestic consumption 2006-2012^{(1)(2)(3)(a)}



Notes: (a) OTP data not available

Bulgaria – Country flows summary

The largest driver of decreasing non-domestic inflows was a decline in volumes from Unspecified market variants, with inflows from Serbia also declining; outflows increased by 34%

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)(b)}



Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow
 (b) Unspecified market variants are defined as those packs which do not bear any market-specific health warning or tax stamp, or mention of 'Duty Free' on the pack

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

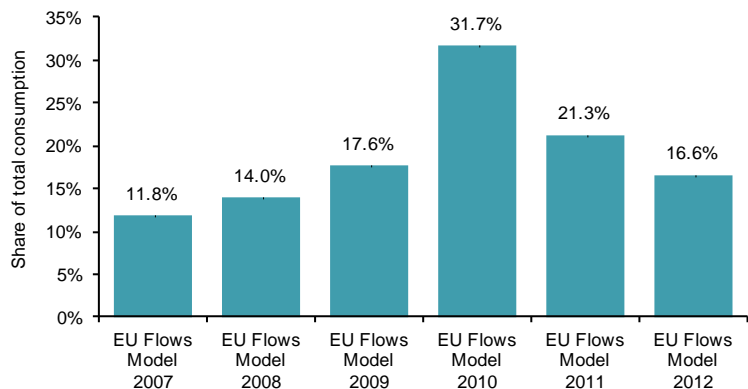
Inflows to Bulgaria							
Billion cigarettes	2007	2008	2009	2010	2011	2012	Change 11/12 %
Duty Free	1.90	2.56	2.07	2.19	1.23	1.28	4%
Unspecified	0.00	0.00	0.77	1.68	1.05	0.47	(56)%
Serbia	0.24	0.10	0.25	0.29	0.20	0.17	(15)%
Other countries	0.18	0.32	0.41	0.77	0.36	0.31	(15)%
Total inflows	2.33	2.97	3.50	4.93	2.84	2.23	(22)%
Outflows from Bulgaria							
Billion cigarettes	2007	2008	2009	2010	2011	2012	Change 11/12 %
UK	0.09	0.13	0.09	0.03	0.06	0.08	26%
Germany	0.05	0.04	0.04	0.03	0.07	0.06	(9)%
Netherlands	0.02	0.02	0.00	0.04	0.03	0.03	(5)%
Other countries	0.51	0.31	0.34	0.17	0.12	0.21	71%
Total outflows	0.67	0.49	0.47	0.27	0.29	0.38	34%

Outflows from Bulgaria have increased significantly during the year, driven by widening price differentials between other European markets

- The largest outflow from Bulgaria was to the UK, which increased by 26% in 2012, largely due to the widening price differential between the two countries
 - The price differential between a 20 pack of Marlboros in Bulgaria and the UK grew from €5.70 at the end of 2011 to €6.93 at the end of 2012
- Inflows from Unspecified market variants and Serbia declined by 56% and 15% respectively in 2012, driven by improved border controls and anti-illicit trade measures

Estimated non-domestic incidence in Bulgaria decreased from 21.3% in 2011 to 16.6% in 2012

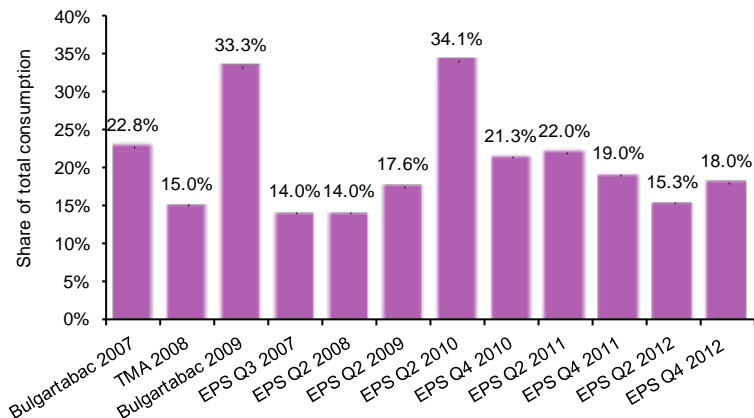
Non-domestic market estimates 2007-2012^{(1)(2)(a)(b)}



The EU Flows Model estimate for non-domestic consumption in 2012 is based on the results of the Empty Pack Surveys undertaken in the second and fourth quarters of 2012

- The EU flows model estimate is based on the arithmetic average results of the Q2 and Q4 EPS surveys, with no further adjustments made to the survey results

Other non-domestic market estimates 2007-2012^{(2)(a)(b)}

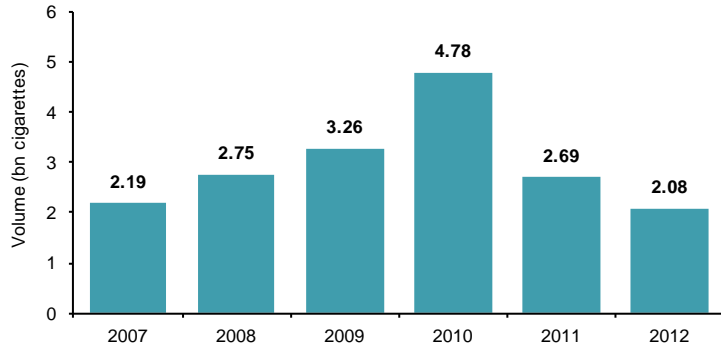


Sources: (1) KPMG EU Flows Model 2006 - 2012
(2) PMI Empty Pack Surveys 2006 – 2012

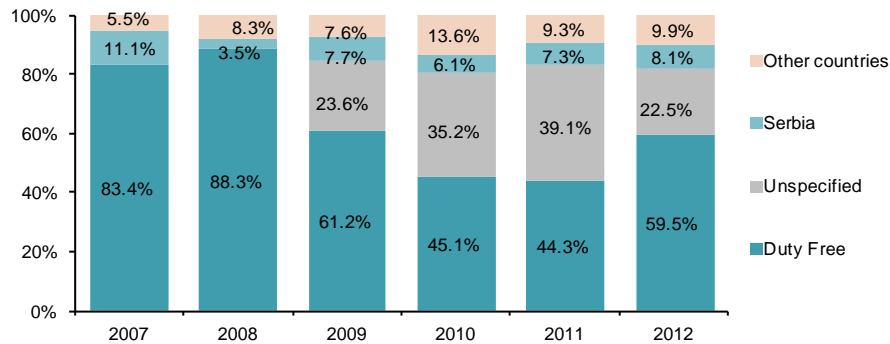
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.
(b) EPS results from focus studies have been excluded from Q3 and Q4 2012 EPS estimates shown here.

C&C declined by 23% in 2012, largely due to a decline in volumes from Unspecified market variants

Total inflows of C&C
2007-2012^{(1)(2)(a)(b)}



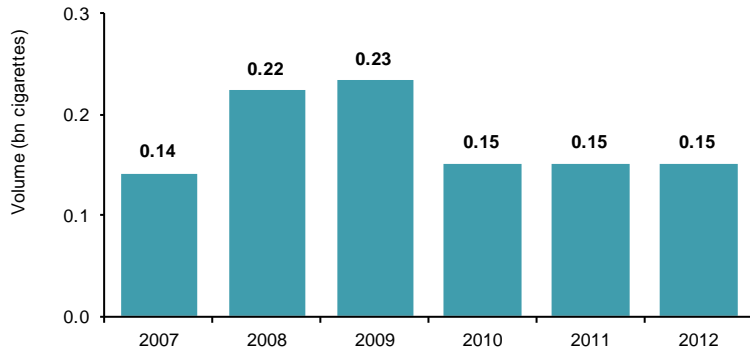
Share of C&C by origin
2007-2012^{(1)(2)(a)(b)}



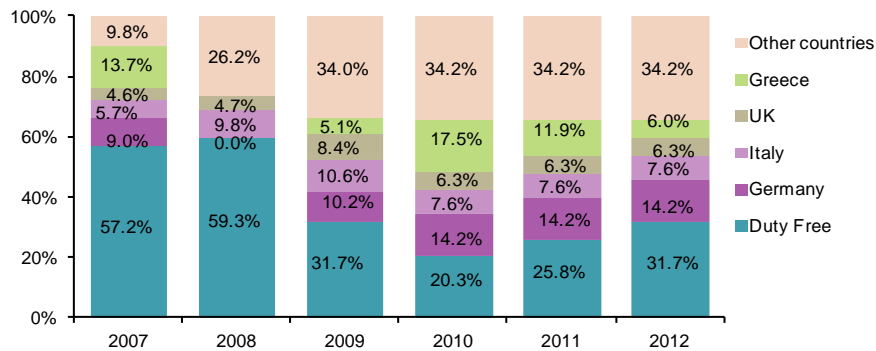
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.
 (b) Unspecified market variants are those which do not bear any market-specific health warning or mention Duty Free on the label.
 Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

Non-domestic legal inflows remained stable in 2012 with the majority of ND(L) coming from Duty Free and Germany

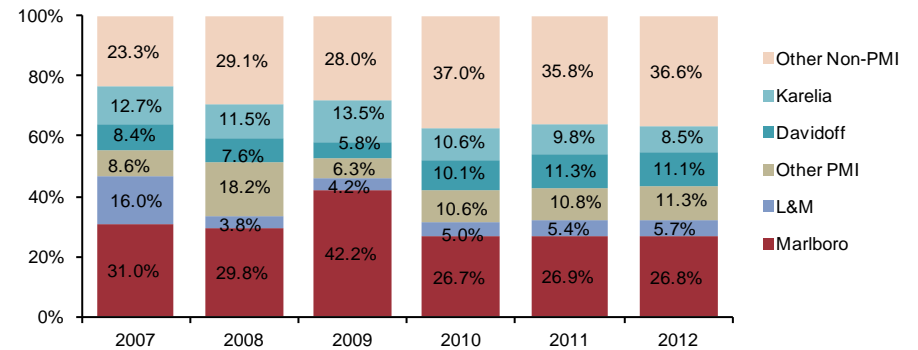
Total inflows of ND(L)
2007-2012^{(1)(2)(a)}



Share of ND(L) by origin
2007-2012^{(1)(2)(a)}



Share ND(L) by brand
2007-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

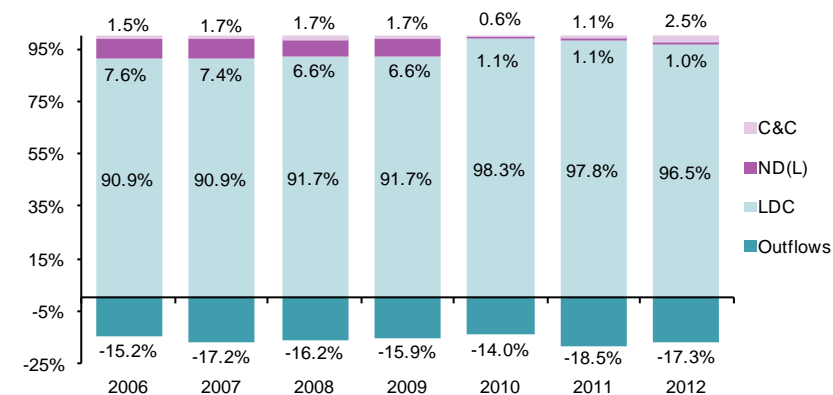
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C&C levels in Cyprus more than doubled in 2012, driving an increase of around 50% in total non-domestic inflows

Total Cyprus consumption ⁽¹⁾⁽²⁾⁽³⁾								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarettes								
Legal domestic sales (LDS)	1.60	1.67	1.72	1.71	1.75	1.51	1.39	(8)%
Outflows	(0.23)	(0.27)	(0.26)	(0.25)	(0.22)	(0.24)	(0.21)	(12)%
Legal domestic consumption (LDC)	1.38	1.40	1.46	1.45	1.53	1.27	1.17	(7)%
Non-domestic legal (ND(L))	0.12	0.11	0.10	0.10	0.02	0.01	0.01	(11)%
Counterfeit and contraband (C&C)	0.02	0.03	0.03	0.03	0.01	0.01	0.03	>100%
Total non-domestic	0.14	0.14	0.13	0.13	0.03	0.03	0.04	50%
Total cigarette consumption	1.51	1.55	1.59	1.58	1.56	1.29	1.22	(6)%

Cyprus Other Tobacco Product market ^{(3)(a)}								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarette equivalent								
OTP (LDS)	0.00	0.00	0.00	0.00	0.36	0.38	0.47	25%

Share of Cyprus cigarettes consumption by type 2006-2012⁽¹⁾⁽²⁾

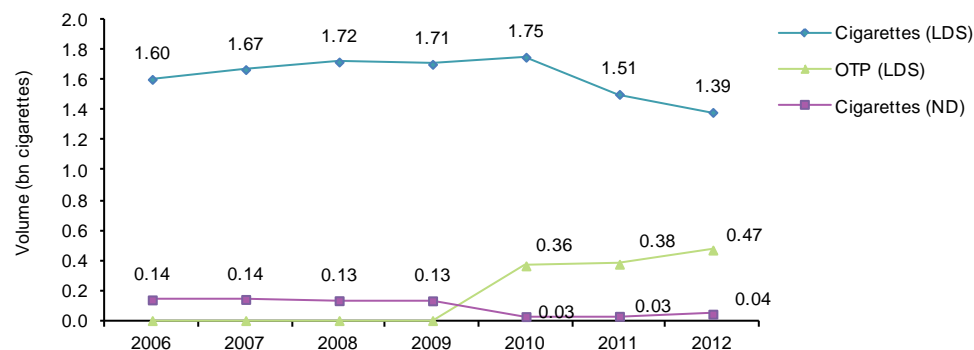


Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) PMI Empty Pack Surveys 2006 - 2012
 (3) LDS/IMS data provided by PMI

Legal domestic sales in Cyprus declined by 8% in 2012, driven partly by increasing non-domestic incidence and rising OTP volumes, with overall cigarette consumption declining by 6% during the year

- OTP volumes increased during the year, growing by 25% and representing over 25% of the legal domestic market in 2012

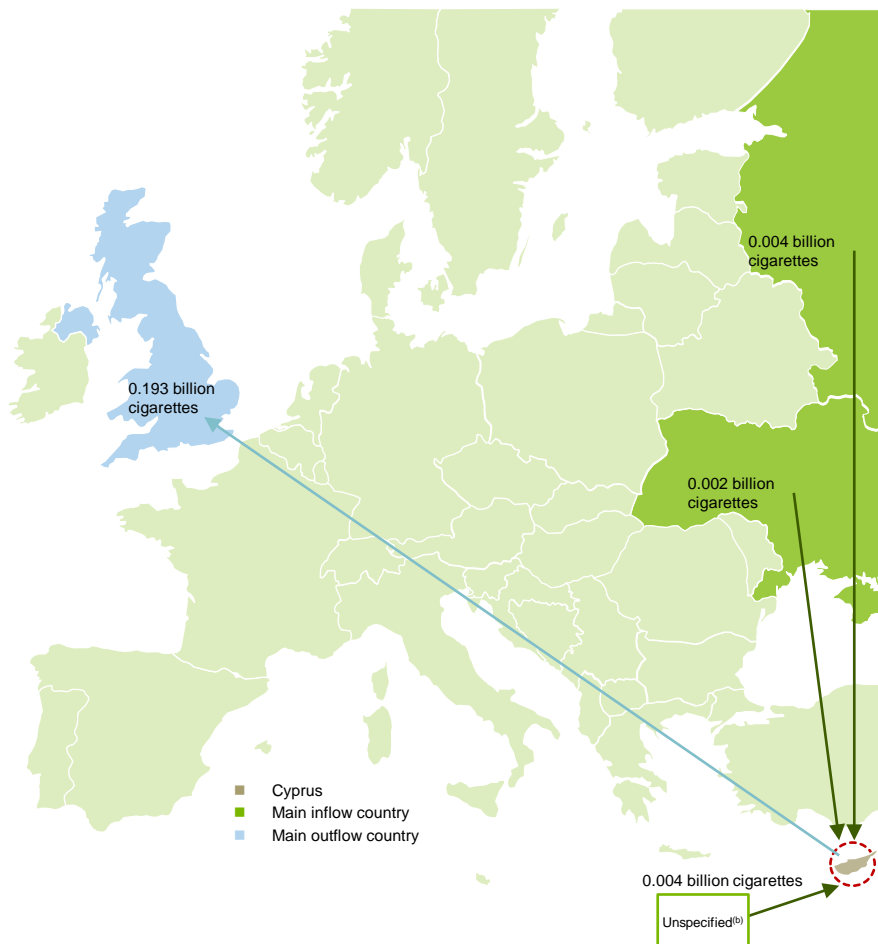
Cyprus legal domestic sales (cigarettes and OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

Increased non-domestic inflows in Cyprus were mainly driven by new inflows from Russia and growing volumes from Unspecified market variants

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)(b)}



Inflows to Cyprus								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Russia	0.000	0.000	0.008	0.008	0.005	0.000	0.004	-
Unspecified	0.000	0.000	0.000	0.000	0.000	0.003	0.004	39%
Romania	0.002	0.002	0.002	0.002	0.002	0.003	0.002	(7)%
Ukraine	0.002	0.002	0.000	0.000	0.000	0.000	0.002	-
Other countries	0.135	0.138	0.123	0.122	0.020	0.023	0.031	32%
Total inflows	0.138	0.141	0.132	0.131	0.027	0.028	0.043	50%

Outflows from Cyprus								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
UK	0.213	0.250	0.241	0.214	0.200	0.205	0.193	(5)%
France	0.000	0.007	0.007	0.007	0.000	0.000	0.005	-
Netherlands	0.000	0.000	0.000	0.000	0.000	0.006	0.004	(31)%
Other countries	0.017	0.009	0.010	0.032	0.018	0.028	0.008	(71)%
Total outflows	0.230	0.266	0.258	0.252	0.218	0.239	0.211	(12)%

In line with other Mediterranean markets, non-domestic inflows to Cyprus increased, with significant growth in flows of Unspecified cigarettes

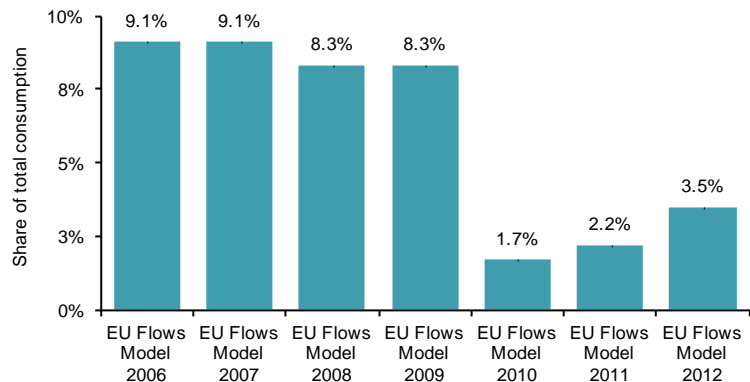
- There has also been a significant increase in flows from Russia in 2012
- Outflows to Italy and Spain declined significantly in 2012, returning in line with 2010 levels

Notes: (a) Map shows flows over 1% of consumption, apart from flows from Russia and Unspecified market variants, shown here, which represent the country's main inflows. Countries which are both source and destination countries are coded according to the larger flow
 (b) Unspecified market variants are defined as those packs which do not bear any market-specific health warning or tax stamp, or mention of 'Duty Free' on the pack

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

Estimated non-domestic incidence in Cyprus increased from 2.2% in 2011 to 3.5% in 2012

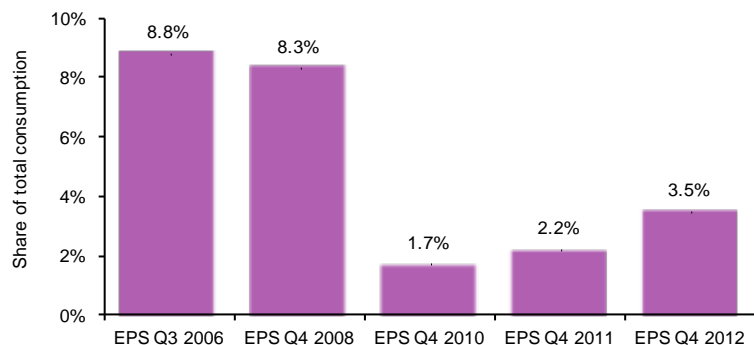
Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The EU Flows Model estimate for non-domestic consumption in 2012 is based on the results of the Empty Pack Survey undertaken in the fourth quarter of 2012

- The EU flows model estimate is based on the Q4 EPS survey, with no further adjustments made to the survey results

Other non-domestic market estimates 2006-2012^{(2)(a)}



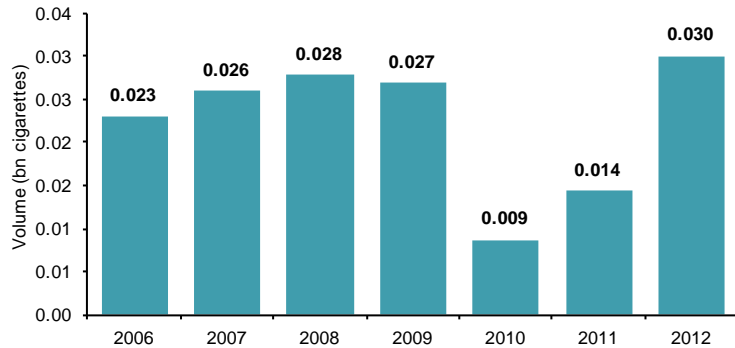
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2006 – 2012

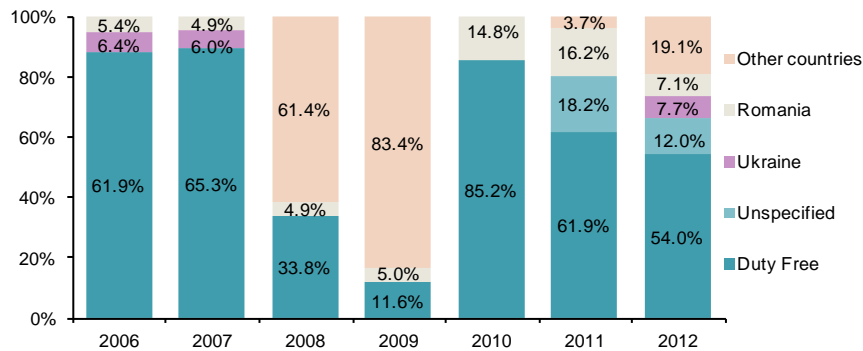
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

C&C in Cyprus increased by over 100% in 2012, largely due to increased inflows from Ukraine

Total inflows of C&C
2006-2012^{(1)(2)(a)(b)}



Share of C&C by origin
2006-2012^{(1)(2)(a)(b)}

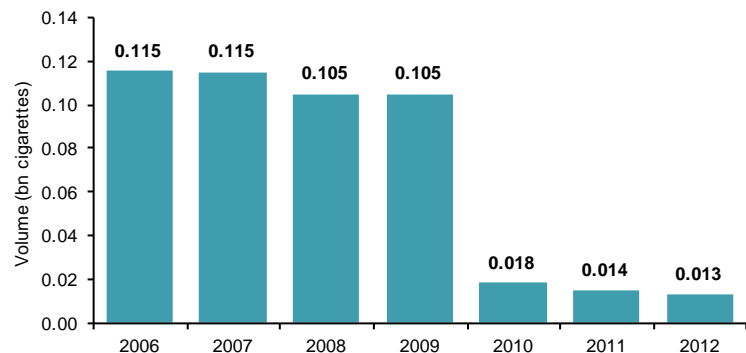


Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

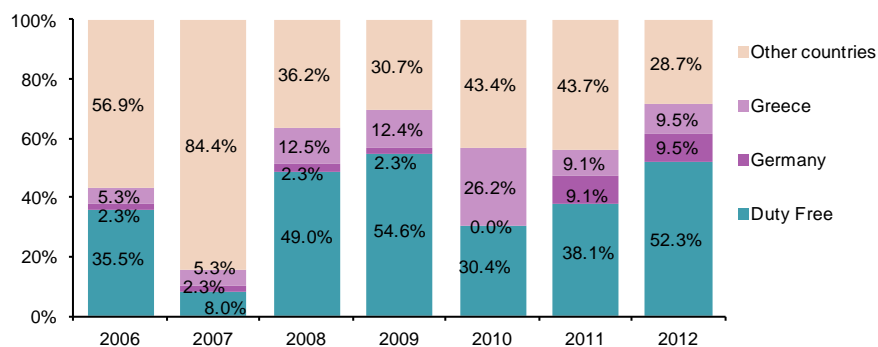
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.
(b) Unspecified market variants are defined as those packs which do not bear any market-specific health warning or tax stamp, or mention of 'Duty Free' on the pack

Non-domestic legal volumes in Cyprus remained stable as a proportion of total consumption in 2012, with Duty Free and Germany representing the largest legal inflows; PMI brands increased to 19.5% of ND(L) during the year

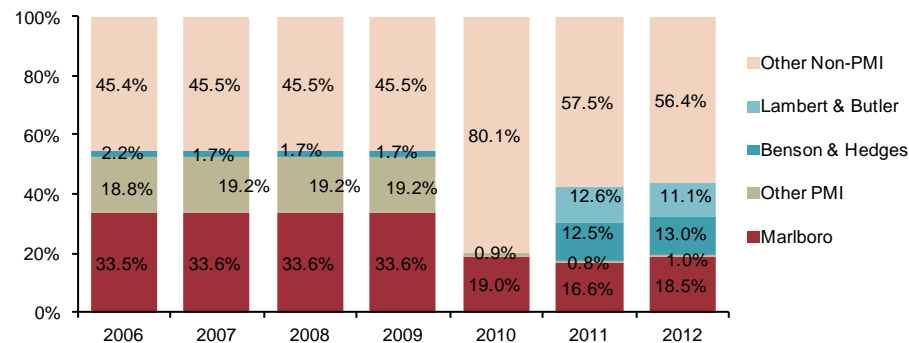
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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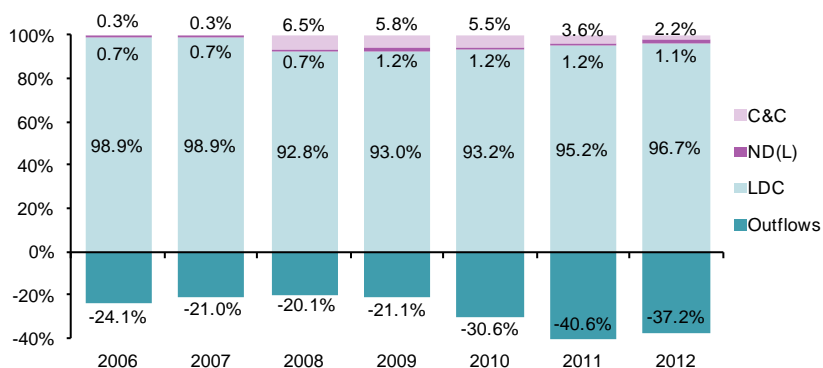
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Consumption of manufactured cigarettes decreased by 1%. The decline in cigarette sales was offset by a large increase in sales of other tobacco products

Total Czech Republic consumption ⁽¹⁾⁽²⁾⁽³⁾								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	24.31	23.97	22.77	21.65	21.06	21.06	20.46	(3)%
Outflows	-4.76	-4.19	-4.06	-4.00	-5.21	-6.30	-5.68	(10)%
Legal domestic consumption (LDC)	19.54	19.78	18.71	17.65	15.85	14.76	14.78	0%
Non-domestic legal (ND(L))	0.15	0.15	0.15	0.23	0.21	0.19	0.16	(15)%
Counterfeit and contraband (C&C)	0.06	0.06	1.30	1.09	0.94	0.56	0.34	(40)%
Total non-domestic	0.21	0.21	1.45	1.32	1.15	0.75	0.50	(34)%
Total cigarette consumption	19.75	19.99	20.16	18.97	17.01	15.51	15.28	(1)%

Czech Republic Other Tobacco Product market ⁽³⁾								
Billion cigarette equivalent	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
OTP (LDS)	-	1.60	0.27	0.87	1.19	1.52	1.84	22%

Share of Czech Republic cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)
 (3) LDS/IMS data provided by PMI

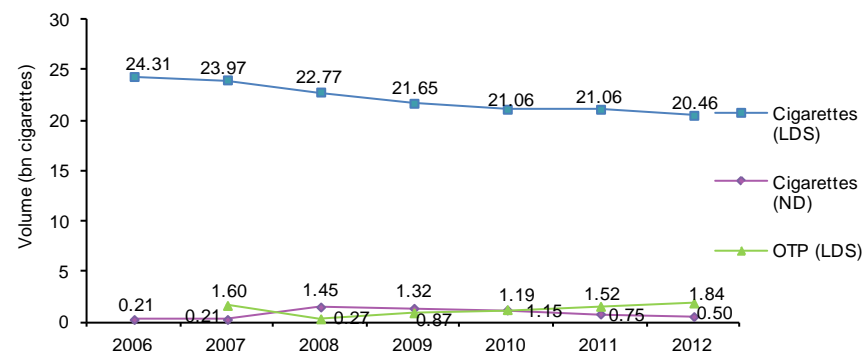
Legal domestic sales of manufactured cigarettes fell by 3%, however overall cigarette consumption fell by only 1% as there was a 10% decrease in outflows; this was slightly offset by a decline in non-domestic consumption

- Legal domestic consumption remained stable, with the fall in total consumption occurring as a result of lower non-domestic consumption
- C&C experienced a significant decline of 40%

The 22% increase in OTP LDS, suggests that consumers are switching from manufactured cigarettes to a cheaper alternative, rather than reducing consumption

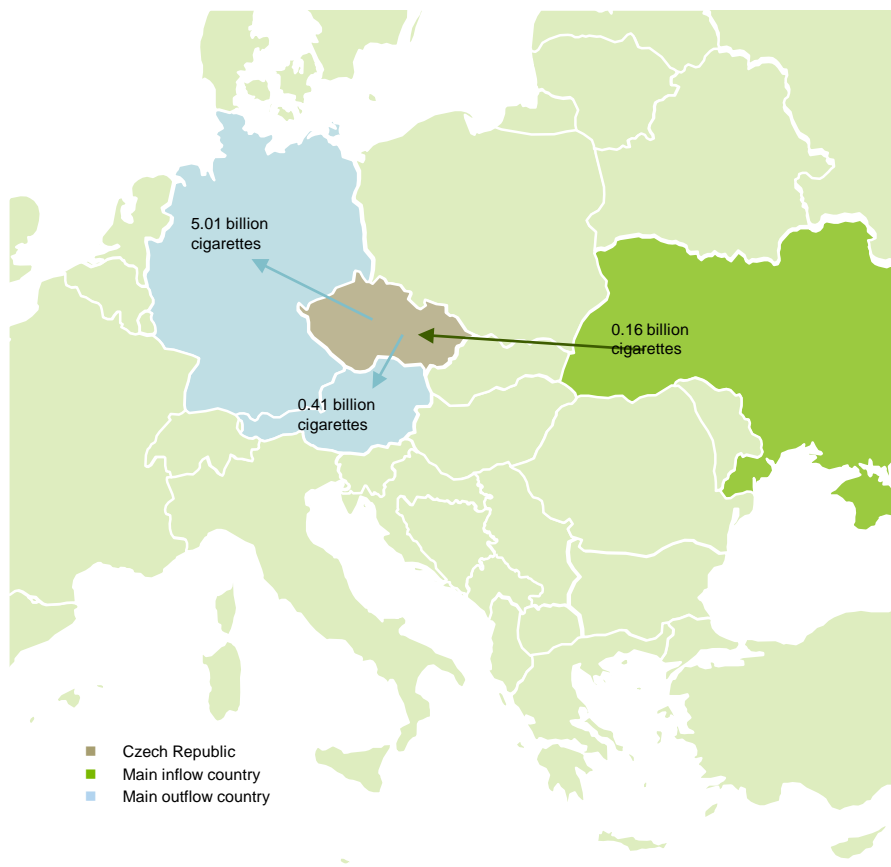
- OTP represents approximately 11% of the combined total cigarette consumption and OTP legal domestic sales; its share of the total market is growing
- Whilst there are no official estimates, illicit OTP may have also become available in the form of untaxed, unbranded green leaf tobacco

Czech Republic legal domestic sales (cigarettes and OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)
 (3) Euromonitor, "Countries and Consumers annual data", January 2012
 (4) PMI, research on open market practices, presented at workshop in Warsaw, December 2012

Inflows to Czech Republic								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Ukraine	0.06	0.06	0.69	0.71	0.51	0.25	0.16	(34)%
Belarus	0.00	0.00	0.00	0.03	0.04	0.11	0.05	(55)%
Russia	0.01	0.01	0.05	0.12	0.07	0.06	0.05	(20)%
Total Inflows	0.21	0.21	1.45	1.32	1.15	0.75	0.50	(34)%

Outflows from Czech Republic								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Germany	3.77	3.28	3.53	3.53	4.66	5.69	5.01	(12)%
Austria	0.17	0.16	0.20	0.23	0.25	0.47	0.41	(12)%
UK	0.21	0.29	0.11	0.07	0.03	0.04	0.06	45%
Total outflows	4.76	4.19	4.06	4.00	5.21	6.30	5.68	(10)%

Inflows into the Czech Republic have historically been low and declined by 34% between 2011 and 2012

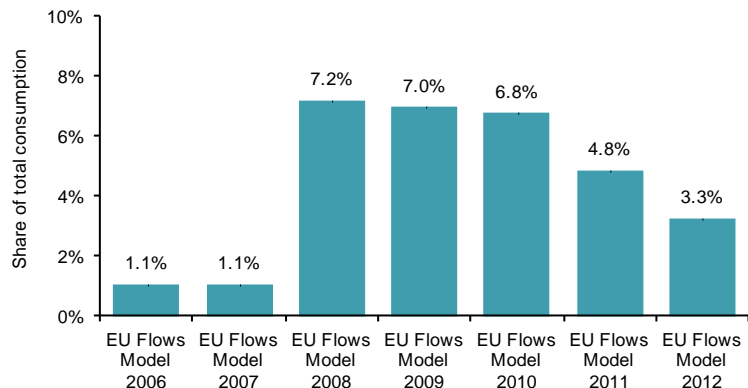
- Improved border controls between the EU27 and Ukraine have significantly reduced flows from Ukraine to other EU 27 countries
- Prices in surrounding countries are either similar or higher

The Czech Republic's key outflow countries, Germany and Austria, experienced a decline in flows of 12% respectively

- Narrowing petrol price differentials have reduced the attractiveness of making regular shopping trips to Czech Republic from Germany
 - The price difference for premium unleaded petrol between Germany and the Czech Republic reduced from 25% in 2009 to 11% in 2012⁽³⁾
- Clampdowns on open markets selling counterfeit clothing, illicit cigarettes and drugs have also reduced the attractiveness of some border shopping trips⁽⁴⁾

Non-domestic incidence in the Czech Republic fell by 1.5 percentage points in 2012, from 4.8% to 3.3%

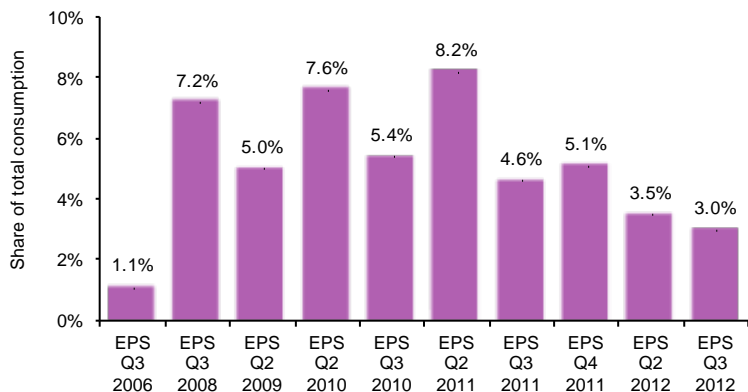
Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The EU flows model calculates non-domestic incidence by inputting the empty pack surveys results from each quarter

- For the Czech Republic, each EPS quarterly wave is weighted equally, as there were no inconsistencies or specific issues or events that may have distorted a quarterly result

Other non-domestic market estimates 2006-2012^{(2)(a)}



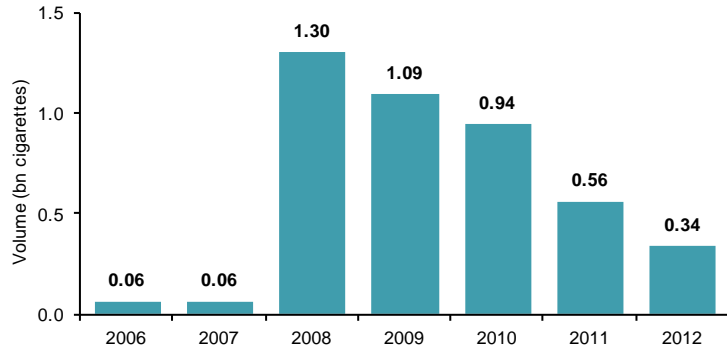
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) NMA Empty Pack Surveys 2006 – 2012

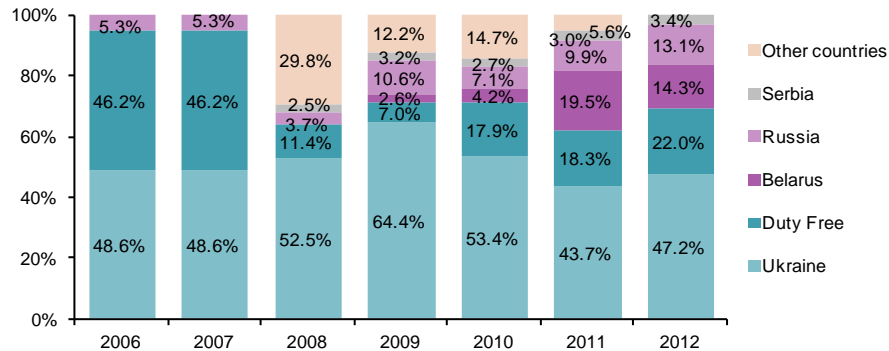
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

C&C continued to fall between 2011 and 2012 although Ukraine remained the largest source market

Total inflows of C&C
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(2)(a)}



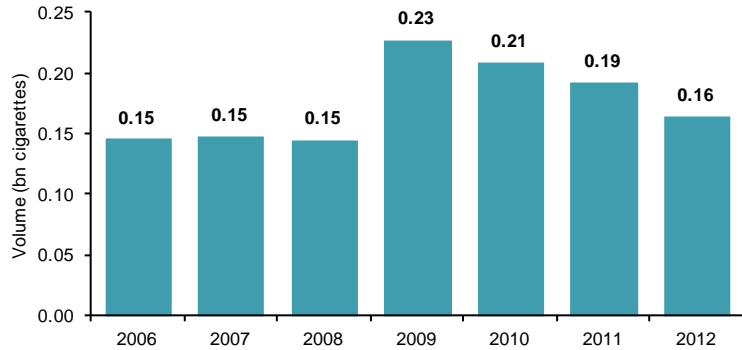
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

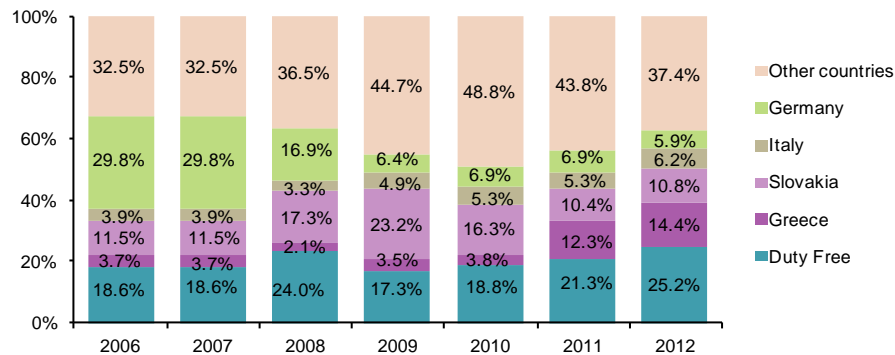
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

ND(L) volumes continued to decline, as a result of a reduction in price differentials in neighbouring countries, whilst source country share and brand shares remained broadly stable

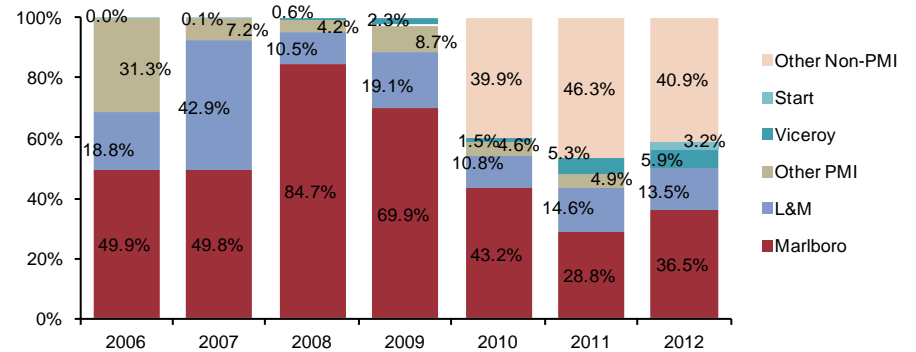
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share of ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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Denmark – Consumption summary

Total manufactured cigarette consumption in Denmark decreased by 9% in 2012, driven by both declining legal domestic sales and non-domestic incidence

Total Denmark consumption ⁽¹⁾⁽²⁾⁽³⁾								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarettes								
Legal domestic sales (LDS)	8.08	7.93	7.79	7.75	7.39	7.13	6.64	(7)%
Outflows	-0.28	-0.17	-0.23	-0.17	-0.17	-0.10	-0.15	52%
Legal domestic consumption (LDC)	7.80	7.76	7.56	7.58	7.22	7.03	6.48	(8)%
Non-domestic legal (ND(L))	0.36	0.36	0.34	0.22	0.31	0.30	0.23	(25)%
Counterfeit and contraband (C&C)	0.15	0.15	0.51	0.28	0.34	0.23	0.17	(27)%
Total non-domestic	0.52	0.51	0.85	0.50	0.65	0.53	0.39	(26)%
Total consumption	8.32	8.28	8.41	8.08	7.87	7.56	6.88	(9)%

LDS Other Tobacco Product market ^{(3)(a)}								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarette equivalent								
OTP (LDS)	-	1.32	0.66	0.86	0.78	0.81	0.85	5%

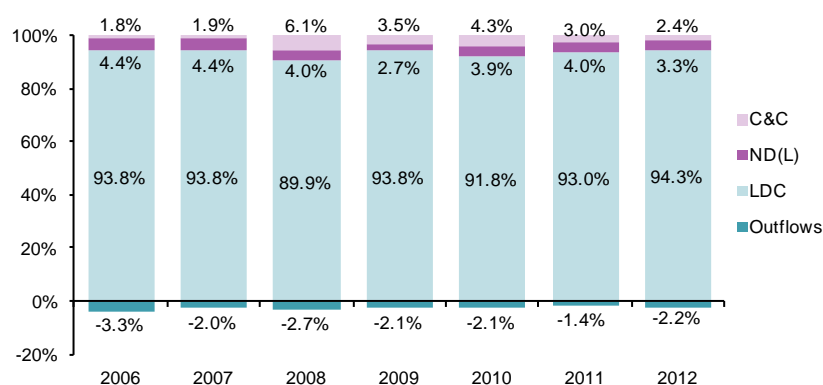
Falling legal domestic sales are the main driver of decreasing consumption in Denmark

- Legal domestic sales fell by 7% in 2012; although outflows increased by 52% to 0.2bn cigarettes, they remained small in proportion to domestic sales levels
- Total non-domestic incidence declined by 26%, with ND(L) and C&C declining at proportionally similar rates of 25% and 27% respectively

OTP sales have increased by 5% in comparison to 2011

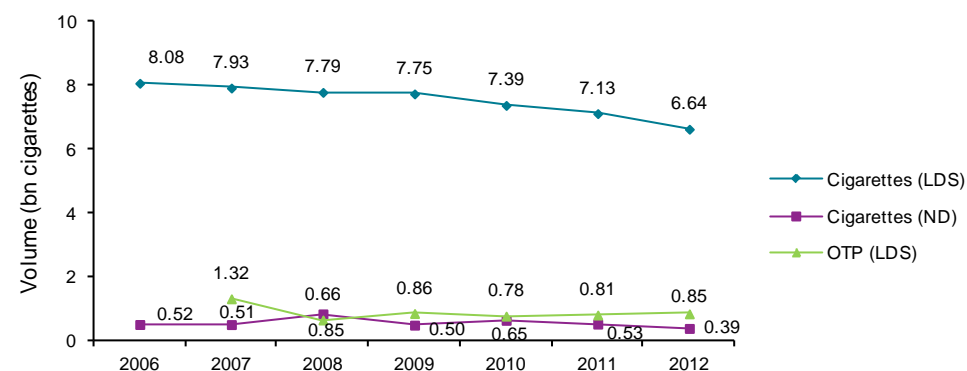
- OTP represented 11% of the combined manufactured cigarette consumption and OTP legal sales in Denmark in 2012

Share of Denmark cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) PMI Empty Pack Surveys 2006 - 2012
 (3) LDS/IMS data provided by PMI

Denmark legal domestic sales (cigarettes & OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Inflows to Denmark								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Germany	0.03	0.02	0.06	0.04	0.03	0.05	0.06	2%
Sweden	0.10	0.10	0.10	0.05	0.17	0.11	0.04	(64)%
Poland	0.04	0.04	0.07	0.03	0.03	0.03	0.02	(10)%
Other countries	0.35	0.35	0.62	0.38	0.43	0.34	0.28	(19)%
Total inflows	0.52	0.51	0.85	0.50	0.65	0.53	0.39	(26)%

Outflows from Denmark								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Sweden	0.17	0.07	0.08	0.03	0.05	0.01	0.03	>100%
Germany	0.03	0.02	0.04	0.04	0.04	0.03	0.03	(12)%
UK	0.03	0.01	0.03	0.05	0.00	0.01	0.02	>100%
Other countries	0.05	0.06	0.08	0.05	0.08	0.05	0.07	49%
Total outflows	0.28	0.17	0.23	0.17	0.17	0.10	0.15	52%

Decreasing inflows from Sweden was the main driver of the overall reduction in inflows in 2012

- Inflows from ‘other countries’ and Poland also declined in 2012
- However, flows from Germany continued to increase in line with increasing cross border trade with Denmark in 2012⁽³⁾

Outflows have increased by 52% in 2012, driven by increased outflows to ‘other countries’

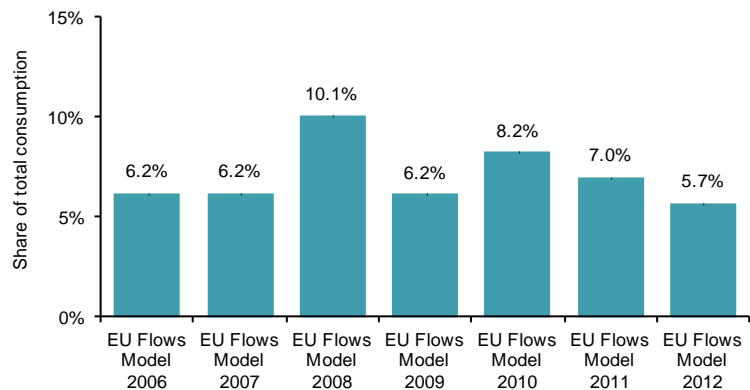
- Outflows to the Netherlands also increased by 14%

Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)
 (3) Status over grænsehandel, Hovedrapport 2012

Non-domestic incidence decreased by 1.3 percentage points in 2012 to 5.7% from 7.0% in 2011

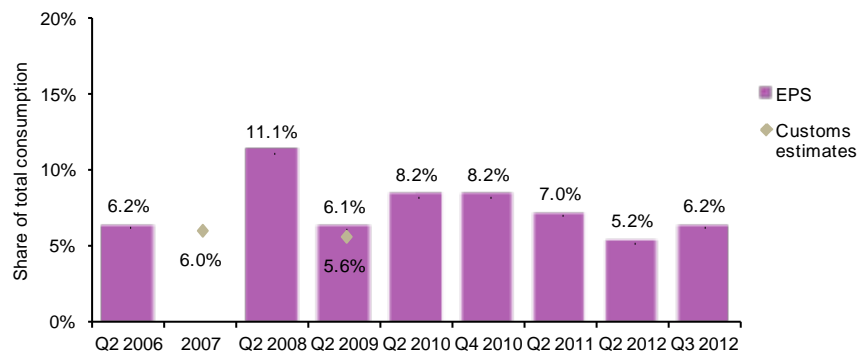
Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The EU flows model calculates non-domestic incidence by inputting the EPS results for each quarter

- Denmark EPS quarterly results were weighted equally between Q2 and Q3

Other non-domestic market estimates 2006-2012^{(2)(a)}



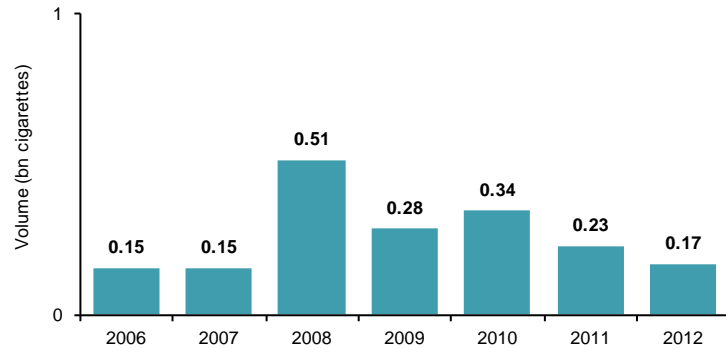
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2006 – 2012

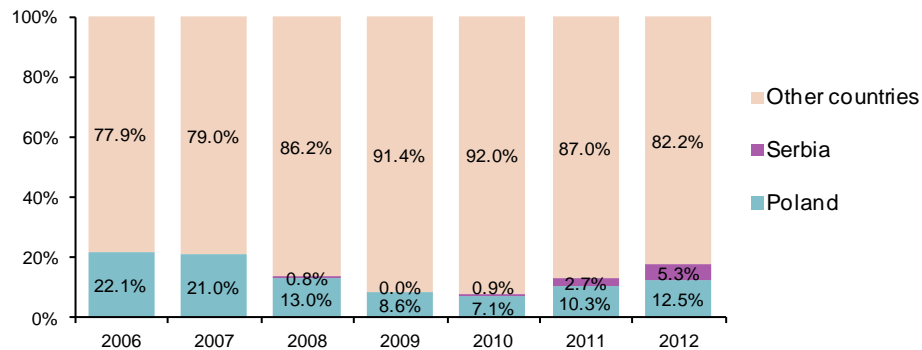
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

C&C volumes have decreased by 27% in 2012. The proportion of C&C inflows from Poland and Serbia has increased

Total inflows of C&C by origin
2006-2012^{(1)(2)(a)}



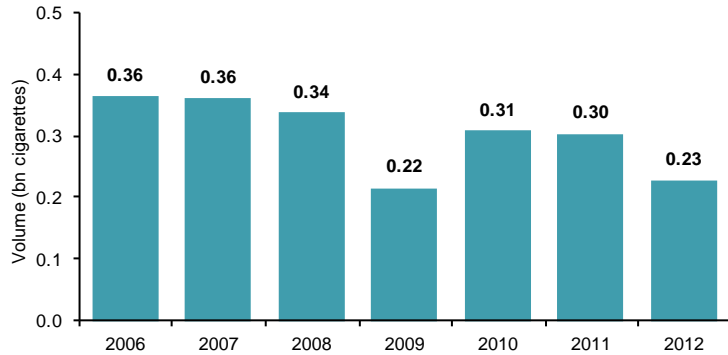
Share of C&C by origin
2006-2012^{(1)(2)(a)}



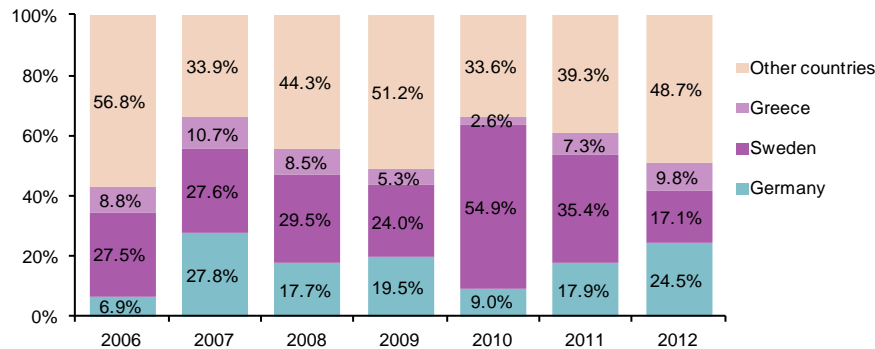
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

Non-domestic legal accounted for 59% of non-domestic consumption in 2012, with Prince being the most popular brand. Germany has become the largest ND(L) source country

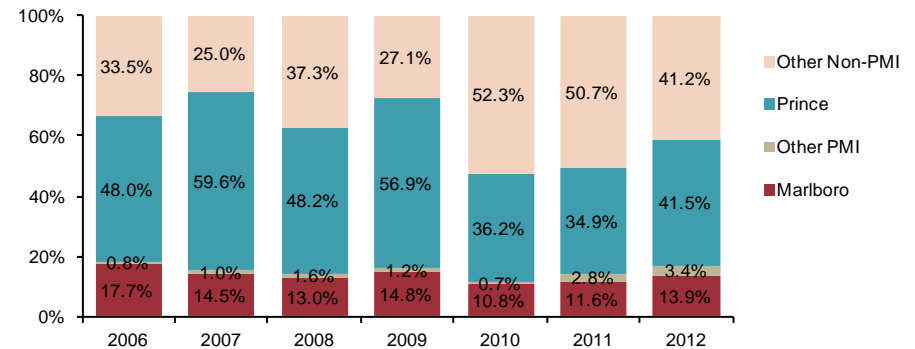
ND(L) by origin
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share of ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

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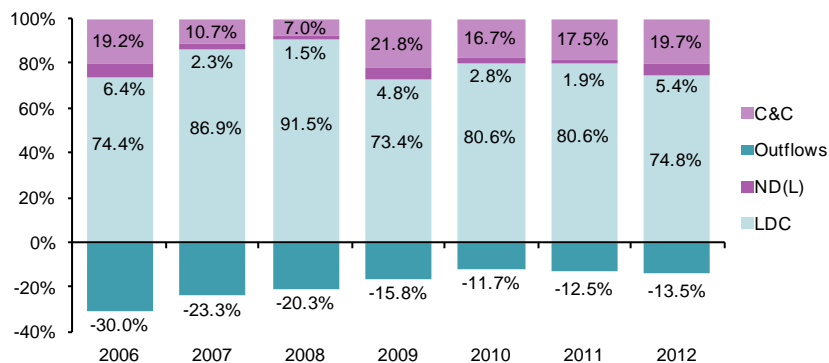
Estonia – Consumption summary

Whilst legal domestic sales decreased in Estonia 2012, non-domestic consumption increased by 32%, largely from Russia

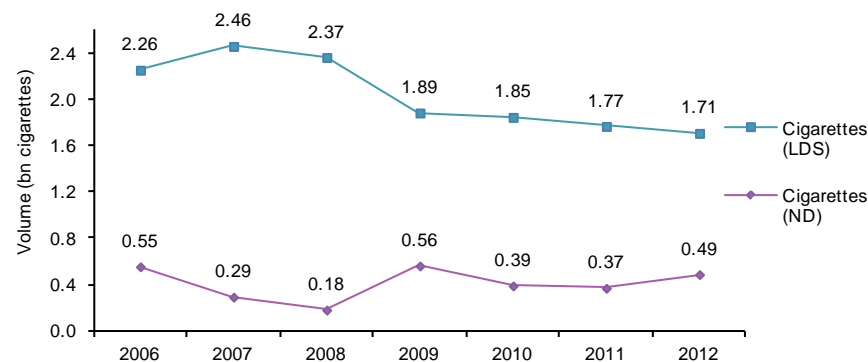
Total Estonia consumption ⁽¹⁾⁽²⁾⁽³⁾								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	2.26	2.46	2.37	1.89	1.85	1.77	1.71	(3)%
Outflows	-0.65	-0.52	-0.43	-0.33	-0.24	-0.24	-0.26	10%
Legal domestic consumption (LDC)	1.61	1.94	1.94	1.55	1.61	1.53	1.45	(5)%
Non-domestic legal (ND(L))	0.14	0.05	0.03	0.10	0.06	0.04	0.10	>100%
Counterfeit and contraband (C&C)	0.42	0.24	0.15	0.46	0.33	0.33	0.38	15%
Total non-domestic	0.55	0.29	0.18	0.56	0.39	0.37	0.49	32%
Total consumption	2.16	2.23	2.12	2.11	2.00	1.90	1.94	2%

The increase in non-domestic consumption came from significant increases in ND(L) and C&C

Share of Estonia cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Estonia legal domestic sales and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)

(3) LDS/IMS data provided by PMI

Notes: (a) OTP data not available

Estonia – Country flows summary

The Estonian market experienced a 26% rise in inflows from Russia, its main non-domestic source market, and a small increase in outflows

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Notes: (a) Map shows flows over 1% of consumption, or top flow if none are greater than 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)
 (3) Statistics Estonia, inbound and outbound tourist trips, February 2013

Inflows to Estonia								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12
Russia	0.22	0.23	0.14	0.51	0.36	0.30	0.38	26%
Belarus	0.00	0.00	0.00	0.00	0.00	0.03	0.05	81%
Other countries	0.34	0.06	0.04	0.05	0.02	0.04	0.05	49%
Total inflows	0.55	0.29	0.18	0.56	0.39	0.37	0.49	32%
Outflows from Estonia								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Finland	0.43	0.25	0.25	0.27	0.21	0.20	0.21	4%
Other countries	0.22	0.27	0.18	0.06	0.03	0.03	0.05	48%
Total outflows	0.65	0.52	0.43	0.33	0.24	0.24	0.26	10%

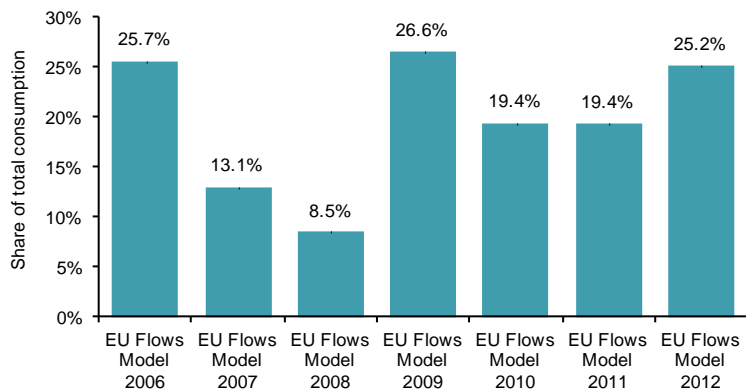
Inflows to Estonia have increased from its main source country Russia, as well as from Belarus

- Russian inflows have increased as a result of a growing number of visitor travelling between each country
 - Visitor flows from Russia increased by 49% in 2012 as Russians take advantage of the choice of shops in Estonia, whilst visitors from Estonia to Russia have increased at an average of 47% in the past three years⁽³⁾
- Belarus inflows have increased, a pattern seen by many countries within the EU, as illicit cigarettes are increasingly coming from this channel

Outflows to Finland increased by 4%, as a result of increased visitor flows from Finland to Estonia

Non-domestic incidence rose in Estonia by 5.8 percentage points in 2012, from 19.4% to 25.2%

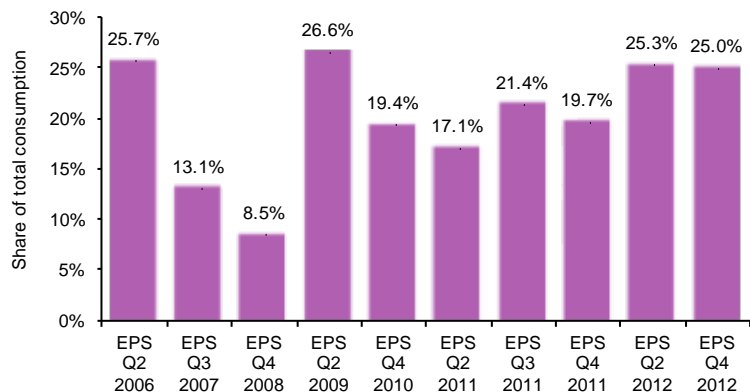
Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The EU flows model calculates non-domestic incidence by inputting the empty pack surveys results from each quarter

- For Estonia, each EPS quarterly wave is weighted equally, as there were no inconsistencies or specific issues or events that may have distorted a quarterly result

Other non-domestic market estimates 2007-2012^{(2)(a)}



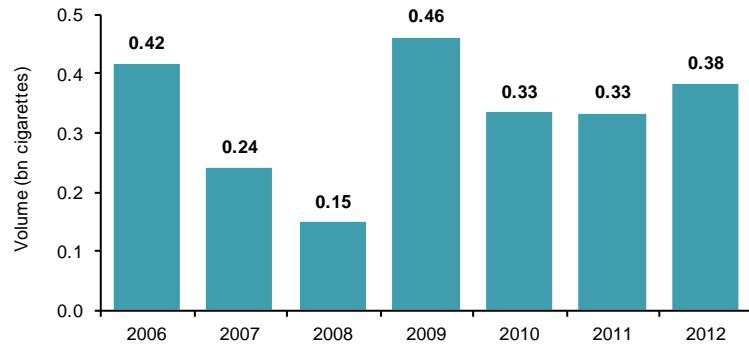
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2007 – 2012

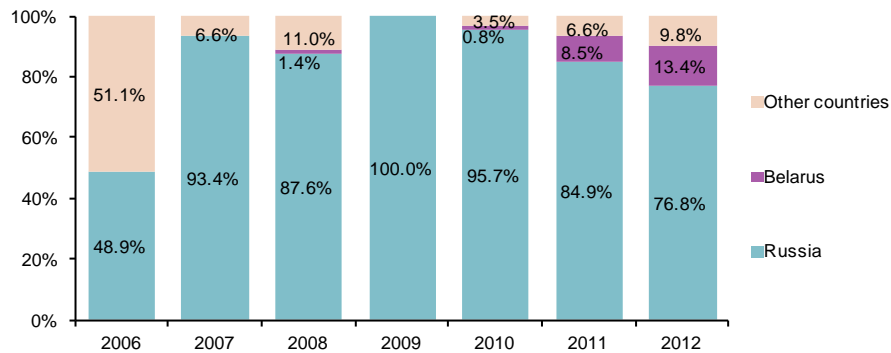
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

The majority of C&C continues to come from Russia, however C&C inflows from Belarus are increasing, as illicit supply chains appear to be growing from Belarus across the EU

Total inflows of C&C
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(2)(a)}

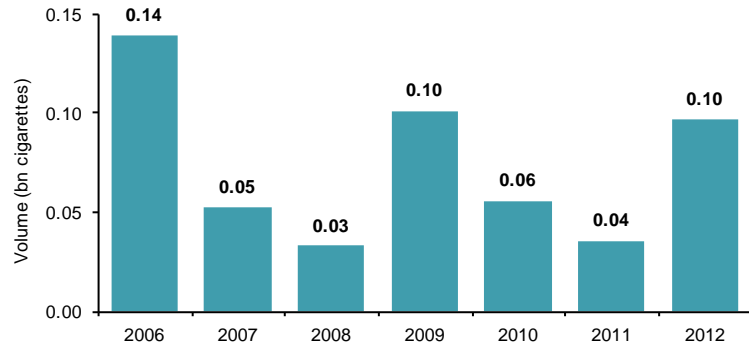


Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

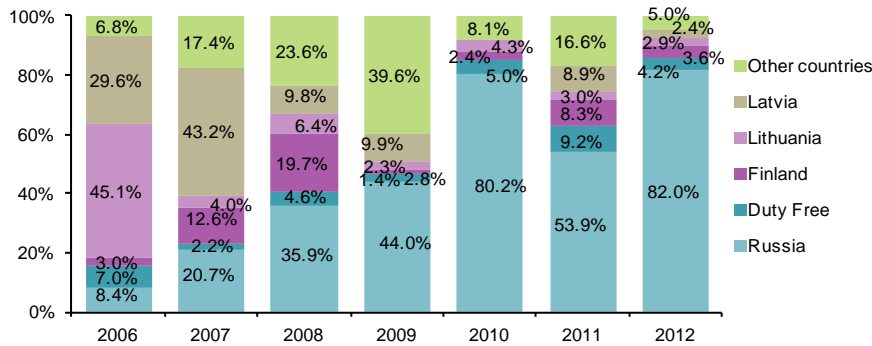
Estonia – ND(L) summary

ND(L) continued to increase from Russia, as inbound and outbound tourist flows increased by 49% in 2012

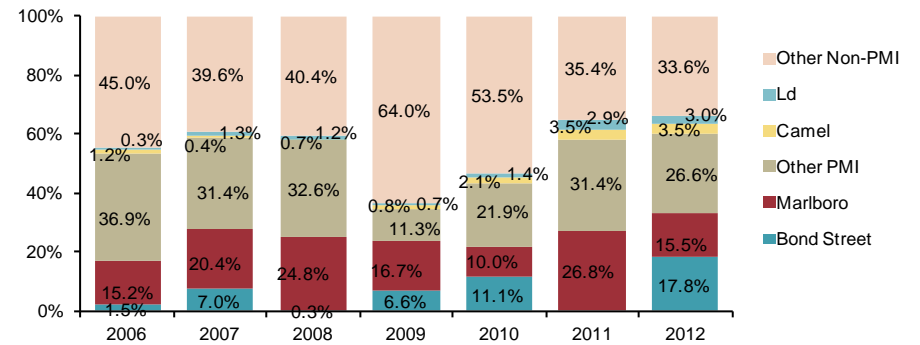
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)

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- Slovenia
- Spain
- Sweden
- United Kingdom

Total consumption of manufactured cigarettes in Finland decreased by 1% in 2012, driven by falling legal domestic sales

Total Finland consumption ⁽¹⁾⁽²⁾⁽³⁾								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	5.05	4.95	4.90	4.88	4.68	4.76	4.65	(2)%
Outflows	-0.07	-0.04	-0.05	-0.04	-0.01	-0.04	-0.04	7%
Legal domestic consumption (LDC)	4.99	4.91	4.85	4.85	4.67	4.72	4.61	(2)%
Non-domestic legal (ND(L))	0.73	0.41	0.44	0.59	0.36	0.40	0.36	(9)%
Counterfeit and contraband (C&C)	0.64	1.08	1.07	0.85	0.95	0.93	1.01	8%
Total non-domestic	1.38	1.49	1.51	1.43	1.31	1.34	1.37	3%
Total consumption	6.36	6.41	6.37	6.28	5.97	6.06	5.98	(1)%

LDS Other Tobacco Product market ^{(3)(a)}								
Billion cigarette equivalent	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
OTP (LDS)	-	1.12	1.11	1.12	1.11	1.12	1.11	(1)%

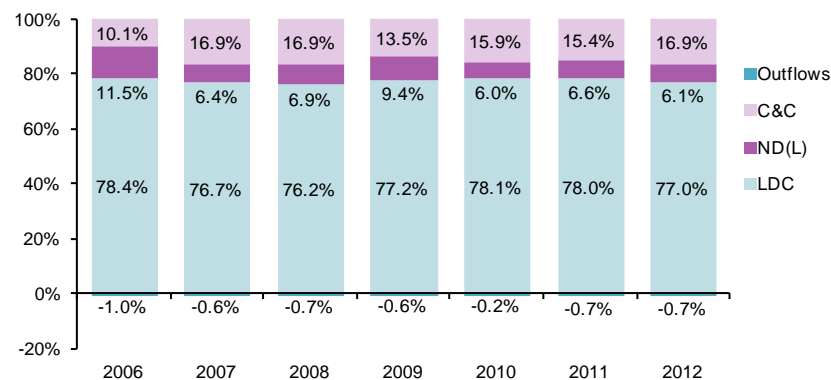
A small decrease in legal domestic sales was partially offset by an increase in non-domestic inflows, leading to a 1% decline in total consumption in 2012

- An overall decline in Finnish consumption is supported by GCTS data, which shows both a decline in regular cigarette smokers, and a decline in the average number of cigarettes smoked per day⁽⁴⁾

OTP volumes have declined slightly in Finland since 2011

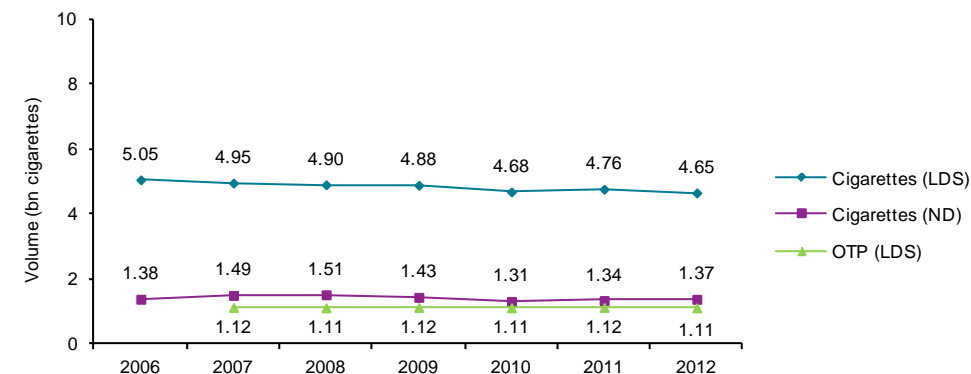
- This suggests that consumers are currently not switching to OTP products in place of manufactured cigarettes
- However, the OTP market is significant at 16% of manufactured cigarette consumption and OTP legal sales combined

Share of country cigarettes consumption by type 2006-2012⁽¹⁾⁽²⁾



Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) PMI Empty Pack Surveys 2006 - 2012
 (3) LDS/IMS data provided by PMI

Finland legal domestic sales (cigarettes & OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



(4) Global Consumer Tracking Survey provided by PMI
 Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

Non-domestic incidence in Finland increased in 2012, driven largely by increasing inflows of cigarettes from Russia and Estonia

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Inflows to Finland								Change
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	11/12 %
Russia	0.62	0.89	0.89	0.83	0.68	0.79	0.82	3%
Estonia	0.43	0.25	0.25	0.27	0.21	0.20	0.21	4%
Other countries	0.33	0.36	0.37	0.34	0.42	0.34	0.35	1%
Total inflows	1.38	1.49	1.51	1.43	1.31	1.34	1.37	3%

Outflows from Finland								Change
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	11/12 %
UK	0.00	0.00	0.01	0.02	0.00	0.00	0.01	>100%
Netherlands	0.01	0.00	0.00	0.00	0.00	0.01	0.01	(44)%
Other countries	0.06	0.04	0.04	0.01	0.01	0.02	0.02	(2)%
Total outflows	0.07	0.04	0.05	0.04	0.01	0.04	0.04	7%

Russia remains the largest source of non-domestic cigarettes in Finland

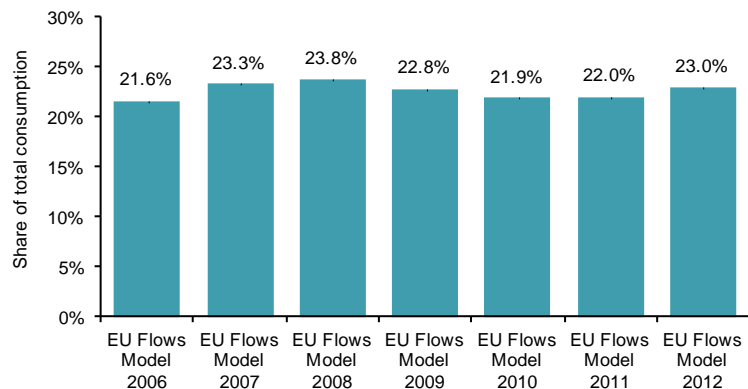
- Russian inflows increased by 3% from 2011 levels, driven by growing Russian tourist visits, and the continuing high price differential between the two countries⁽³⁾
- Estonian inflows showed a 4% increase in 2012, with the main driver being increased ferry travel between Estonia and Finland⁽⁴⁾

Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)
 (3) Euromonitor, Travel and Tourism Statistics, March 2013
 (4) Official Statistics of Finland, Monthly Statistics on International Shipping, January - December 2012

Non-domestic incidence increased by 1.0 percentage point in 2012 to 23% from 22% in 2011

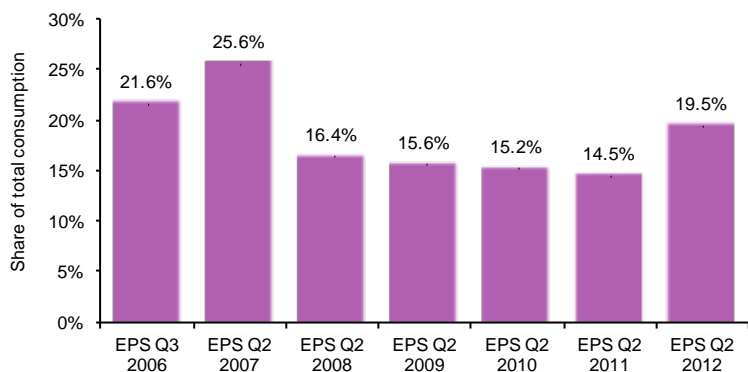
Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The EU flows model calculates non-domestic incidence by inputting the EPS results

- The 2012 EU flows model results were adjusted to include inflows of cigarettes to Finland from Russia, using analysis of tourist trips and border crossing data

Other non-domestic market estimates 2006-2012^{(2)(a)}



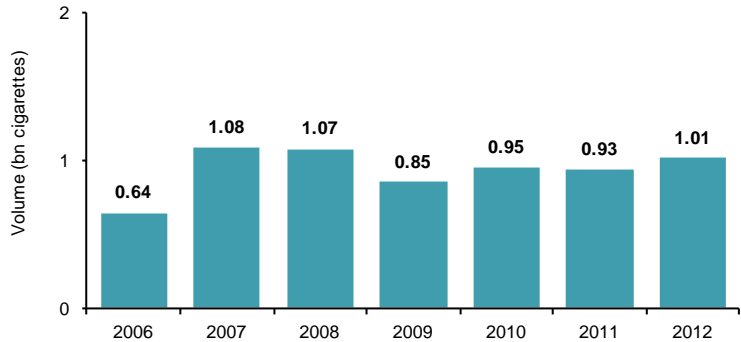
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2006 – 2012

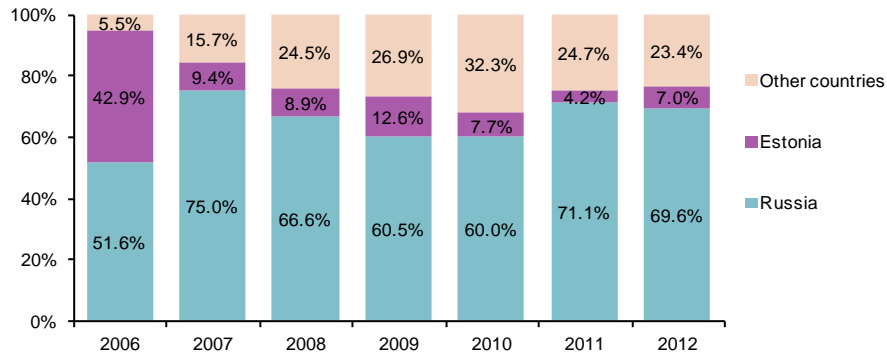
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

C&C flows increased by 8% in 2012, and continued to predominantly come from Russia and Estonia

Total inflows of C&C by origin
2006-2012^{(1)(2)(a)}



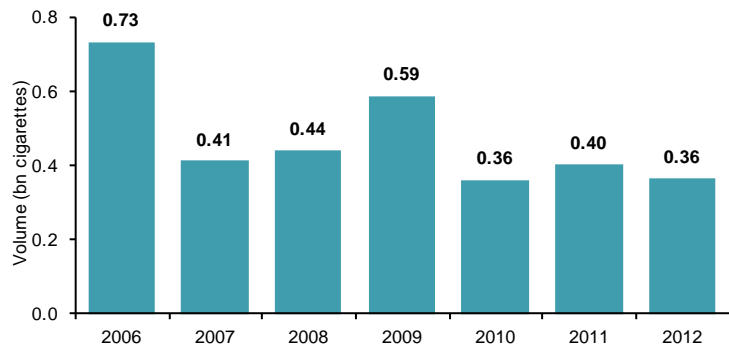
Share of C&C by origin
2006-2012^{(1)(2)(a)}



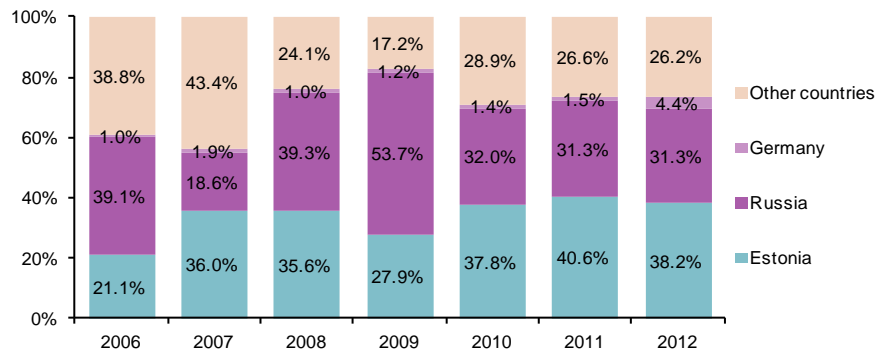
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

Non-domestic legal volume declined by 9% in 2012; these flows were mainly comprised of Estonian and Russian cigarettes, with L&M being the most popular brand

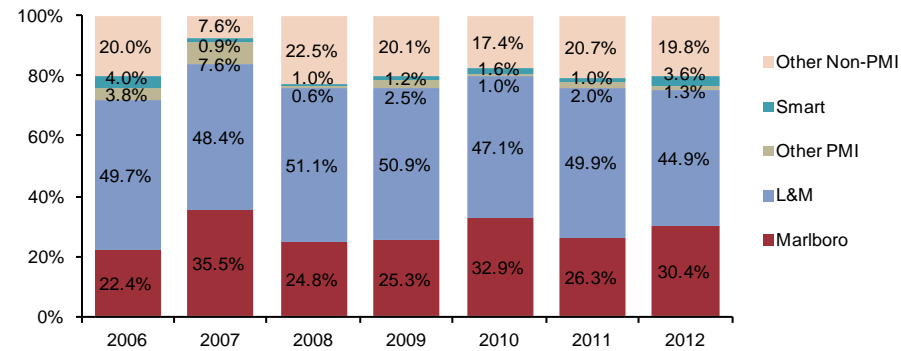
ND(L) by origin
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share of ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

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France – Consumption summary

Legal domestic sales in France declined by 5% in 2012, offset partly by increased non-domestic inflows and growing OTP volumes

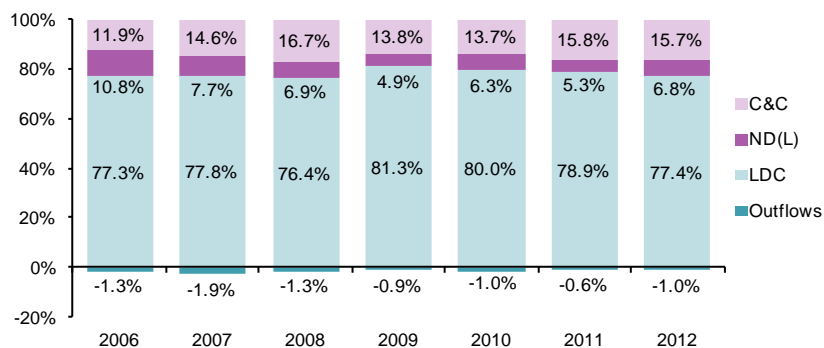
Total France consumption⁽¹⁾⁽²⁾⁽³⁾

Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	55.77	54.95	53.59	54.99	54.80	54.11	51.46	(5)%
Outflows	-0.91	-1.32	-0.92	-0.61	-0.68	-0.42	-0.63	50%
Legal domestic consumption (LDC)	54.86	53.63	52.67	54.38	54.11	53.69	50.83	(5)%
Non-domestic legal (ND(L))	7.66	5.29	4.74	3.29	4.24	3.63	4.50	24%
Counterfeit and contraband (C&C)	8.45	10.04	11.55	9.20	9.29	10.74	10.34	(4)%
Total non-domestic	16.11	15.33	16.29	12.49	13.53	14.37	14.84	3%
Total consumption	70.97	68.95	68.96	66.86	67.64	68.06	65.67	(4)%

France Other Tobacco Product market^{(3)(a)}

Billion cigarette equivalent	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
OTP (LDS)	-	11.15	11.34	13.16	13.61	14.08	14.89	6%

Share of France cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2006 - 2012

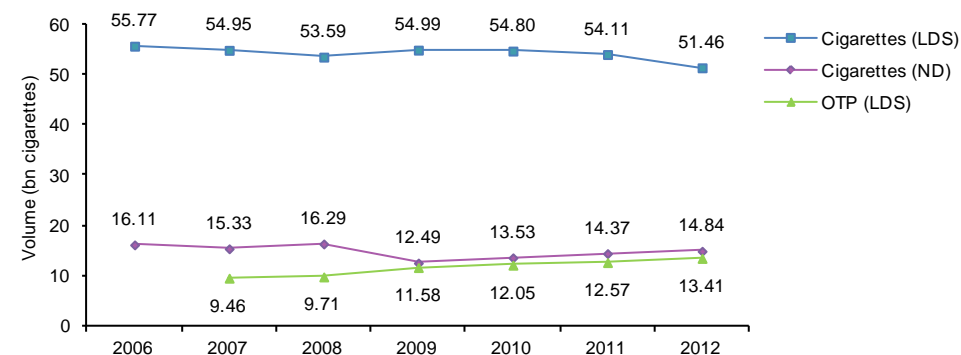
(3) LDS/IMS data provided by PMI

(4) PMF management estimate, February 2013

Legal domestic sales were impacted by price rises which took effect during the year, driving a decline in overall consumption and an increase in switching to non-domestic products and OTP

- Cigarette prices in France increased by around 7% across price segments, increasing the incentive to switch to lower priced alternatives
 - Total non-domestic cigarette consumption rose by 3% in 2012, with increased ND(L) being offset by a slight decline in C&C
 - Legal domestic sales of OTP increased by 6% in 2012, representing 18% of the legal domestic tobacco market
 - E-cigarettes are also gaining an increasing share, comprising an estimated 2% of the tobacco market in 2012⁽⁴⁾

France legal domestic sales (cigarettes and OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

Non-domestic inflows from Spain, Luxembourg and Belgium into France increased in 2012, as price differentials between these countries widened during the year

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

Inflows to France								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Spain	3.42	3.25	4.38	2.40	2.08	1.57	2.33	48%
Luxembourg	1.00	0.95	0.86	0.58	0.52	0.73	1.11	53%
Algeria	0.00	0.26	0.41	0.80	1.00	1.12	1.08	(3)%
Belgium	0.53	0.73	0.71	0.48	0.43	0.90	1.01	12%
Other countries	11.15	10.14	9.93	8.24	9.49	10.05	9.30	(7)%
Total inflows	16.11	15.33	16.29	12.49	13.53	14.37	14.84	3%

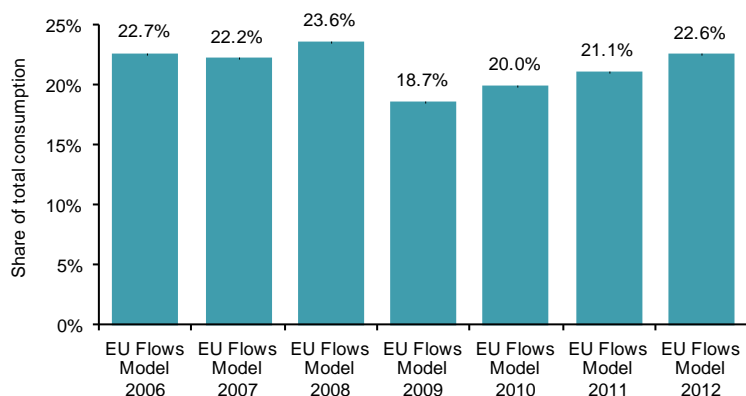
Outflows from France								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Netherlands	0.37	0.35	0.12	0.08	0.35	0.13	0.16	18%
Italy	0.02	0.00	0.05	0.04	0.10	0.08	0.14	68%
Belgium	0.07	0.15	0.03	0.16	0.07	0.06	0.09	41%
Other countries	0.45	0.81	0.73	0.33	0.16	0.14	0.24	74%
Total outflows	0.91	1.32	0.92	0.61	0.68	0.42	0.63	50%

Inflows from Spain into France grew significantly in 2012, with Spanish incidence increasing most markedly in the south of France; inflows from Belgium and Luxembourg were a growing issue during the year

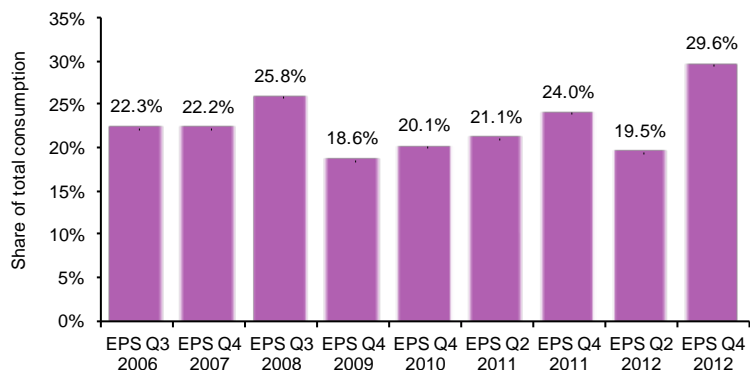
- Inflows from Spain increased by 48% in 2012, with Toulouse and Perpignan attracting the largest volumes; inflows from Algeria declined slightly, though remained significant
- Volumes from Luxembourg and Belgium also increased by 53% and 12%, respectively, with border sales increasing significantly during the year

Estimated non-domestic incidence in France increased from 21.1% in 2011 to 22.6% in 2012

Non-domestic market estimates 2006-2012^{(1)(2)(a)}



Other non-domestic market estimates 2006-2012^{(2)(a)}



2012 EPS results showed a significant increase in non-domestic incidence in Q4, driven largely by a price increase which took effect in October 2012

- This increased level of non-domestic incidence was deemed to be representative of four months of the year only, taking into account increased non-domestic incidence in the month before the anticipated price rise and during the rest of Q4
 - Therefore, the Q4 EPS results have been weighted to represent 4 months of the year, while Q2 results have been weighted to represent the remaining 8 months
- Without this adjustment non-domestic incidence for 2012 would have been 24.6%

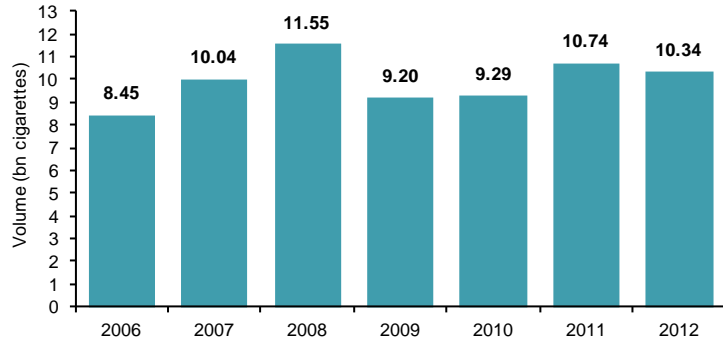
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2006 – 2012

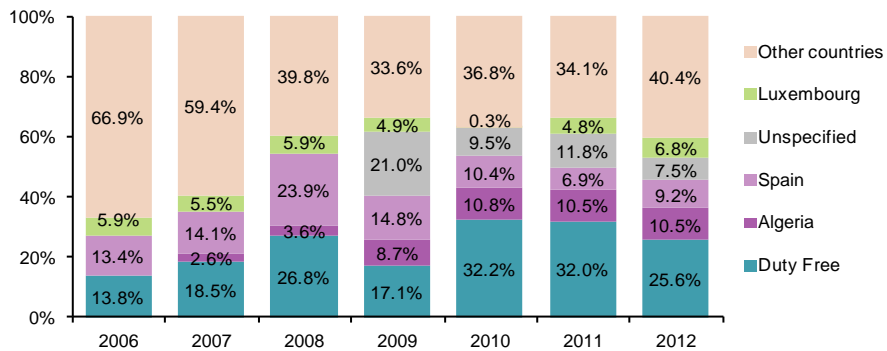
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

C&C declined slightly by 4% in 2012, largely driven by a decline in Duty Free and Unspecified inflows

Total inflows of C&C
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

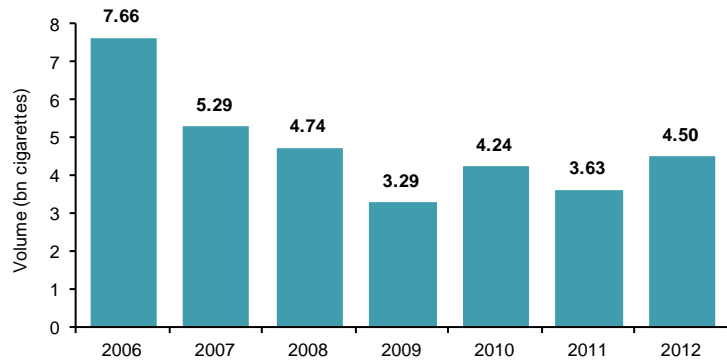
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

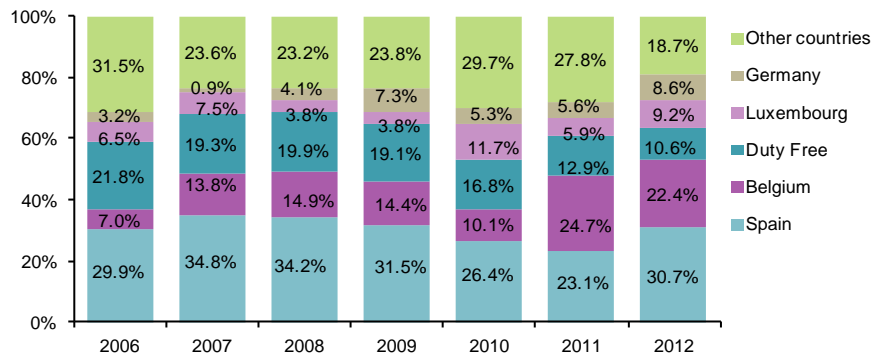
France – ND(L) summary

ND(L) increased by 24% in 2012, driven by growing inflows from neighbouring markets; PMI brands represent around 50% of inflows, down from 58% in 2011

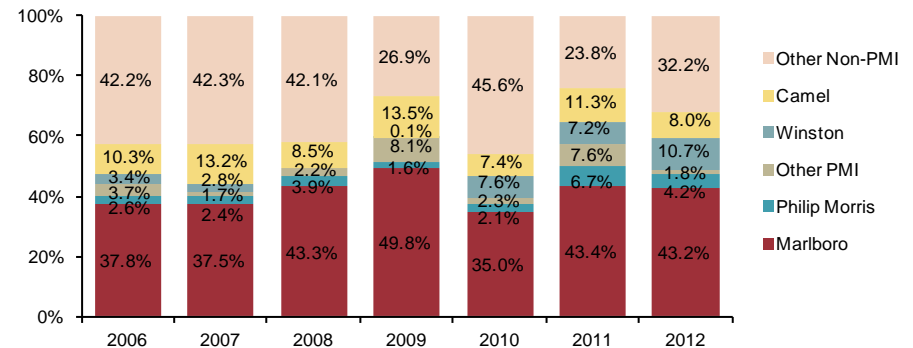
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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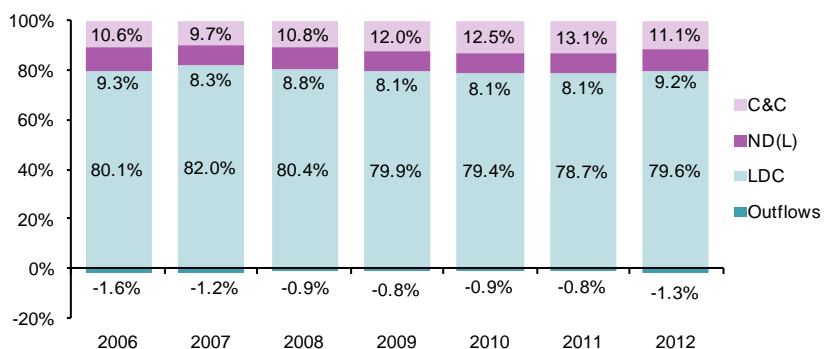
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- United Kingdom

Consumption of manufactured cigarettes decreased whilst sales of OTP, a significant part of the German tobacco market, remained stable

Total Germany consumption ⁽¹⁾⁽²⁾⁽³⁾								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarettes								
Legal domestic sales (LDS)	93.17	89.34	86.95	85.49	83.91	84.47	83.44	(1)%
Outflows	-1.86	-1.31	-0.97	-0.84	-0.95	-0.86	-1.37	59%
Legal domestic consumption (LDC)	91.31	88.03	85.97	84.65	82.96	83.60	82.07	(2)%
Non-domestic legal (ND(L))	10.55	8.87	9.39	8.62	8.43	8.62	9.50	10%
Counterfeit and contraband (C&C)	12.11	10.39	11.53	12.73	13.09	13.96	11.47	(18)%
Total non-domestic	22.66	19.26	20.92	21.35	21.52	22.58	20.98	(7)%
Total consumption	113.97	107.30	106.89	106.00	104.48	106.19	103.04	(3)%

Germany Other Tobacco Product market ^{(3)(a)}								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarette equivalent								
OTP (LDS)	24.19	35.56	33.49	40.75	41.52	43.38	43.97	1%

Share of Germany cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



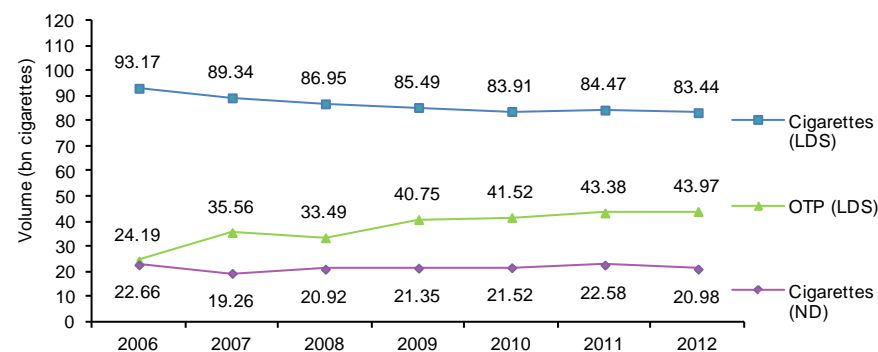
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)
 (3) LDS/IMS data provided by PMI
 (4) PMI Management and EU Tax Tables

The decline in total cigarette consumption is due to lower inflows which declined by 7%

- Legal domestic sales in Germany declined by 1%

Cigarette equivalent OTP legal domestic sales accounted for 35% of total legal domestic sales in Germany

Germany legal domestic sales (cigarettes and OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}

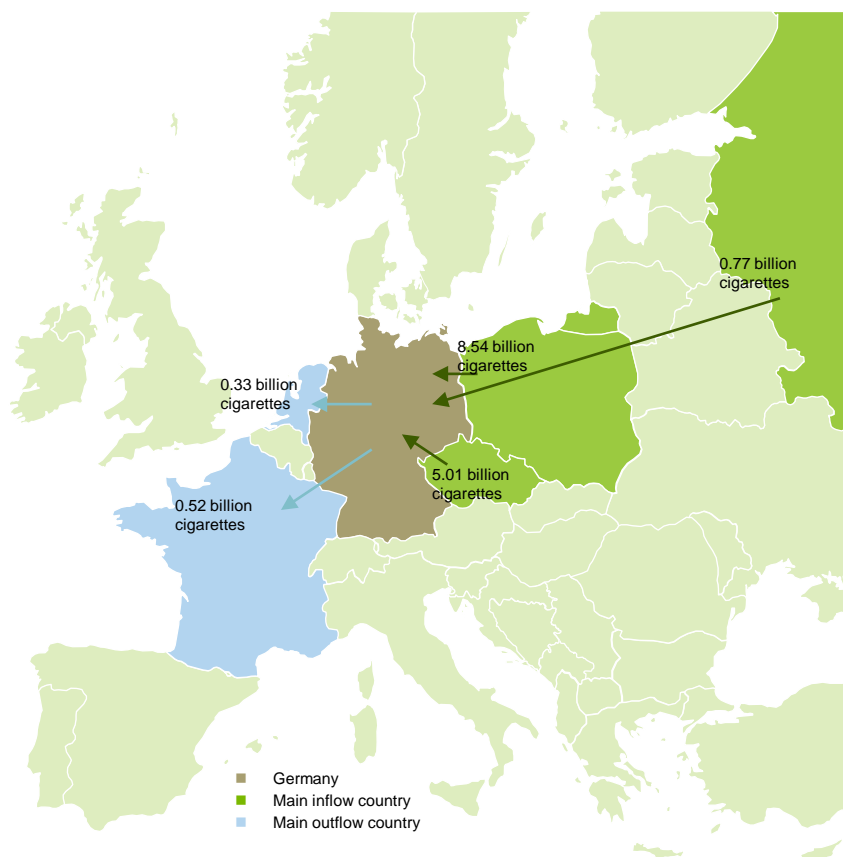


Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

Germany – Country flows summary

Total inflows have declined by 7%, largely due to lower flows from the Czech Republic and Russia; total outflows have increased, due to an increased price differential between Germany and France

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

(b) Based on average price of a pack of 20 Marlboros as of 31 December 2012

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

(3) PMI Management and EU Tax Tables

Inflows to Germany								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Poland	6.53	6.85	6.32	7.54	7.49	8.64	8.54	(1)%
Czech Republic	3.77	3.28	3.53	3.53	4.66	5.69	5.01	(12)%
Russia	1.69	1.13	2.28	1.98	1.55	1.29	0.77	(40)%
Other Countries	10.67	8.00	8.80	8.31	7.83	6.96	6.65	(4)%
Total inflows	22.66	19.26	20.92	21.35	21.52	22.58	20.98	(7)%

Outflows from Germany								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Netherlands	0.45	0.29	0.20	0.13	0.35	0.25	0.33	35%
France	0.68	0.23	0.19	0.24	0.22	0.21	0.52	>100%
Poland	0.22	0.23	0.03	0.01	0.00	0.07	0.08	5%
Other Countries	0.50	0.55	0.55	0.46	0.37	0.33	0.44	32%
Total outflows	1.86	1.31	0.97	0.84	0.95	0.86	1.37	59%

Inflows to Germany from Poland and the Czech Republic are the highest in Europe

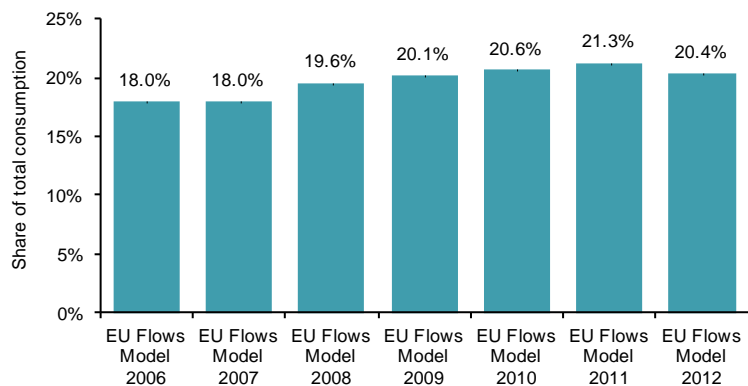
- Large price differentials between German and Polish and Czech cigarettes, along with a freedom to bring 40 packs per visitor across the border, has driven these high flows
 - Cigarette prices in Poland and the Czech Republic are 41% and 35% cheaper respectively^{(3)(b)}
- Flows from the Czech Republic reduced by 12% as authorities have reduced illegal activities at open markets (sales of drugs, counterfeit clothing, illicit cigarettes), along with lower petrol price differentials

Outflows to France increased significantly in 2012, as a result of a higher price increase in France, compared to Germany^(b)

Germany – Comparison of external sources for non-domestic estimates

Non-domestic incidence fell by 0.9 percentage points in 2012, from 21.3% to 20.4%

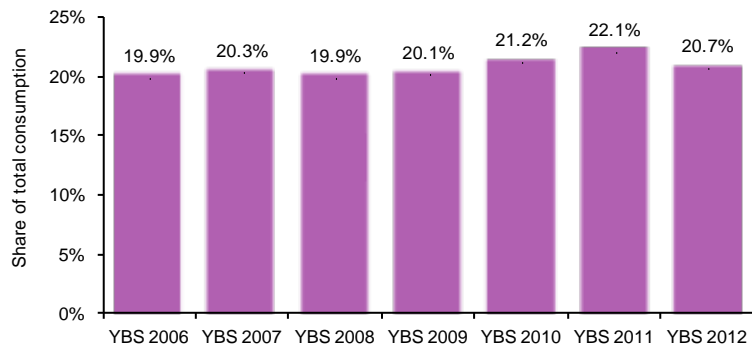
Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The EU flows model calculates non-domestic incidence by inputting the yellow bag survey results

- The Yellow Bag survey provides monthly input which is equally weighted, as there were no inconsistencies or specific issues or events that may have distorted the results
- Each pack collected was weighted, in order to obtain a sample representative of the population of the town
 - In 2011 the Görlitz collection centre was excluded from the sample, as it is right on the border and the majority of packs surveyed were non-domestic; however, this year the Yellow Bag Survey was adjusted in order to account for this discrepancy, resulting in the Görlitz results being included again^(a)

Other non-domestic market estimates 2006-2012^{(2)(a)}



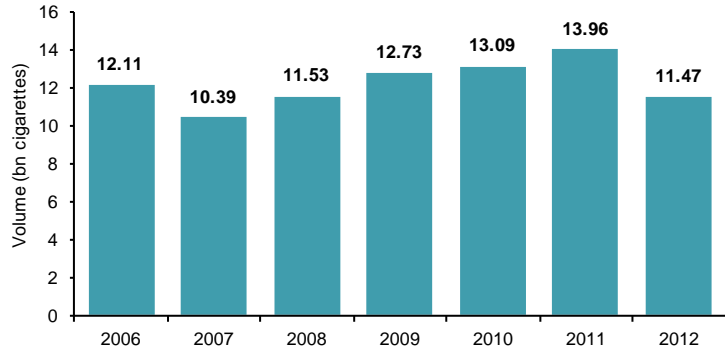
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2006 – 2012

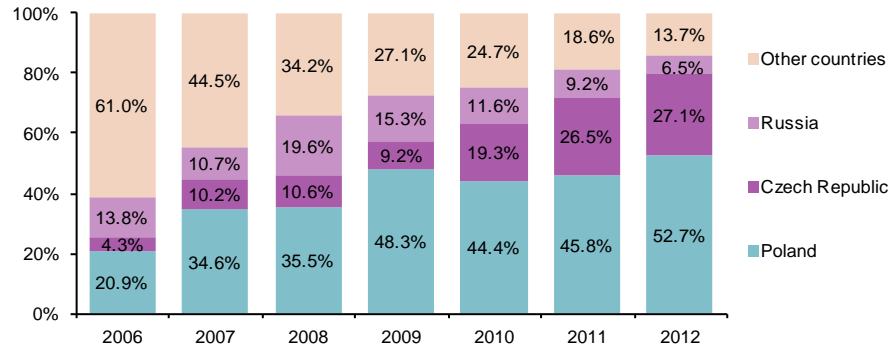
Notes: (a) Agreed with PMI local management and the PMI Illicit Trade Strategies and Prevention (ITS&P) group

Despite a decline in C&C of 18%, the majority of C&C continues to come from Poland and the Czech Republic

Total inflows of C&C
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(2)(a)(b)(c)}

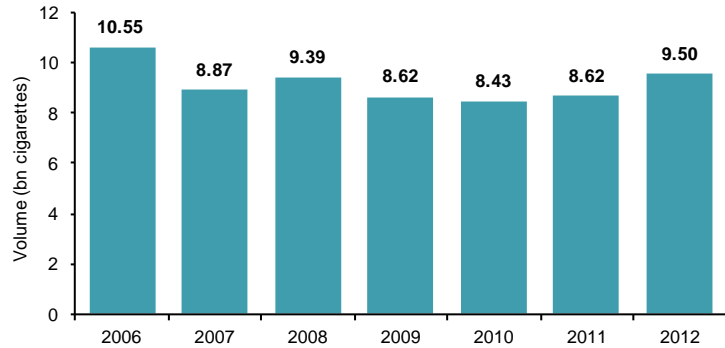


Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

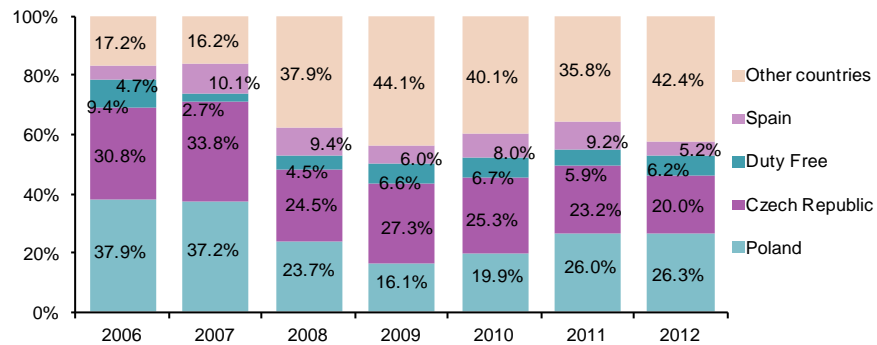
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

ND(L) increased by 10% between 2011 and 2012, driven by an increased propensity for German visitors to buy higher volumes of cigarettes when they travel, predominantly in lower priced countries, but buying preferred international brands

Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Note: (a) ND(L) flows decreased from Czech Republic as whilst the number of visitors from Germany increased by 9%, the average number of packs bought by each smoker declined from 23 to 21 packs. Similarly ND(L) flows from Poland increased by 11% despite the number of visitors increasing by 17% as the average number of packs bought decreased from 28 to 27 packs.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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- Slovakia
- Slovenia
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- Sweden
- United Kingdom

Greece – Consumption summary

C&C inflows increased by 16% in 2012, driving total non-domestic incidence in Greece to over 14% of consumption during the year

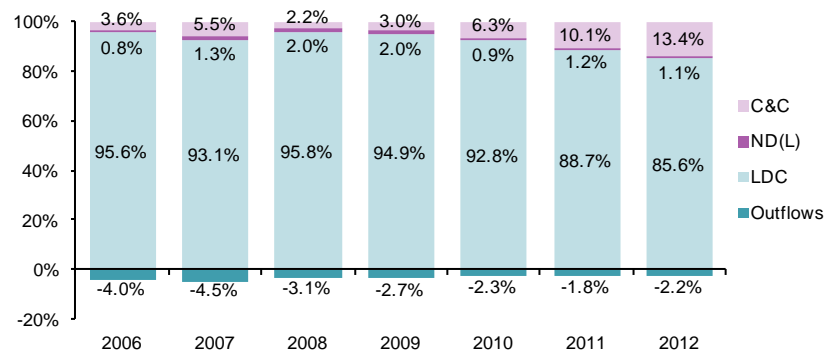
Total Greece consumption ⁽¹⁾⁽²⁾⁽³⁾								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	33.57	32.74	32.23	30.97	27.78	24.24	20.45	(16)%
Outflows	-1.34	-1.49	-1.02	-0.85	-0.66	-0.50	-0.50	2%
Legal domestic consumption (LDC)	32.22	31.25	31.21	30.11	27.12	23.75	19.94	(16)%
Non-domestic legal (ND(L))	0.26	0.45	0.64	0.64	0.26	0.32	0.25	(22)%
Counterfeit and contraband (C&C)	1.22	1.85	0.72	0.97	1.83	2.70	3.12	16%
Total non-domestic	1.48	2.30	1.36	1.61	2.09	3.02	3.37	12%
Total consumption	33.70	33.55	32.57	31.72	29.21	26.77	23.31	(13)%

LDS Other Tobacco Product market ^{(3)(a)}								
Billion cigarette equivalent	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
OTP (LDS)	-	1.65	1.82	2.50	2.86	3.56	4.75	34%

Legal domestic sales declined significantly in 2012, impacted by worsening macroeconomic conditions and price rises during the year; this was further impacted by increased non-domestic consumption and rising OTP volumes

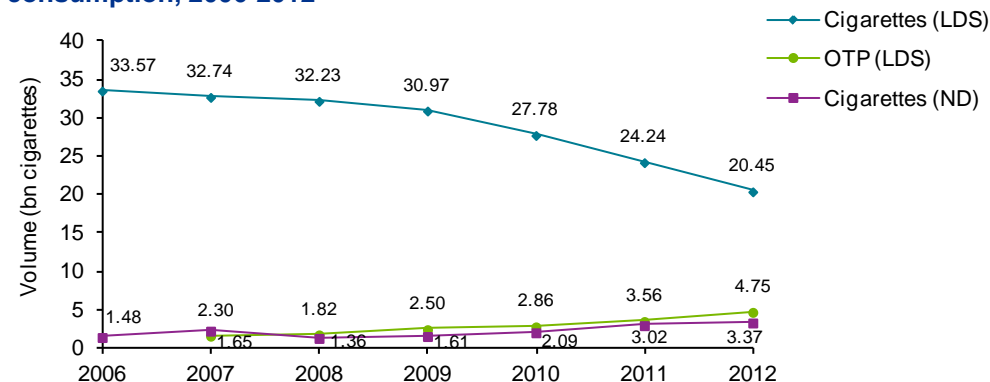
- Non-domestic incidence increased from 11.3% of total consumption in 2011 to 14.4% in 2012, driven by increased C&C flows
 - Growth in C&C volumes was impacted by increased inflows of Unspecified cigarettes; this increase was partly offset by ND(L) which declined by 22% in 2012
- Legal domestic sales of OTP also increased significantly in 2012, growing by 34% in 2012

Share of Greek cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) PMI Empty Pack Surveys 2006 – 2012
 (3) LDS/IMS data provided by PMI

Greece legal domestic sales (cigarettes and OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

The greatest driver of increased non-domestic incidence in 2012 was growing inflows of cigarettes of Unspecified market variant

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)(b)}



Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow
 (b) Unspecified market variants are defined as those packs which do not bear any market-specific health warning or tax stamp, or mention of 'Duty Free' on the pack
 Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

Inflows to Greece								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Unspecified	0.00	0.00	0.00	0.29	0.52	1.21	2.12	76%
Duty Free	1.04	1.60	1.07	0.86	0.99	1.12	0.76	(32)%
Russia	0.01	0.01	0.01	0.08	0.02	0.01	0.04	>100%
Bulgaria	0.01	0.15	0.07	0.04	0.02	0.03	0.03	4%
Other countries	0.41	0.54	0.21	0.33	0.54	0.66	0.42	(36)%
Total inflows	1.48	2.30	1.36	1.61	2.09	3.02	3.37	12%

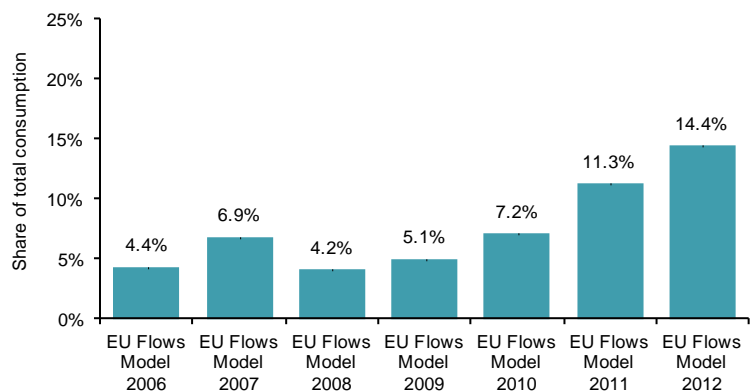
Outflows from Greece								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Germany	0.27	0.28	0.24	0.26	0.19	0.17	0.18	5%
UK	0.68	0.76	0.32	0.28	0.16	0.12	0.16	35%
Italy	0.02	0.07	0.04	0.08	0.08	0.05	0.02	(68)%
Other countries	0.37	0.38	0.42	0.23	0.23	0.15	0.15	(2)%
Total outflows	1.34	1.49	1.02	0.85	0.66	0.50	0.50	2%

Non-domestic inflows increased by 12% in 2012, while outflows from Greece increased only slightly

- Cigarettes of Unspecified market variant grew by 76% in 2012, making up over 60% of total inflows
- This increase was partly offset by a decline in Duty Free volumes, which decreased by 32% in 2012
- Outflows from Greece remained broadly stable, increasing by just 2% in 2012, with growing outflows to the UK and Germany being offset by declining outflows to Italy

Estimated non-domestic incidence in Greece increased from 11.3% in 2011 to 14.4% in 2012

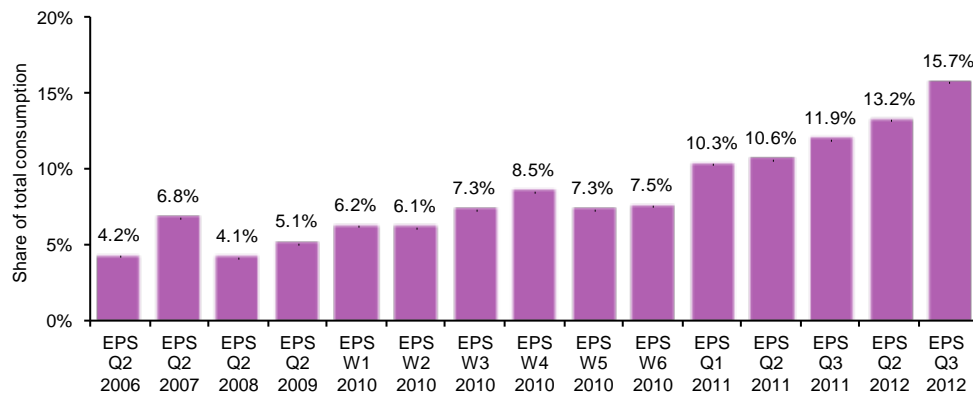
Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The EU Flows Model estimate for non-domestic consumption in 2012 is based on the results of the Empty Pack Surveys undertaken in the second and third quarters of 2012

- The EU flows model estimate is based on the arithmetic average results of the Q2 and Q3 EPS surveys, with no further adjustments made to the survey results

Other non-domestic market estimates 2006-2012^{(2)(a)}



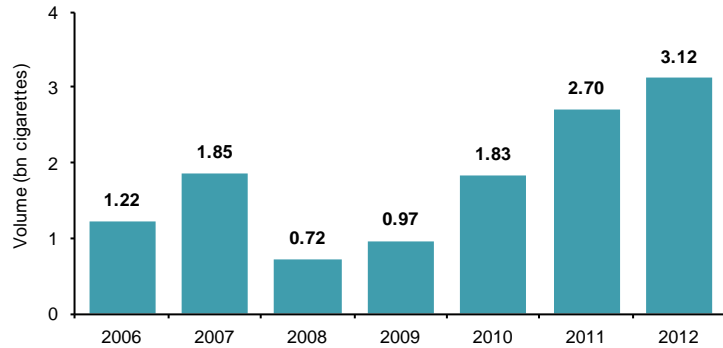
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2006 – 2012

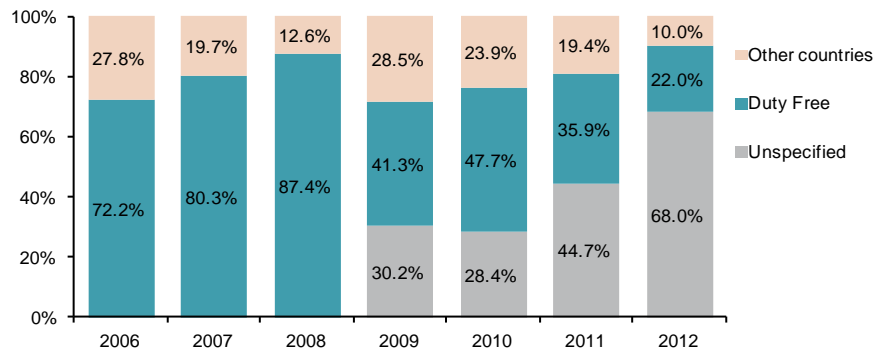
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

Increasing inflows of Unspecified cigarettes have driven a significant increase of 16% in C&C during the year

Total inflows of C&C
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(2)(a)(b)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

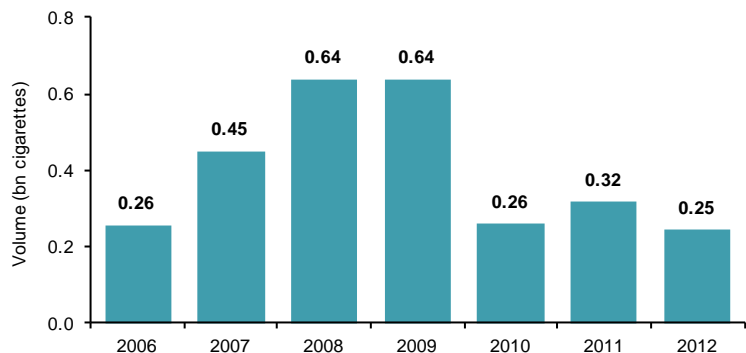
(b) Unspecified market variants are those which do not bear any market-specific health warning or mention Duty Free on the label.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

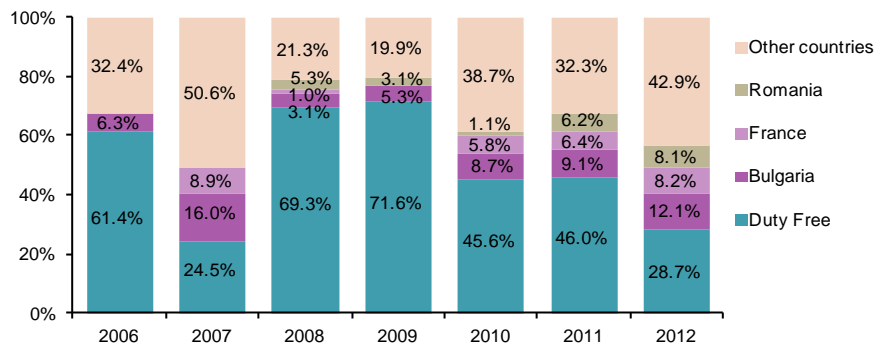
(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

Non-domestic legal inflows declined by 22% in 2012, driven by a decline in Duty Free volumes; Marlboro remains the most frequently purchased ND(L) brand with PMI brands making up around 50% of overall ND(L) volumes

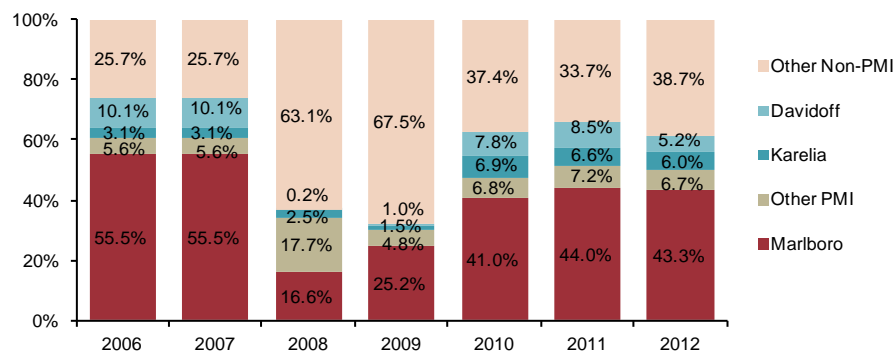
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share of ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

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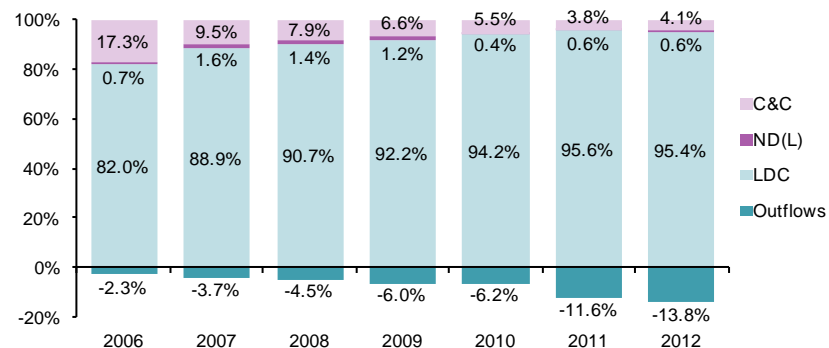
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- Spain
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- United Kingdom

Whilst legal domestic sales of manufactured cigarettes decreased by 20%, sales of OTP grew by 17%

Total Hungary consumption ⁽¹⁾⁽²⁾⁽³⁾								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	15.87	16.46	16.30	15.30	14.18	13.94	11.21	(20)%
Outflows	-0.44	-0.66	-0.78	-0.93	-0.87	-1.50	-1.41	(6)%
Legal domestic consumption (LDC)	15.43	15.80	15.53	14.36	13.31	12.44	9.80	(21)%
Non-domestic legal (ND(L))	0.14	0.28	0.24	0.18	0.05	0.08	0.06	(26)%
Counterfeit and contraband (C&C)	3.26	1.69	1.35	1.03	0.78	0.49	0.42	(14)%
Total non-domestic	3.40	1.97	1.59	1.21	0.83	0.57	0.48	(16)%
Total consumption	18.83	17.77	17.11	15.57	14.14	13.01	10.28	(21)%

Hungary Other Tobacco Product market ^{(3)(a)}								
Billion cigarette equivalent	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
OTP (LDS)	1.18	1.63	2.17	2.99	4.34	5.92	6.93	17%

Share of Hungary cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)
 (3) LDS/IMS data provided by PMI
 (4) PMI management discussions and tax tables
 (5) European Commission "Excise Duty tables", January 2013.

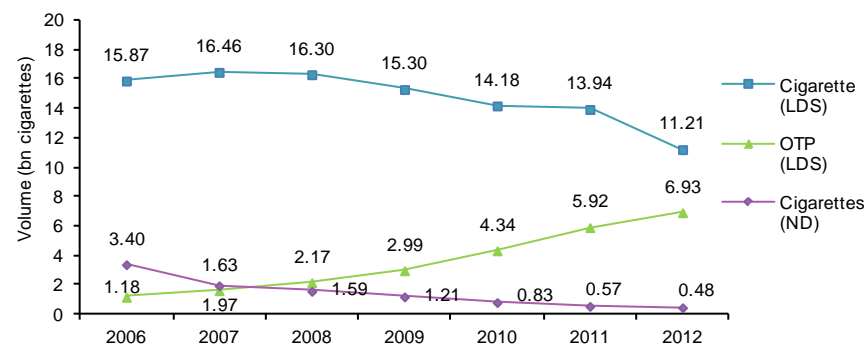
The decrease in total consumption was in line with the decrease in legal domestic sales. Taxes were increased in Hungary and this resulted in several price increases throughout 2012

- Prices of manufactured cigarettes increased by 19% in local currency, with the price of a standard pack of 19 Marlboro increasing from HUF680 to HUF810 in 2012⁽⁴⁾
- An indoor smoking ban in public places was also implemented on 1st January 2012

The decline in manufactured cigarette sales appears to be being partly offset by increased legal domestic sales of OTP, which appears to be becoming a larger share of the total market

- Despite successive price rises, the price of 20 RYO cigarette equivalents is one third of the average cost of 20 manufactured cigarettes^{(a)(c)}

Hungary legal domestic sales (cigarettes and OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(b)}

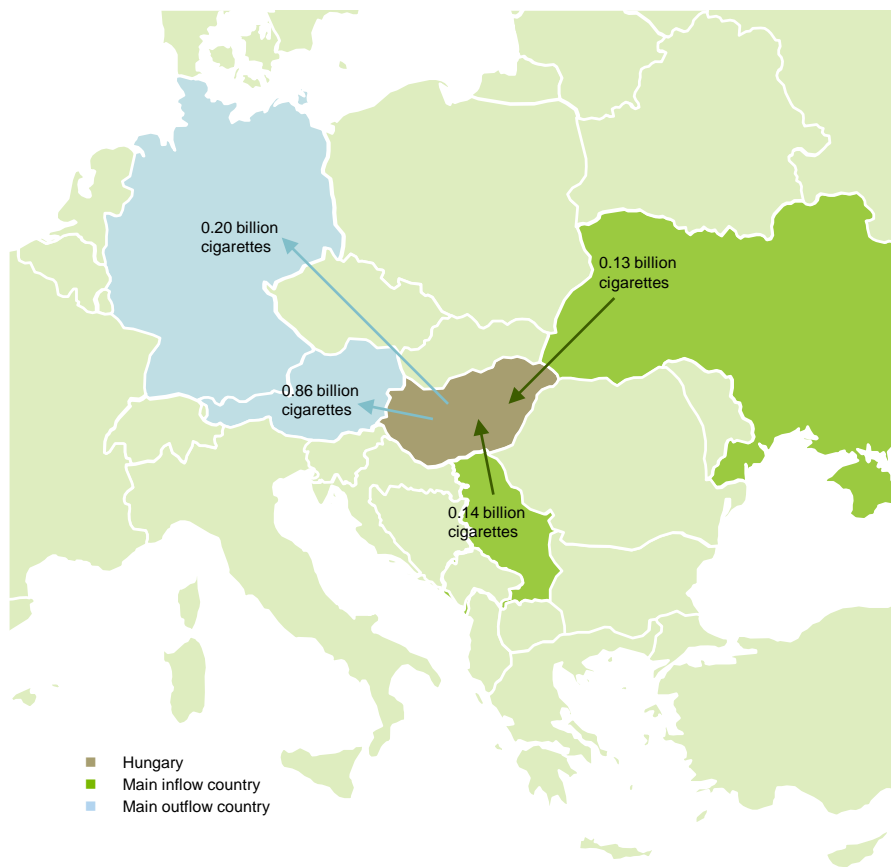


Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.
 (b) The price gap was based on the weight averaged price of 20 cigarettes and 1 KG of RYO tobacco, based on European Commission Excise Duty Tables

Hungary – Country flows summary

Inflows continued to decline, whilst outflows also decreased by 6%

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Notes: (a) Map shows flows over 1% of consumption, or top flow if none are greater than 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

- Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)
 (3) World Customs Journal, Tackling Cigarette Smuggling with Enforcement, January 2013
 (4) KPMG analysis of tax tables provided by PMI

Inflows to Hungary								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Serbia	0.05	0.06	0.00	0.12	0.19	0.10	0.14	40%
Ukraine	2.48	1.42	1.14	0.81	0.46	0.25	0.13	(48)%
Belarus	0.00	0.00	0.00	0.00	0.00	0.00	0.07	n/a
Other countries	0.88	0.49	0.45	0.28	0.17	0.22	0.14	(38)%
Total inflows	3.40	1.97	1.59	1.21	0.83	0.57	0.48	(16)%

Outflows from Hungary								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Austria	0.13	0.32	0.45	0.48	0.48	0.99	0.86	(13)%
Germany	0.12	0.12	0.13	0.16	0.17	0.21	0.20	(5)%
UK	0.03	0.10	0.04	0.10	0.02	0.09	0.12	38%
Other countries	0.16	0.12	0.16	0.19	0.20	0.21	0.23	8%
Total outflows	0.44	0.66	0.78	0.93	0.87	1.50	1.41	(6)%

Inflows to Hungary have reduced by half from Ukraine as the border has been increasingly tightly policed

- Significant improvements have been made to the Ukrainian-Hungarian border, including x-ray machines and sniffer dogs⁽³⁾
- Inflows were recorded from Belarus for the first time

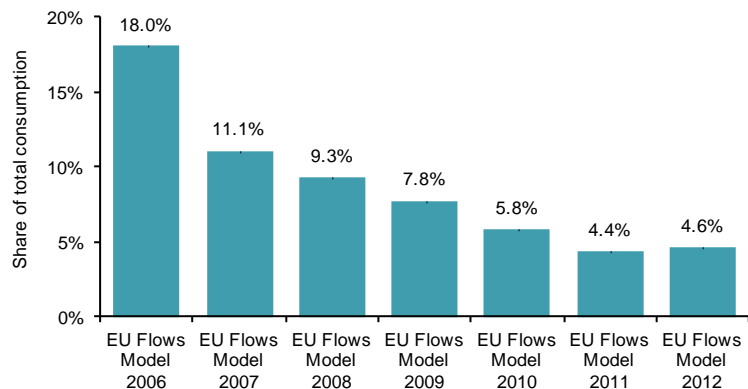
Outflows from Hungary to Austria have also reduced, mainly due to higher prices

- Whilst there was no change in the average price of Marlboro in Austria in 2012, the price rises in Hungary have resulted in the price gap reducing from €2.17 to €1.52⁽⁴⁾

Hungary – Comparison of external sources for non-domestic estimates

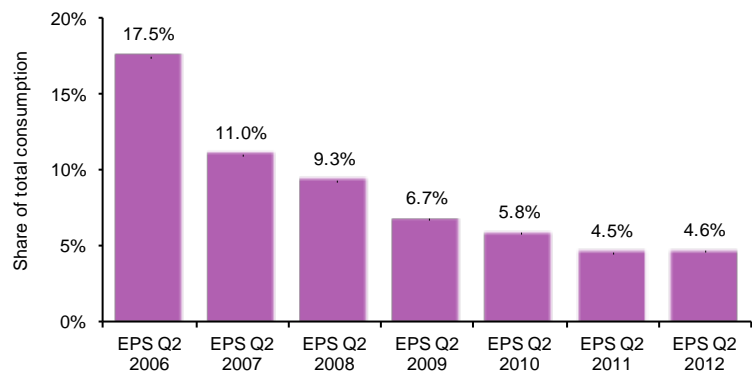
Non-domestic incidence rose by 0.2 percentage points in 2012 from 4.4% to 4.6%

Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The Hungary EPS has a focus study which can over-sample areas with higher levels of non-domestic incidence, therefore when inputting into the EU flows model, the focus samples are excluded

Other non-domestic market estimates 2006-2012^{(2)(a)}



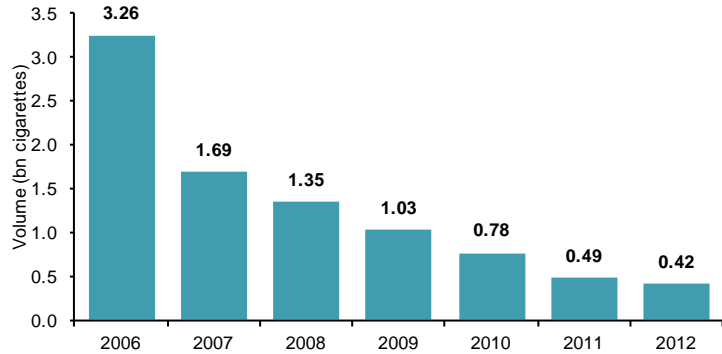
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2006 – 2012

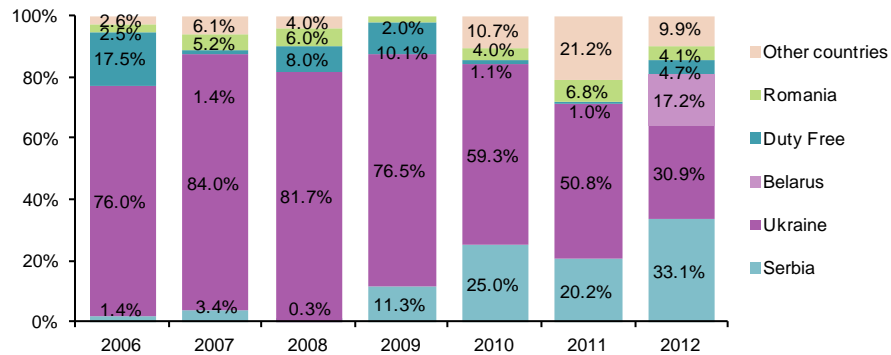
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

C&C inflows to Hungary appear to have declined, however there is an increased share of volumes coming from countries such as Belarus

Total inflows of C&C
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(2)(a)}



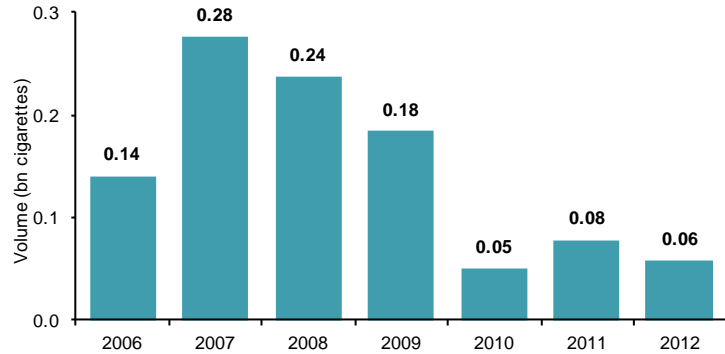
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

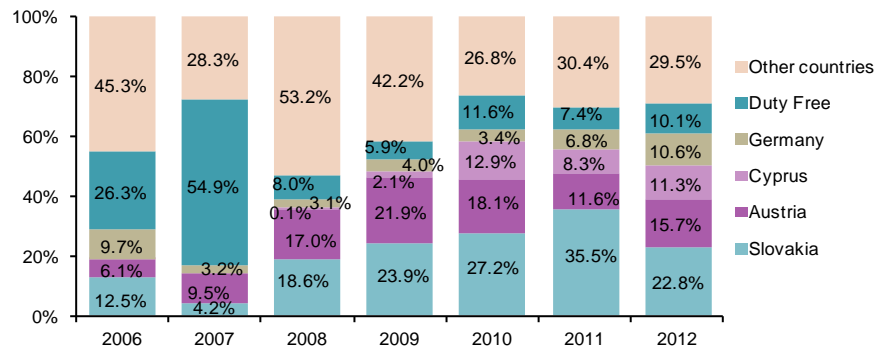
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

The majority of ND(L) comes from neighbouring countries and holiday destinations

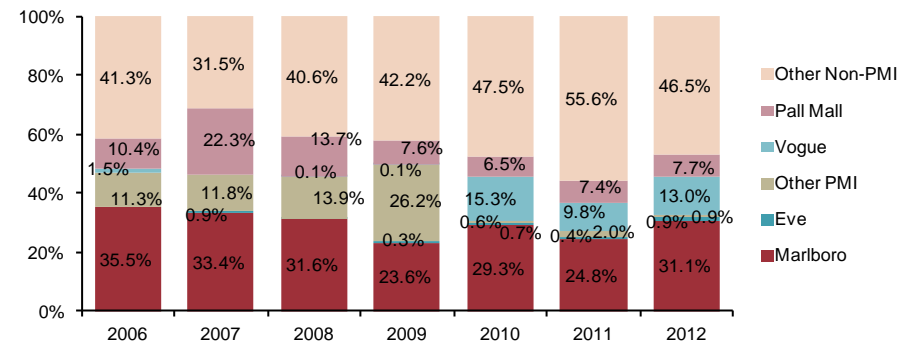
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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Total consumption of manufactured cigarettes fell by 9% in 2012, driven by a decline in both legal domestic sales and non-domestic consumption

Total Ireland consumption ⁽¹⁾⁽²⁾⁽³⁾								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarettes								
Legal domestic sales (LDS)	5.63	5.39	5.08	4.52	4.28	4.09	3.70	(9)%
Outflows	-0.12	-0.23	-0.13	-0.09	-0.07	-0.06	-0.07	17%
Legal domestic consumption (LDC)	5.52	5.16	4.96	4.43	4.21	4.03	3.63	(10)%
Non-domestic legal (ND(L))	0.99	0.85	0.45	0.60	0.61	0.55	0.47	(15)%
Counterfeit and contraband (C&C)	0.74	1.22	1.60	1.44	1.15	0.99	0.97	(2)%
Total non-domestic	1.72	2.07	2.05	2.04	1.76	1.54	1.43	(7)%
Total consumption	7.24	7.23	7.01	6.47	5.97	5.57	5.07	(9)%

LDS Other Tobacco Product market ^{(3)(a)}								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarette equivalent								
OTP (LDS)	-	-	0.23	0.31	0.32	0.33	0.46	40%

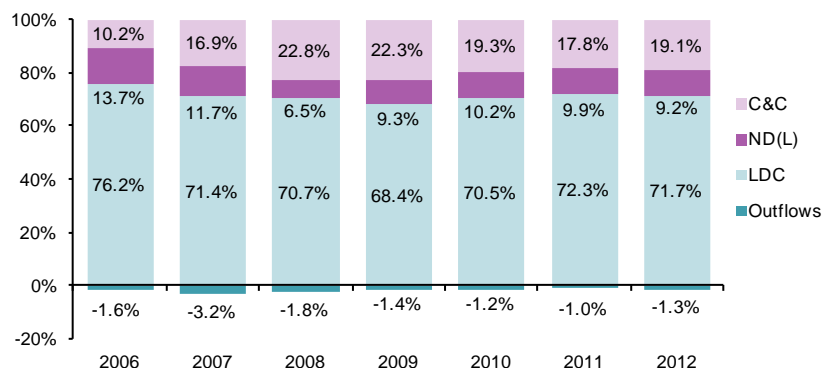
Total cigarette consumption in Ireland fell by 9% in 2012

- The majority of this decline was attributed to falling legal domestic sales, which have decreased by 9% in 2012
- Although falling on an absolute basis, non-domestic incidence in Ireland remained at 28% of total consumption in 2012

OTP sales continued to grow in 2012

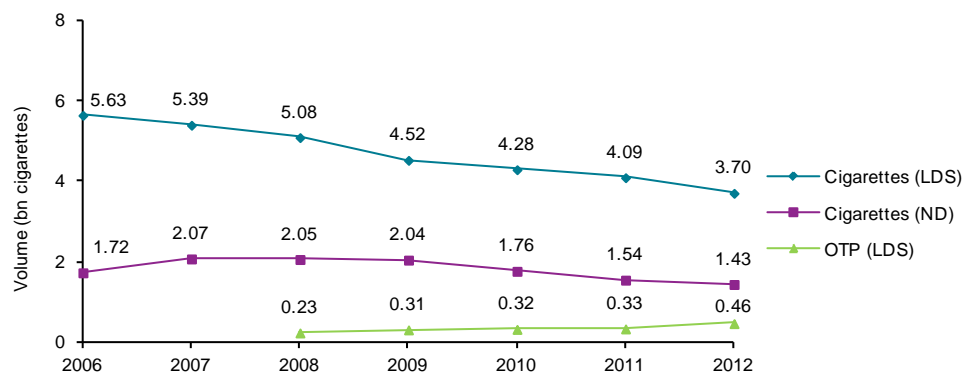
- OTP legal domestic sales have increased by 40% in 2012, suggesting that some Irish smokers may be switching from manufactured cigarettes to OTP

Share of Ireland cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) PMI Empty Pack Surveys 2006 – 2012
 (3) LDS/IMS data provided by PMI

Ireland legal domestic sales (cigarettes & OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

Inflows to Ireland fell by 7% in 2012, largely due to decreased flows from the UK; a large increase in outflows to the UK was the result of changing price differentials

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Inflows to Ireland								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Poland	0.33	0.37	0.18	0.14	0.22	0.19	0.19	(4)%
Spain	0.51	0.49	0.50	0.37	0.25	0.15	0.14	(7)%
UK	0.03	0.14	0.19	0.35	0.20	0.24	0.14	(44)%
Other countries	0.85	1.07	1.18	1.17	1.10	0.96	0.97	2%
Total inflows	1.72	2.07	2.05	2.04	1.76	1.54	1.43	(7)%

Outflows from Ireland								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
UK	0.08	0.14	0.09	0.05	0.02	0.03	0.05	82%
Netherlands	0.03	0.03	0.00	0.02	0.02	0.01	0.00	(61)%
Other countries	0.01	0.07	0.03	0.02	0.03	0.01	0.01	(44)%
Total outflows	0.12	0.23	0.13	0.09	0.07	0.06	0.07	17%

A 44% decrease in inflows from the UK was the main contributor to falling non-domestic volumes in Ireland

- In 2012, price rises and exchange rate movements moved the price of cigarettes in the UK above that in Ireland, resulting in reduced inflows from the UK

Outflows from Ireland increased by 17% in 2012, driven by increased flows to the UK

- As UK prices rose above that in Ireland, outflows subsequently increased to the UK

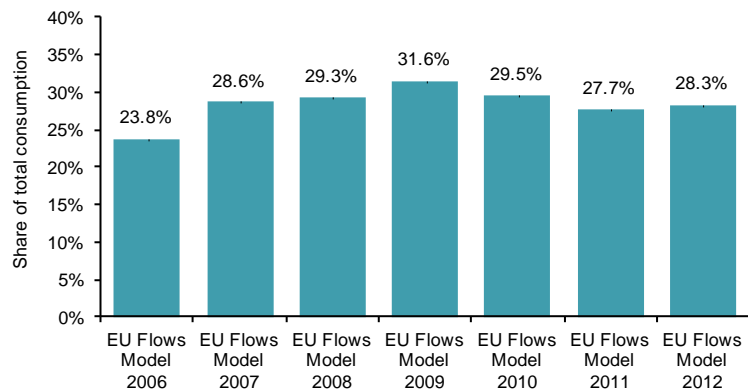
Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

Non-domestic incidence increased by 0.6 percentage points in 2012 from 27.7% to 28.3%

Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The EU flows model calculates non-domestic incidence by inputting the EPS results for each quarter

- Ireland EPS quarterly results were weighted equally between Q2 and Q4
- One adjustment was made to the EPS data:
 - Spanish inflows to Ireland were uplifted to reflect the increased incidence of flows from Spain, due to Irish holidaymakers travelling in the Summer months

Other non-domestic market estimates 2006-2012^{(2)(a)}



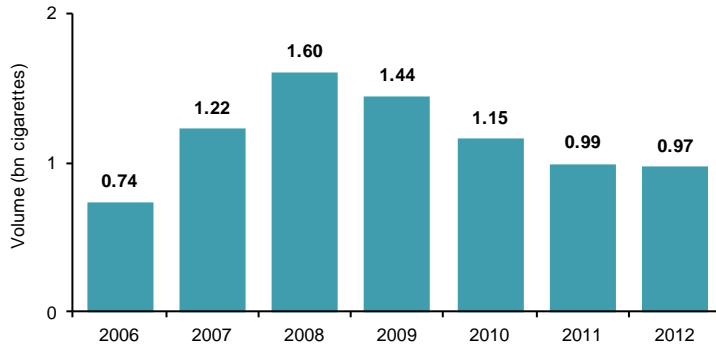
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2006 – 2012

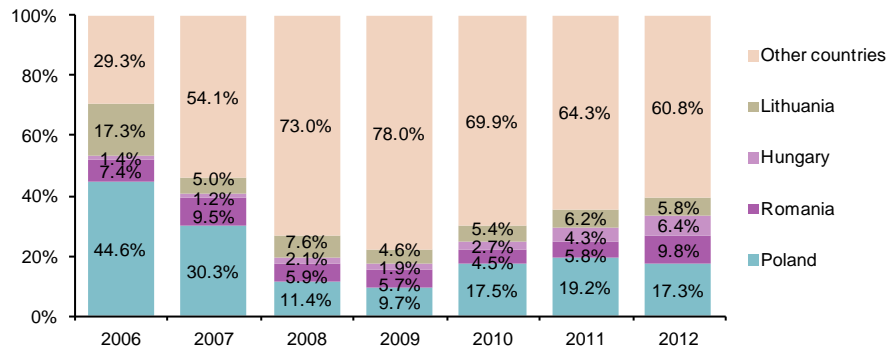
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

C&C volumes fell by 2% in 2012, with a slight decline in C&C inflows from Poland offset by increases from Romania and Hungary

Total inflows of C&C by origin
2006-2012^{(1)(2)(a)}



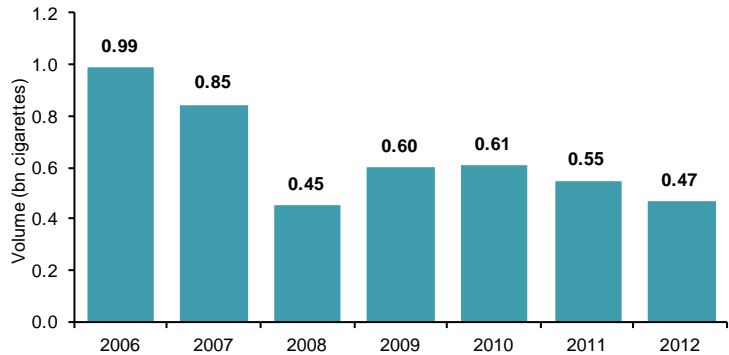
Share of C&C by origin
2006-2012^{(1)(2)(a)}



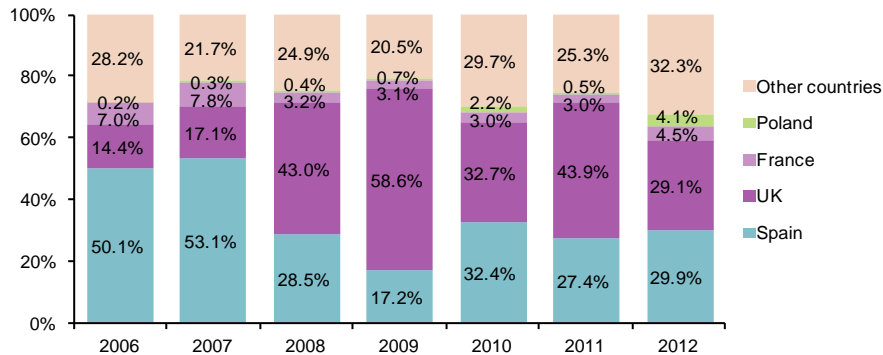
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

Non-domestic legal declined by 15% in 2012; these flows were mainly comprised of UK and Spanish cigarettes

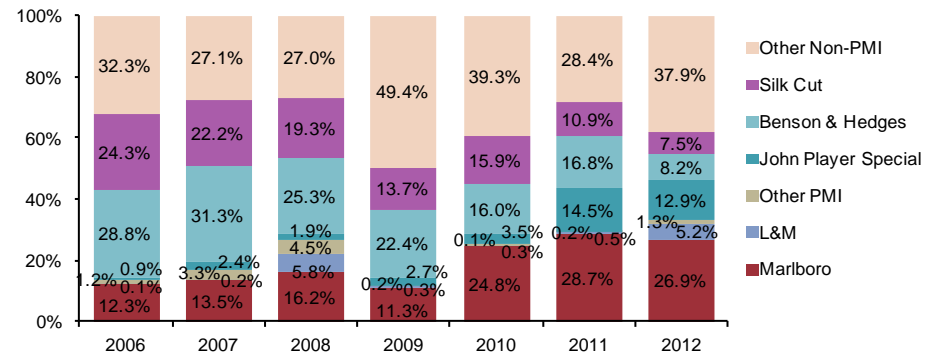
ND(L) by origin
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share of ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

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- Malta
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- Slovakia
- Slovenia
- Spain
- Sweden
- United Kingdom

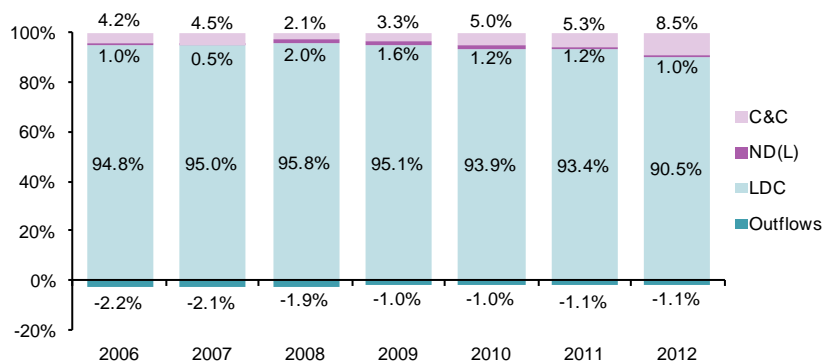
Italy – Country flows summary

Non-domestic incidence in Italy rose significantly as C&C increased by over 50% during the year, increasing to 7.3bn cigarettes

Total Italy consumption ⁽¹⁾⁽²⁾⁽³⁾								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	93.81	92.81	92.00	89.16	87.05	85.47	78.74	(8)%
Outflows	-2.13	-2.01	-1.83	-0.92	-0.93	-1.01	-0.93	(8)%
Legal domestic consumption (LDC)	91.68	90.80	90.17	88.24	86.12	84.46	77.81	(8)%
Non-domestic legal (ND(L))	0.98	0.51	1.91	1.46	1.09	1.12	0.84	(25)%
Counterfeit and contraband (C&C)	4.04	4.31	2.00	3.04	4.55	4.81	7.29	52%
Total non-domestic	5.02	4.82	3.90	4.50	5.64	5.93	8.13	37%
Total consumption	96.70	95.62	94.08	92.74	91.76	90.39	85.94	(5)%

Italy Other Tobacco Product market ^{(3)(a)}								
Billion cigarette equivalent	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
OTP (LDS)	-	1.35	1.71	2.52	3.33	4.67	6.52	40%

Share of Italy cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾

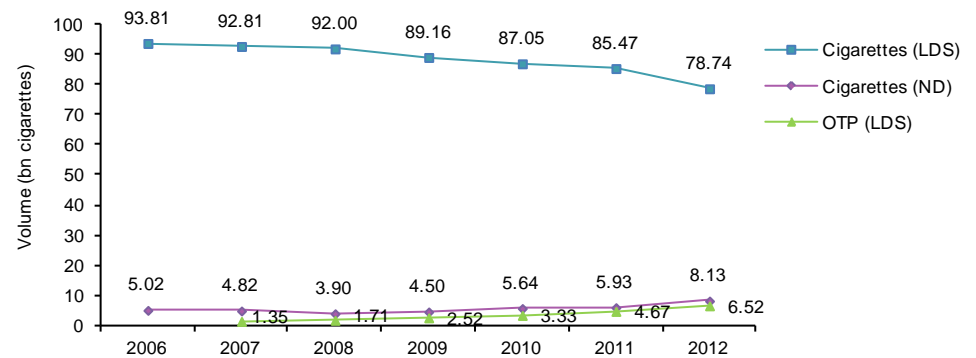


Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) PMI Empty Pack Surveys 2006 – 2012
 (3) LDS/IMS data provided by PMI

Legal domestic sales in Italy declined by 8% in 2012, impacted by worsening macro-economic conditions and price rises during the year; this was offset partly by an increase in non-domestic consumption and OTP sales

- Non-domestic incidence increased to 9.5% of total consumption in 2012, with a decline in non-domestic legal inflows offset by increasing C&C flows
- While total cigarette consumption in Italy declined by 5% in 2012, legal domestic sales of OTP increased significantly, indicating switching at the bottom end of the market
 - OTP volumes increased by 40% in 2012, in line with the increase seen in 2011

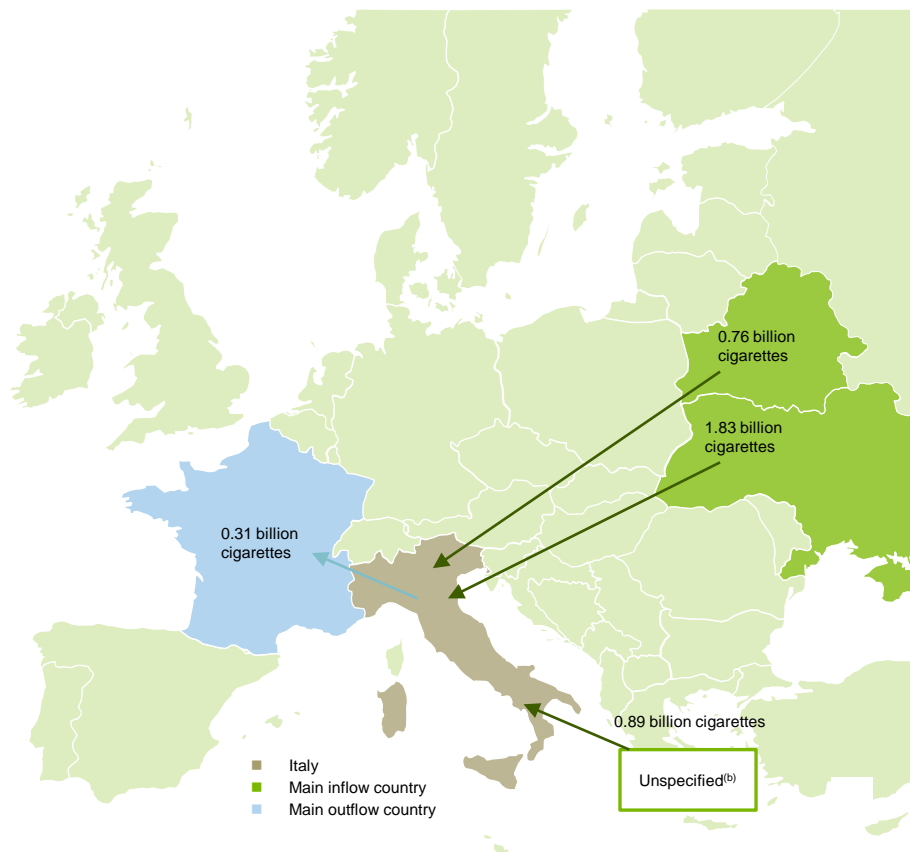
Italy legal domestic sales (cigarettes and OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

Non-domestic inflows into Italy increased by 37% in 2012, mainly driven by increased inflows from Belarus, Ukraine and Unspecified market variants

Key inflows and outflows (billion cigarettes) and change from 2011⁽¹⁾(2)(a)(b)



Inflows to Italy								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Ukraine	0.89	1.00	0.67	0.92	1.61	1.52	1.83	20%
Belarus	0.00	0.00	0.00	0.01	0.01	0.04	0.76	>100%
Unspecified	0.00	0.00	0.00	0.02	0.14	0.68	0.89	31%
Other countries	4.13	3.82	3.24	3.55	3.88	3.70	4.65	26%
Total inflows	5.02	4.82	3.90	4.50	5.64	5.93	8.13	37%

Outflows from Italy								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
France	0.71	0.50	0.62	0.32	0.38	0.51	0.31	(40)%
Netherlands	0.65	0.45	0.25	0.06	0.21	0.18	0.17	(1)%
Germany	0.16	0.13	0.09	0.08	0.11	0.10	0.10	10%
Other countries	0.62	0.93	0.87	0.46	0.23	0.23	0.34	50%
Total outflows	2.13	2.01	1.83	0.92	0.93	1.01	0.93	(8)%

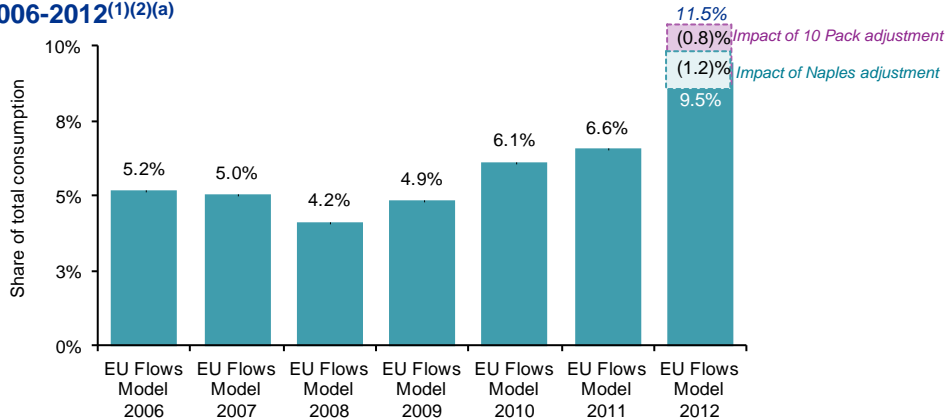
The Italian cigarette market was heavily impacted by increased non-domestic inflows in 2012, comprised mainly of C&C volumes

- Inflows rose most significantly in Naples, where total non-domestic incidence rose to over 55%; Naples is the destination of over half of the volumes from Ukraine and Belarus
 - Unspecified inflows increased throughout the country
- Outflows from Italy declined by 8% in 2012, mainly due to a decline in flows to France

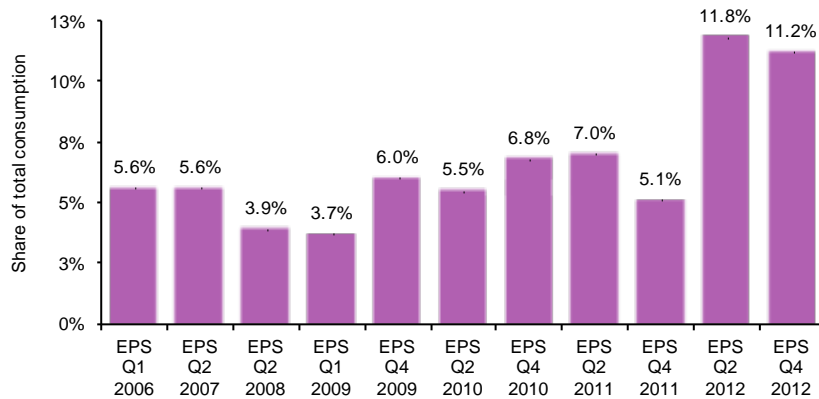
Notes: (a) Map shows flows over 1% of consumption, or top flow if none are greater than 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow
 (b) Unspecified market variants are defined as those packs which do not bear any market-specific health warning or tax stamp, or mention of 'Duty Free' on the pack
 Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)

Non-domestic incidence in Italy rose to 9.5% in 2012, with two adjustments made to EPS results

Non-domestic market estimates 2006-2012^{(1)(2)(a)}



Other non-domestic market estimates 2006-2012^{(2)(a)}



The EU Flows Model estimate for non-domestic consumption in 2012 is based on the results of the Empty Pack Surveys 2012, adjusted to account for the significant increase in non-domestic incidence in Naples, and revised in line with the market share of 10 packs

- As non-domestic incidence in Naples rose to over 55% in 2012, this sample was not deemed to be representative of the wider Southern region of Italy
 - Therefore, an adjustment was made to reduce the weight of Naples to represent 17.3% of the Southern region, in line with the population of the province of Naples
 - The weighting of other cities in the region was increased proportionately, with the total impact of the adjustment being a decline in the overall non-domestic incidence of 1.2 percentage points
- An adjustment was made to account for oversampling of 10 packs in the EPS survey
 - 10 packs made up 20.4% of packs sold in Italy in 2012, according to IMS data, but represented 34.9% of packs collected in the EPS
 - Therefore, domestic 10 packs were reweighted in line with IMS data, with the weighting of domestic 20 packs increased proportionally, reducing non-domestic incidence by 0.8 percentage points in 2012
- These two adjustments result in a non-domestic estimate for 2012 of 9.5%

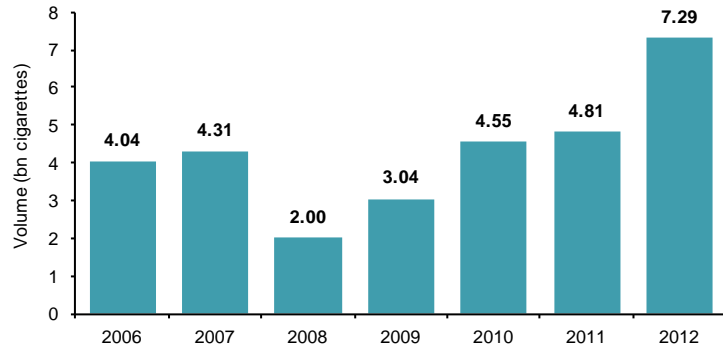
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2006 – 2012

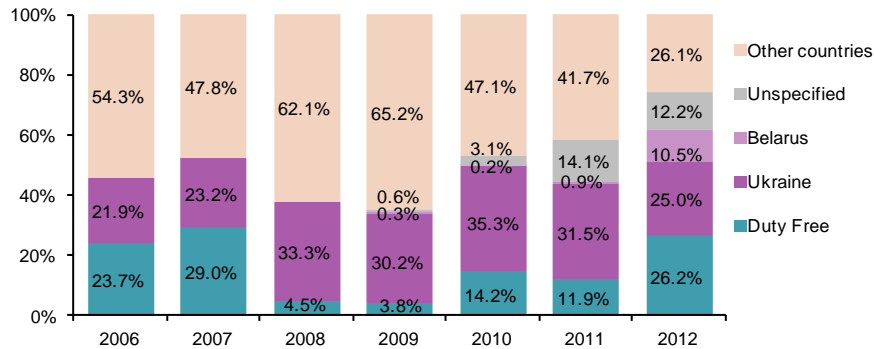
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

Significantly increased C&C levels, up by 52%, were mainly driven by inflows from Duty Free, Ukraine and Belarus

Total inflows of C&C
2006-2012^{(1)(2)(a)}



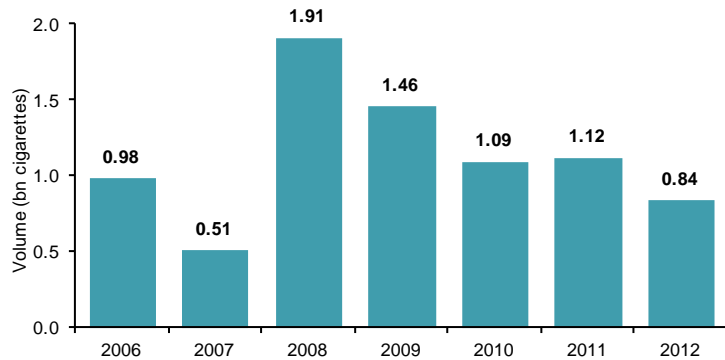
Share of C&C by origin
2006-2012^{(1)(2)(a)}



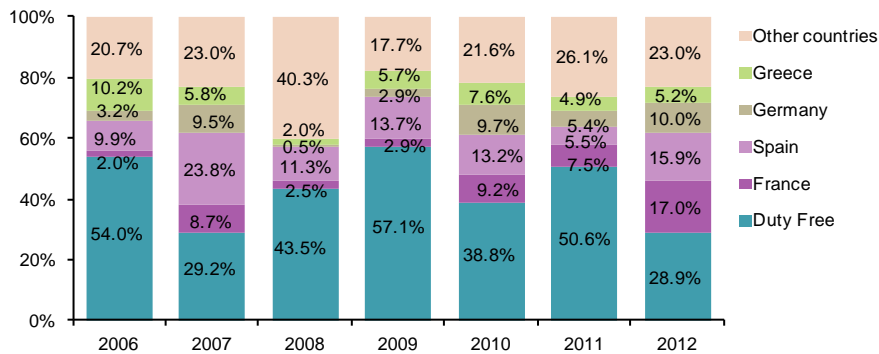
Note: (a) Unspecified market variants are those which do not bear any market-specific health warning or mention Duty Free on the label.
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)

Non-domestic legal inflows decreased by 25% in 2012 as tourism flows declined relative to those from illegal channels; Marlboro remains the most frequently bought ND(L) brand

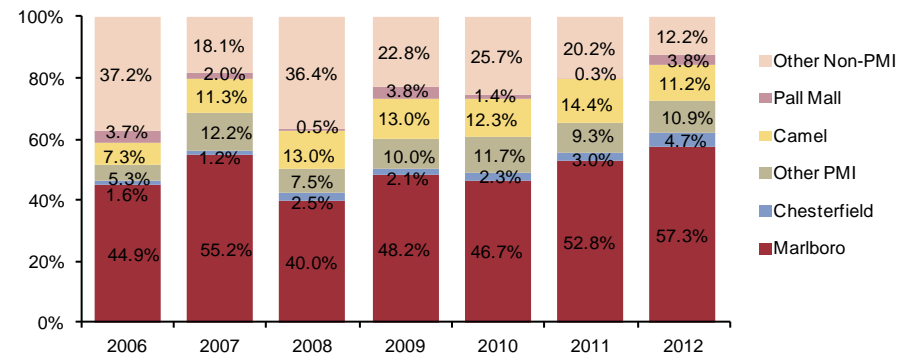
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share of ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)

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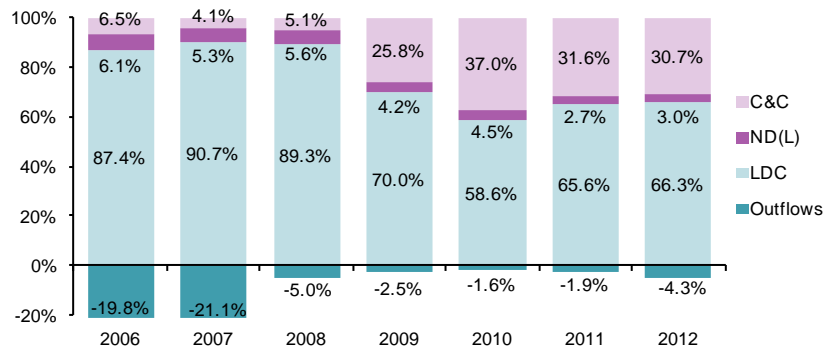
Overall consumption of manufactured cigarettes decreased by 10%. Inflows to Latvia decreased by 11% but outflows doubled

Total Latvia consumption (1)(2)(3)								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	4.45	4.71	3.46	2.12	1.65	1.77	1.68	(6)%
Outflows	-0.82	-0.89	-0.18	-0.07	-0.04	-0.05	-0.10	>100%
Legal domestic consumption (LDC)	3.63	3.82	3.28	2.04	1.61	1.72	1.57	(9)%
Non-domestic legal (ND(L))	0.25	0.22	0.21	0.12	0.12	0.07	0.07	0%
Counterfeit and contraband (C&C)	0.27	0.17	0.19	0.75	1.02	0.83	0.73	(12)%
Total non-domestic	0.53	0.39	0.39	0.88	1.14	0.90	0.80	(11)%
Total consumption	4.15	4.22	3.67	2.92	2.75	2.63	2.38	(10)%

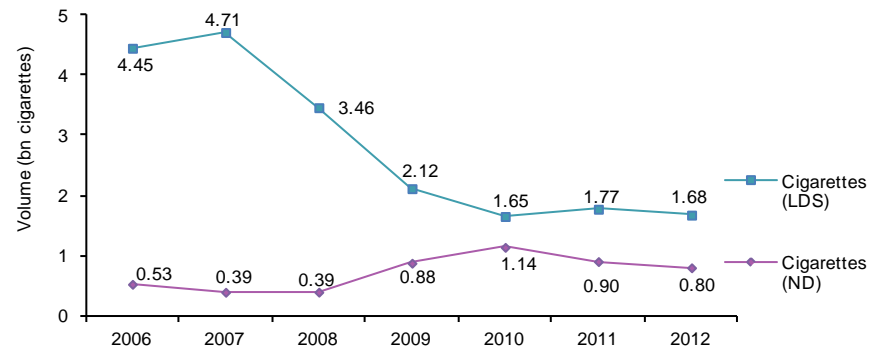
The largest volume decrease in consumption came from legal domestic sales

- Whilst overall smoking incidence is understood to have remained stable in Latvia⁽⁴⁾, declines in total population, especially between the ages of 20 and 45⁽⁵⁾, has resulted in a decline in total consumption
- Outflows have also significantly increased, largely as a result of both tourism into Latvia and workers leaving Latvia to work in the UK, Germany and Sweden⁽⁶⁾
- C&C inflows have declined as a result of lower flows from Russia

Share of Latvia cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Latvia legal domestic sales and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) Synovate/ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)
 (3) LDS/IMS data provided by PMI

Sources: (4) Global Consumer Tracking Survey, PMI management
 (5) World Bank, Population projections, February 2013
 (6) Interview with local PMI management, March 2013
 Notes: (a) OTP data not available

Latvia – Country flows summary

A decline in non-domestic inflows from Russia was replaced by rapidly growing inflows from Belarus, the majority of which are C&C

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Inflows to Latvia								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Russia	0.24	0.17	0.20	0.72	0.86	0.64	0.43	(32)%
Belarus	0.00	0.00	0.04	0.10	0.24	0.23	0.33	46%
Other countries	0.29	0.23	0.16	0.05	0.04	0.03	0.03	(4)%
Total inflows	0.53	0.39	0.39	0.88	1.14	0.90	0.80	(11)%
Outflows from Latvia								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
UK	0.23	0.33	0.04	0.02	0.01	0.02	0.04	>100%
Ireland	0.13	0.20	0.02	0.02	0.02	0.01	0.01	15%
Sweden	0.01	0.06	0.01	0.00	0.00	0.00	0.01	87%
Other countries	0.45	0.31	0.11	0.03	0.02	0.02	0.05	>100%
Total outflows	0.82	0.89	0.18	0.07	0.04	0.05	0.10	103%

Inflows to Latvia have reduced from Russia but increased significantly from Belarus

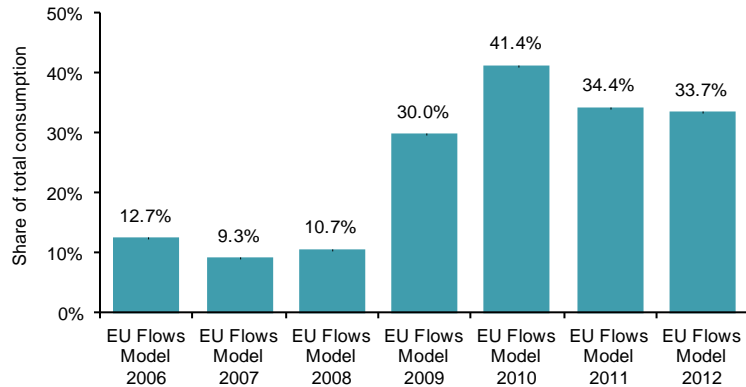
Outflows from Latvia are generally cigarettes bought by tourists from the UK and migrant workers⁽⁴⁾

Notes: (a) Map shows flows over 1% of consumption, or top flow if none are greater than 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

- Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)
 (3) Statistics Latvia, Inbound and outbound tourist trips, February 2013
 (4) Interview with local PMI management

Non-domestic incidence fell in Latvia by 0.7 percentage points in 2012 from 34.4% to 33.7%

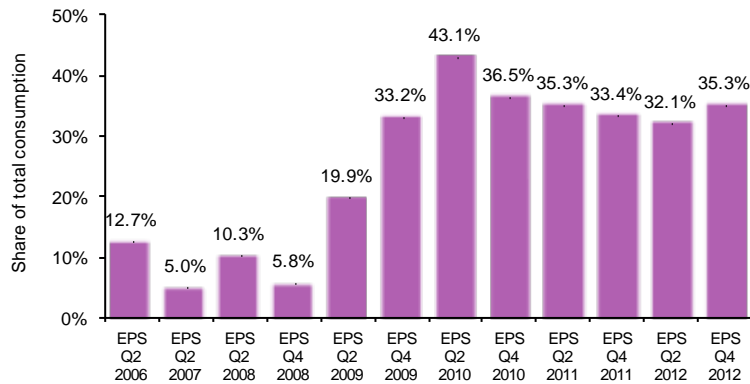
Non-domestic market estimates 2007-2012^{(1)(2)(a)}



The EU flows model calculates non-domestic incidence by inputting the empty pack surveys results from each quarter

- For Latvia, each EPS quarterly wave is weighted equally, as there were no inconsistencies or specific issues that required any additional weighting

Other non-domestic market estimates 2007-2012^{(2)(a)}



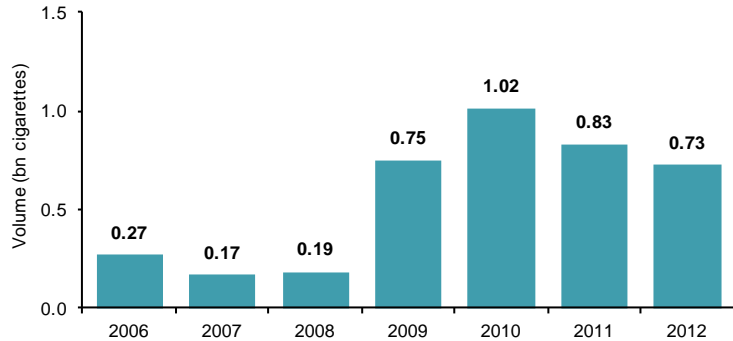
Sources: (1) KPMG EU Flows Model 2007 - 2012

(2) PMI Empty Pack Surveys 2007 – 2012

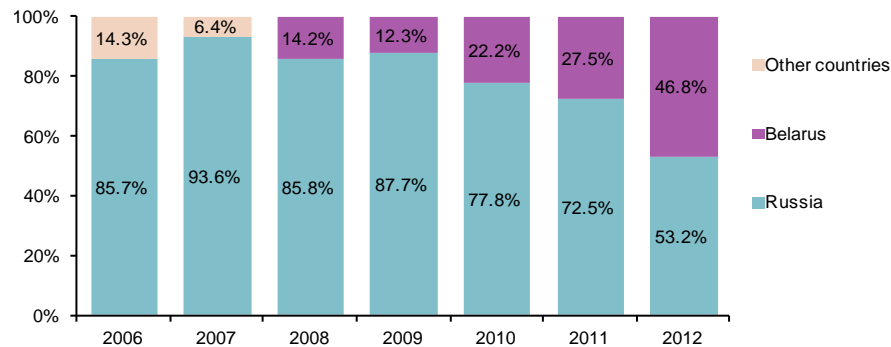
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

C&C from Russia continued to decline, however there was a significant growth in cigarettes from Belarus compared with previous years

Total inflows of C&C
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

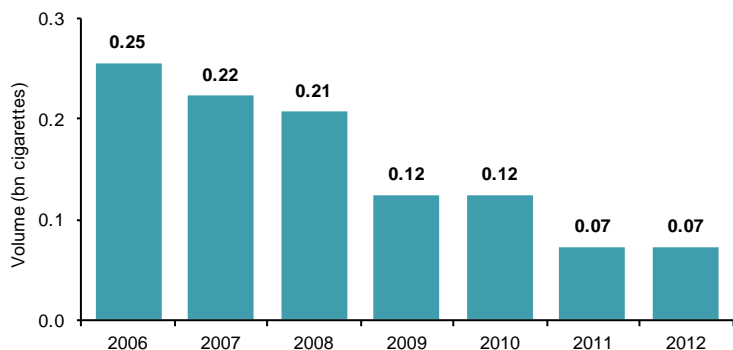
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

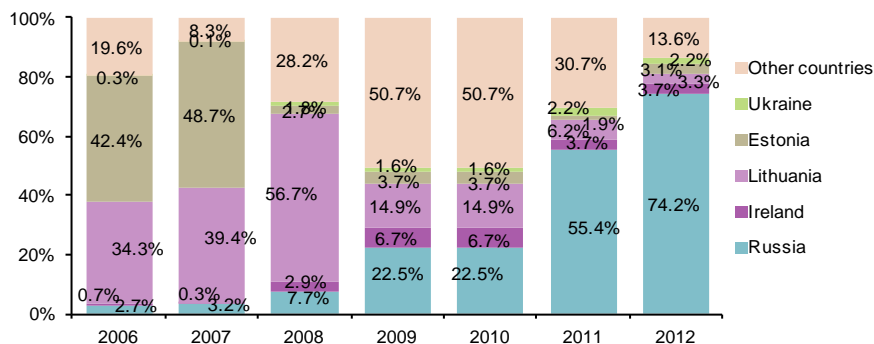
Latvia – ND(L) summary

ND(L) flows remained stable, with an increase in the proportion of cigarettes from Russia, due to the significant growth in Russian visitors to Latvia; brand shares remained broadly stable

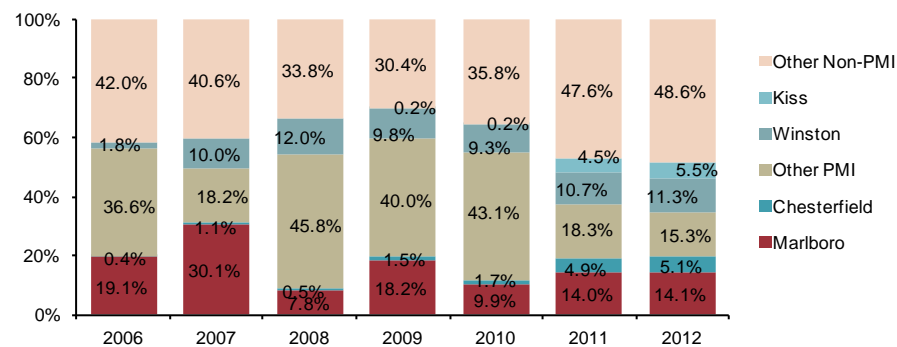
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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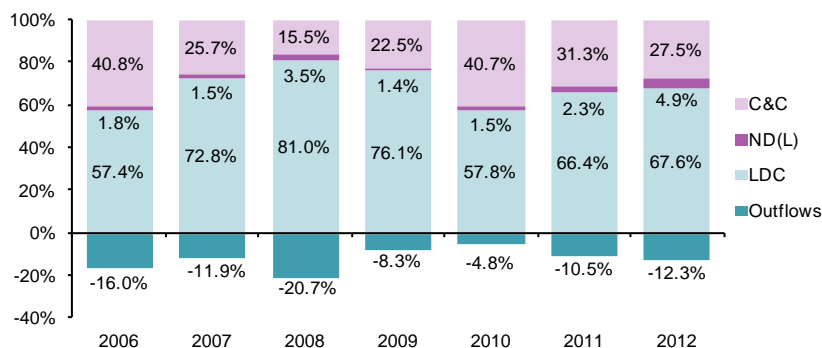
Overall consumption of manufactured cigarettes decreased by 7%. The decrease is mainly due to a decline in C&C

Total Lithuania consumption ⁽¹⁾⁽²⁾⁽³⁾								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12
Legal domestic sales (LDS)	4.14	5.27	5.84	4.17	2.48	2.70	2.62	(3)%
Outflows	-0.90	-0.74	-1.19	-0.41	-0.19	-0.37	-0.40	9%
Legal domestic consumption (LDC)	3.24	4.53	4.65	3.76	2.29	2.34	2.22	(5)%
Non-domestic legal (ND(L))	0.10	0.09	0.20	0.07	0.06	0.08	0.16	94%
Counterfeit and contraband (C&C)	2.30	1.60	0.89	1.11	1.61	1.10	0.90	(18)%
Total non-domestic	2.40	1.70	1.09	1.18	1.67	1.18	1.06	(10)%
Total consumption	5.65	6.23	5.74	4.94	3.96	3.52	3.28	(7)%

Despite a decline in non-domestic consumption, it remains at 32.4% of the total market

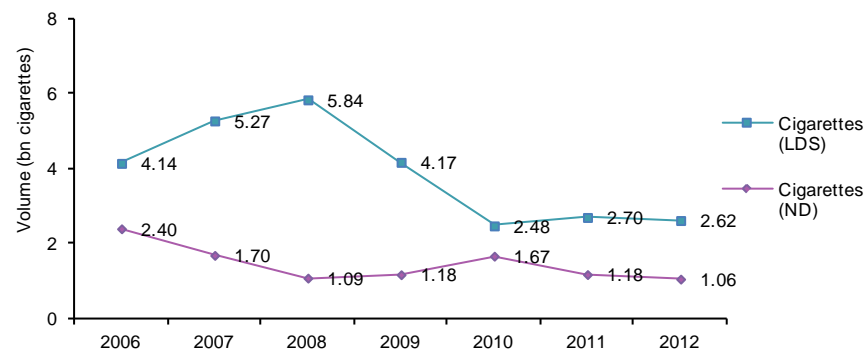
- Inflows from Belarus, although slightly lower than 2011, continue to be a key driver of C&C
- Flows of visitors to Russia from Lithuania increased by 20% per year between 2009 and 2011, a trend also identified by higher levels of ND(L)⁽⁴⁾
- In addition, prices in Russia rose by 20% in 2012, resulting in a narrower price differential, therefore reducing the incentive to bring in cigarettes from Russia

Share of Lithuania cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)
 (3) LDS/IMS data provided by PMI
 (4) Statistics Lithuania, Statbank, March 2013

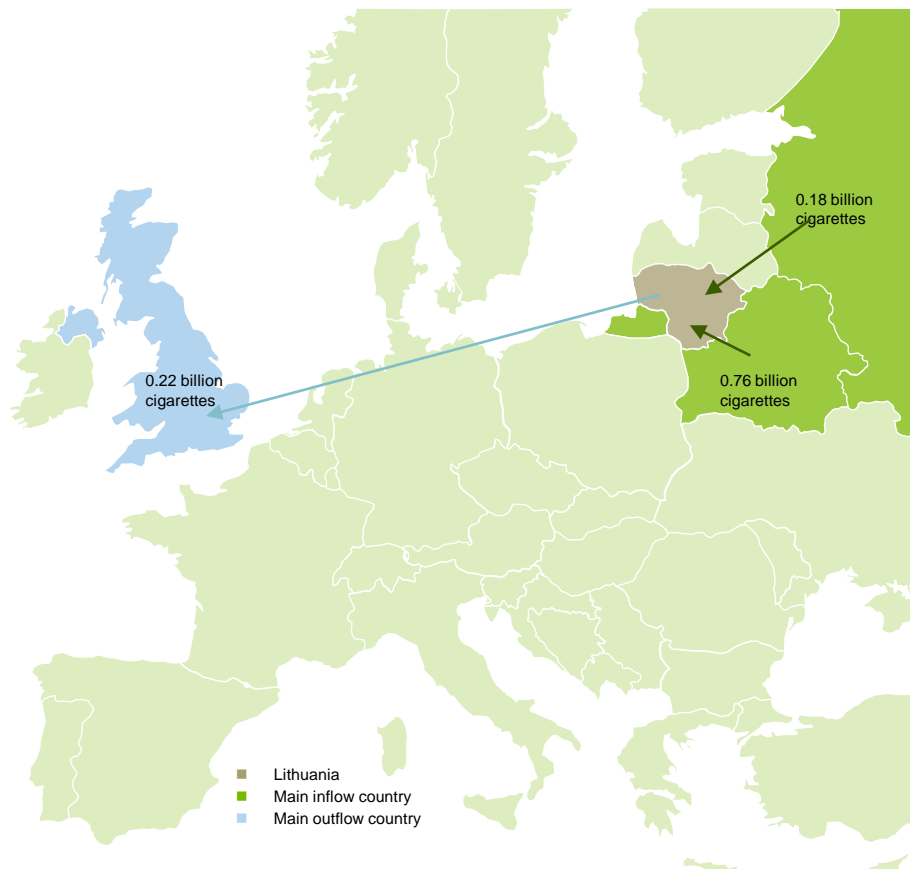
Lithuania legal domestic sales and non-domestic consumption 2006-2012^{(1)(2)(3)(a)}



Notes: (a) OTP data not available

Non-domestic inflows have decreased, mainly due to lower flows from Russia, however, non-domestic incidence remained significant at 32.4% of total consumption

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Inflows to Lithuania								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Belarus	0.02	0.02	0.12	0.23	0.78	0.80	0.76	(5)%
Russia	1.57	1.24	0.66	0.87	0.78	0.28	0.18	(37)%
Ukraine	0.09	0.02	0.03	0.01	0.01	0.01	0.00	(39)%
Other countries	0.72	0.41	0.29	0.07	0.10	0.09	0.12	25%
Total inflows	2.40	1.70	1.09	1.18	1.67	1.18	1.06	(10)%

Outflows from Lithuania								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
UK	0.20	0.15	0.32	0.19	0.06	0.21	0.22	6%
Ireland	0.13	0.06	0.12	0.07	0.06	0.06	0.06	(5)%
Germany	0.04	0.05	0.05	0.02	0.02	0.03	0.03	17%
Other countries	0.54	0.48	0.69	0.13	0.04	0.07	0.09	27%
Total outflows	0.90	0.74	1.19	0.41	0.19	0.37	0.40	9%

The small decline in inflows suggests that the increased investment on border protection and surveillance is starting to have a positive impact on reducing illegal flows⁽³⁾

- Whilst Russia was historically the largest inflow market, more recent statistics suggest that three quarters of smuggling attempts come from Belarus, a significant change which is backed up by the annual decline in flows from Russia and growth from Belarus⁽⁴⁾

Outflows have increased, owing to increased visitor numbers and a large number of Lithuanians working in the UK, Ireland and Germany

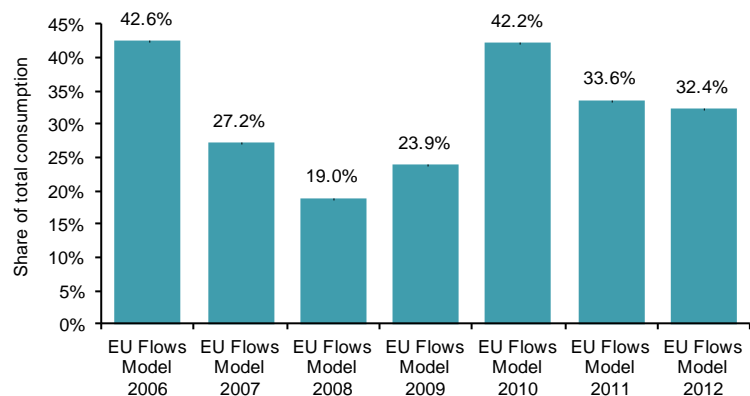
- Visitor numbers to Lithuania grew by 12% between 2010 and 2011⁽⁵⁾

Notes: (a) Map shows flows over 1% of consumption, or top flow if none are greater than 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)
 (3) Lithuanian Customs Authority, Fight against cigarette smuggling, January 2012
 (4) State Border Guard Service (VSAT) statistics, 2011
 (5) Statistics Lithuania, Flows of visitors, 2012

Non-domestic incidence in Lithuania fell by 1.2 percentage points in 2012 from 33.6% to 32.4%

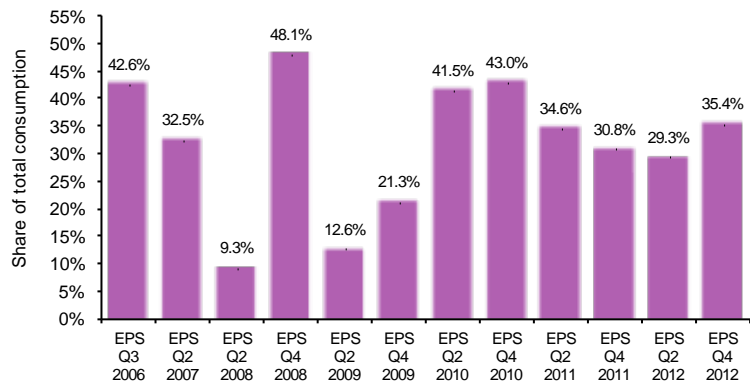
Non-domestic market estimates 2007-2012^{(1)(2)(a)}



The EU flows model calculates non-domestic incidence by inputting the empty pack surveys results from each quarter

- For Lithuania, each EPS quarterly wave is weighted equally, as there were no inconsistencies or specific issues that required any additional weighting

Other non-domestic market estimates 2007-2012^{(2)(a)}



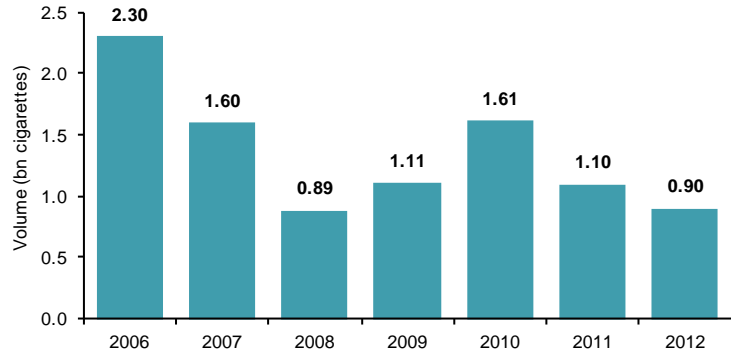
Sources: (1) KPMG EU Flows Model 2007 - 2012

(2) PMI Empty Pack Surveys 2007 - 2012

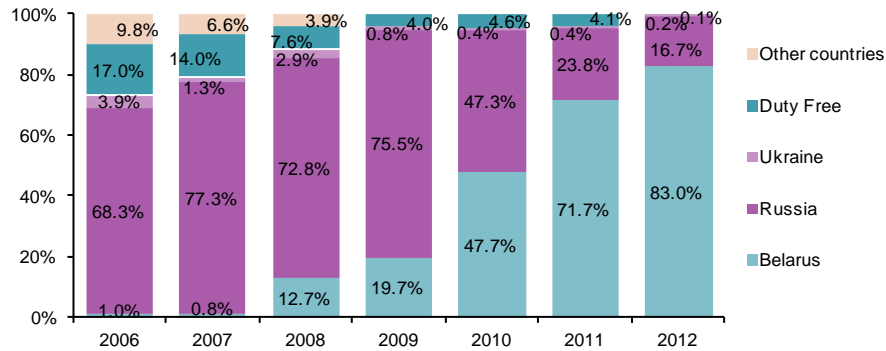
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

Belarus continued to be the largest inflow market of C&C

Total inflows of C&C
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(2)(a)}



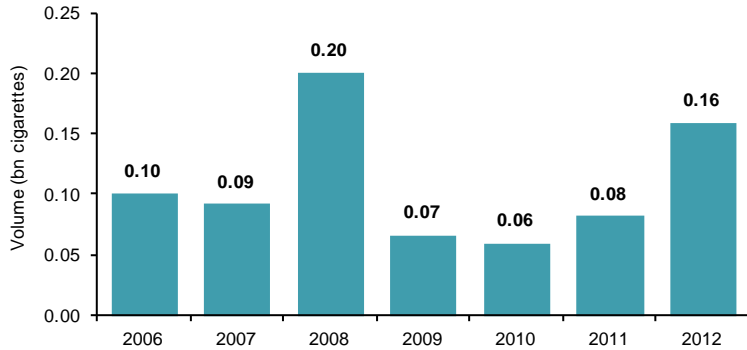
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

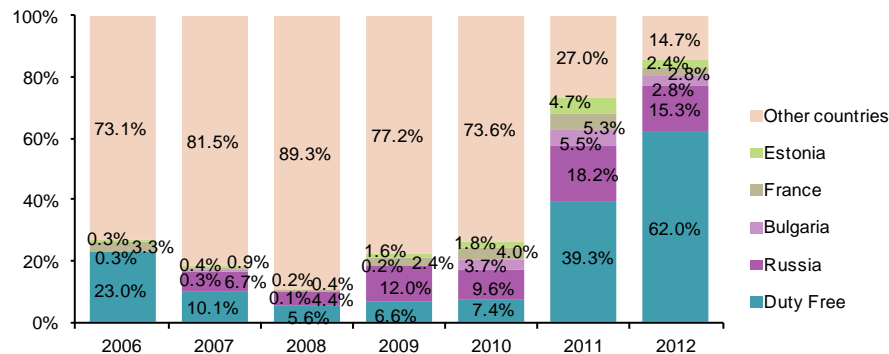
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

There has been an increasing trend towards ND(L) in Lithuania coming from Duty Free purchases; Winston has gained the largest brand share

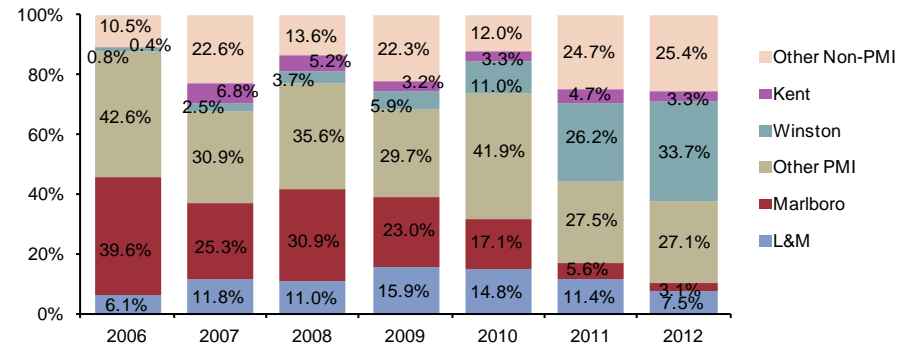
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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- Slovakia
- Slovenia
- Spain
- Sweden
- United Kingdom

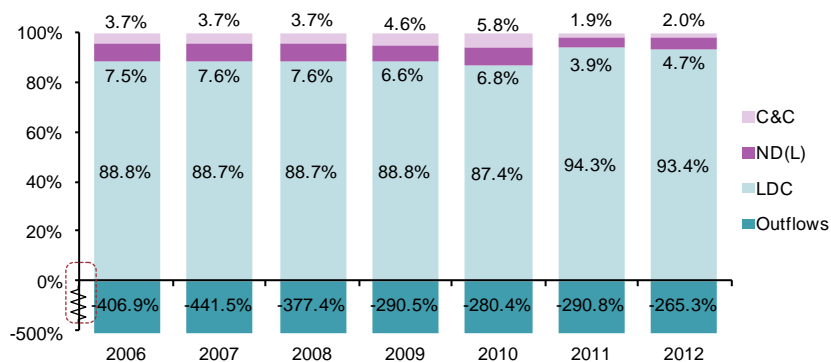
Luxembourg – Consumption summary

Total non-domestic incidence in Luxembourg increased by 15% in 2012, driven mainly by increasing ND(L) volumes

Total Luxembourg consumption ⁽¹⁾⁽²⁾⁽³⁾								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	4.77	5.05	4.43	4.15	3.93	3.94	3.68	(7)%
Outflows	-3.92	-4.20	-3.59	-3.18	-3.00	-2.98	-2.72	(8)%
Legal domestic consumption (LDC)	0.85	0.84	0.84	0.97	0.93	0.96	0.96	(1)%
Non-domestic legal (ND(L))	0.07	0.07	0.07	0.07	0.07	0.04	0.05	21%
Counterfeit and contraband (C&C)	0.04	0.04	0.04	0.05	0.06	0.02	0.02	4%
Total non-domestic	0.11	0.11	0.11	0.12	0.13	0.06	0.07	15%
Total consumption	0.96	0.95	0.95	1.10	1.07	1.02	1.03	0%

Luxembourg Other Tobacco Product market ^{(3)(a)}								
Billion cigarette equivalent	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
OTP (LDS)	3.87	4.81	4.55	4.93	5.50	5.74	6.14	7%

Share of Luxembourg consumption by type 2006-2012⁽¹⁾⁽²⁾

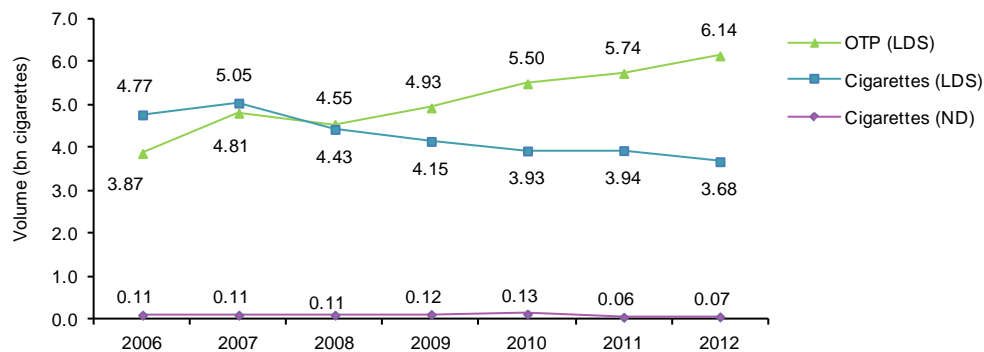


Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) PMI Empty Pack Surveys 2006 – 2012
 (3) LDS/IMS data provided by PMI

Total cigarette consumption in Luxembourg remained flat in 2012, with increasing non-domestic incidence offsetting a decline of 7% in legal domestic sales

- C&C increased by 4% during the year, while ND(L) increased by 21%
- Outflows from Luxembourg remain significantly higher than domestic consumption, however total outflow volumes declined by 8% during the year
- Legal domestic sales of OTP increased during the year, growing by 7% from 2011

Luxembourg legal domestic sales (cigarettes and OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

Outflows from Luxembourg declined by 8% during the year, while total inflows grew by 15%

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Inflows to Luxembourg								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
France	0.02	0.02	0.02	0.02	0.01	0.01	0.02	>100%
Germany	0.02	0.02	0.02	0.02	0.00	0.02	0.01	(47)%
Belgium	0.03	0.03	0.03	0.04	0.06	0.01	0.00	(50)%
Other countries	0.04	0.04	0.04	0.05	0.06	0.03	0.03	17%
Total inflows	0.11	0.11	0.11	0.12	0.13	0.06	0.07	15%

Outflows from Luxembourg								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
France	1.00	0.95	0.86	0.58	0.52	0.73	1.11	53%
Belgium	0.47	0.25	0.31	0.12	0.23	0.47	0.51	10%
Germany	0.35	0.38	0.44	0.80	0.38	0.41	0.46	13%
Other countries	2.10	2.63	1.97	1.68	1.87	1.37	0.63	(54)%
Total outflows	3.92	4.20	3.59	3.18	3.00	2.98	2.72	(8)%

As prices in neighbouring countries increased in 2012, outflows from Luxembourg to France, Germany and Belgium grew in 2012

- Outflows to France increased by 53% in 2012, with packs from Luxembourg being picked up throughout the country

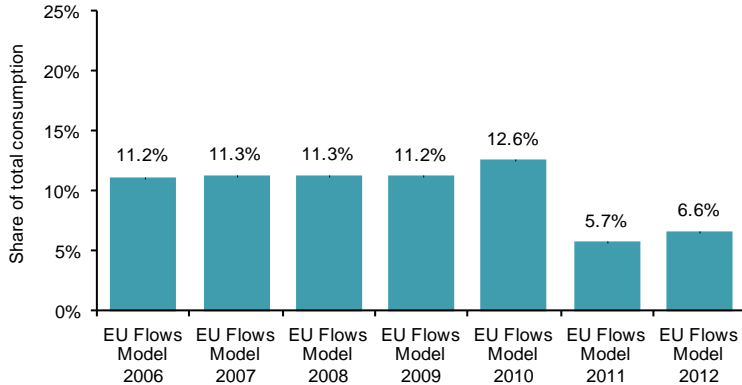
Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

Non-domestic incidence for Luxembourg increased from 5.7% in 2011 to 6.6% in 2012

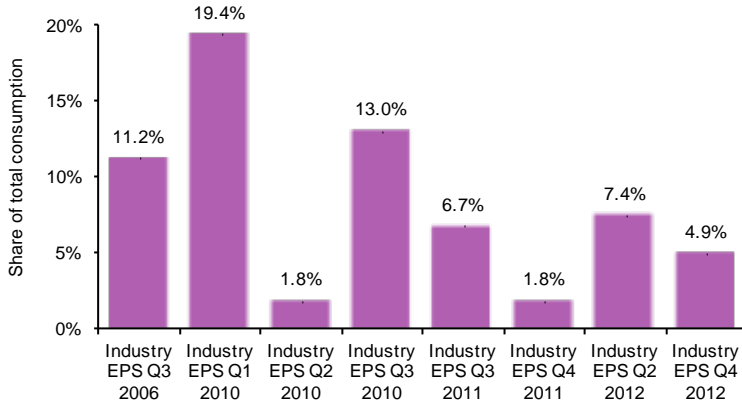
Non-domestic market estimates 2007-2012^{(1)(2)(a)(b)}



The EU Flows Model estimate for non-domestic consumption in 2012 is based on the results of the Empty Pack Surveys undertaken in the second and fourth quarters of 2012

- EPS results for the EU flows model have been reweighted to reflect the relative population of the two cities sampled, Luxembourg City and Esch-sur-Alzette
- The EU flows model estimate is based on the arithmetic average results of the reweighted Q2 and Q4 EPS surveys

Other non-domestic market estimates 2007-2012^{(2)(a)(b)}



Sources: (1) KPMG EU Flows Model 2006 - 2012

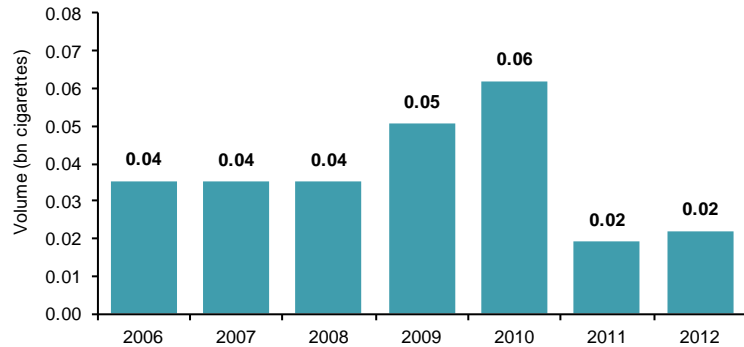
(2) Industry Empty Pack Surveys 2006 – 2012

Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

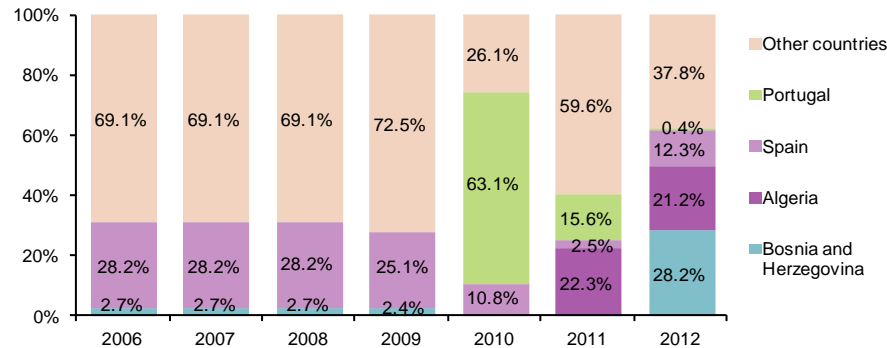
(b) Q4 2012 EPS results for Luxembourg remain preliminary and have not been analysed by all companies.

C&C increased by 4% in 2012, with declining inflows from Portugal being offset by increased volumes from Bosnia and Herzegovina

Total inflows of C&C
2006-2012^{(1)(2)(a)(b)}



Share of C&C by origin
2006-2012^{(1)(2)(a)(b)}

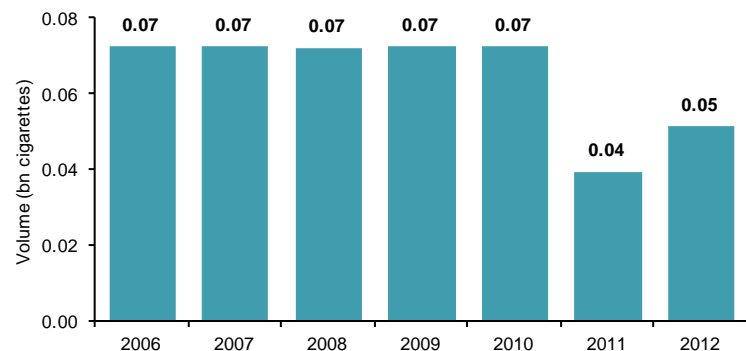


Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

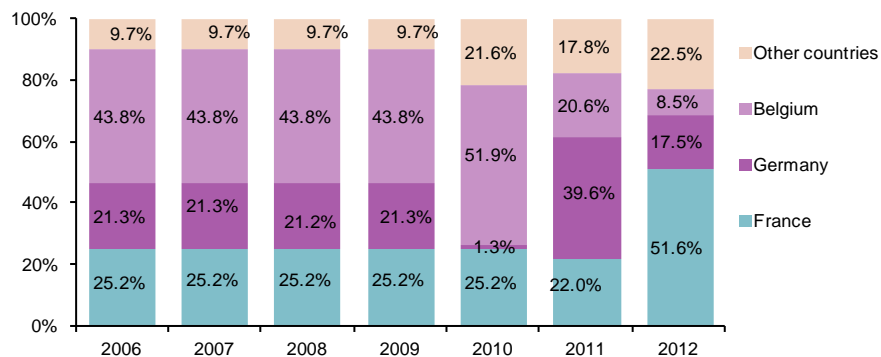
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.
(b) Due to the small EPS sample size and relatively low proportion of C&C in Luxembourg, very small volumes can have a large proportional impact on C&C results. For example, only 2 packs of the full year sample of 325 were collected from Bosnia & Herzegovina in 2012; however, this represents over 25% of C&C.

Non-domestic legal inflows in Luxembourg increased during the year, with Camel increasing to 18.6% of ND(L) in 2012

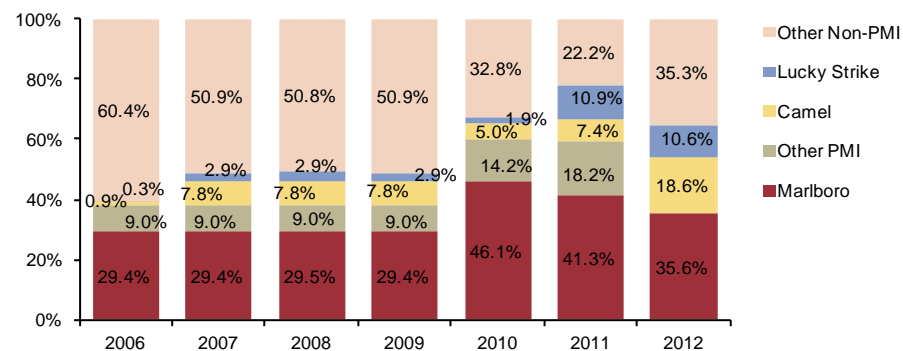
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

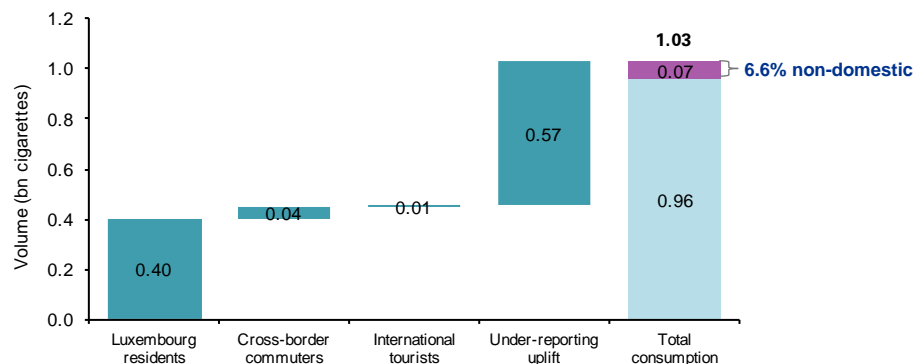
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

Luxembourg

Estimation of consumption

Consumption estimates 2012⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾



Consumption calculation 2012		
	Luxembourg	Belgium
Population 15+ (million) ⁽¹⁾	0.4	9.0
Smoking incidence ^{(2)(b)}		
• Daily smokers	17.0%	10.5%
• Occasional smokers	6.0%	1.1%
Avg. daily consumption ⁽²⁾	14.7 ^(c)	15.6
Implied consumption (bn cigarettes) ^(a)	0.40	5.15
KPMG consumption (bn cigarettes) ⁽⁴⁾	n/a	11.65
Implied understatement	44%	44%
Consumption estimate (bn cigarettes)	1.03	n/a

The scale of outflows from Luxembourg and the small size of the domestic market make an exact measurement of domestic consumption very challenging

- The estimation of outflows from Luxembourg requires the measurement of flows from Luxembourg into all other countries
 - These inflows are particularly difficult to measure as they are likely to be concentrated geographically within markets and are relatively small compared to the domestic markets of the destination countries
- As a result, this approach is likely to underestimate the volume of flows out of Luxembourg and hence overstate consumption

We have used consumer survey data⁽²⁾⁽³⁾ to adjust the estimation of the consumption in 2012

- We have used consumer survey data to estimate domestic consumption by residents, commuters and visitors to Luxembourg
 - We estimated the extent of under-reporting in the survey data at 44% by performing the same calculation for Belgium, and comparing the result to our own consumption estimates
- Applying an uplift for under-reporting implies total consumption of 1.03 billion cigarettes

- Notes:
- (a) Implied consumption for Luxembourg includes 0.07 billion cigarettes attributed to international commuters and tourists
 - (b) Figures for occasional smokers have remained consistent with prior years due to a lack of data
 - (c) Average daily consumption in Luxembourg is calculated as an average of GCTS daily consumption figures for the Netherlands and Belgium
- Sources:
- (1) Oxford Economic Forecasts (OEF)
 - (2) Global Consumer Tracking Survey provided by PMI
 - (3) Smoking incidence estimated by Luxembourg Cancer foundation, quoted in "Smokers in the minority in Luxembourg" on Wort.lu on 29/01/13.
 - (4) KPMG EU Flows Model

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Malta – Consumption summary

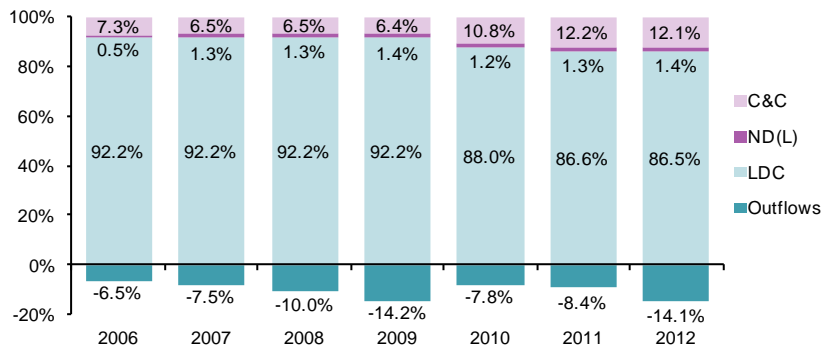
Total consumption in Malta declined by 8% in 2012, as non-domestic inflows declined by 8%; outflows increased by 53% during the year

Total Malta consumption ⁽¹⁾⁽²⁾⁽³⁾								Change
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	11/12 %
Legal domestic sales (LDS)	0.535	0.535	0.535	0.529	0.550	0.520	0.505	(3)%
Outflows	-0.035	-0.040	-0.053	-0.071	-0.045	-0.046	-0.071	53%
Legal domestic consumption (LDC)	0.500	0.495	0.482	0.458	0.505	0.474	0.434	(8)%
Non-domestic legal (ND(L))	0.003	0.007	0.007	0.007	0.007	0.007	0.007	0%
Counterfeit and contraband (C&C)	0.040	0.035	0.034	0.032	0.062	0.067	0.061	(9)%
Total non-domestic	0.042	0.042	0.041	0.039	0.069	0.074	0.068	(8)%
Total consumption	0.542	0.536	0.523	0.497	0.574	0.547	0.502	(8)%

Legal domestic sales in Malta decreased by 3% in 2012, with legal domestic consumption also impacted by increasing outflows

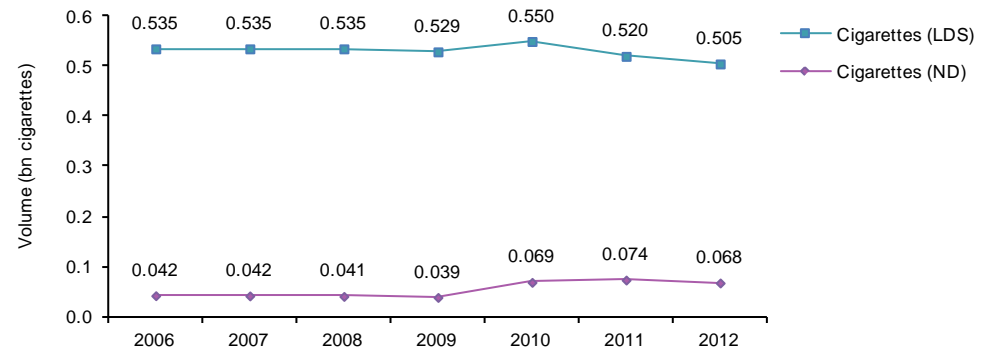
- C&C and ND(L) remained relatively stable at 12.1% and 1.4% of total consumption in 2012, respectively
- Increased outflows from Malta were mainly driven by inbound tourism, which increased to an all-time high in 2012⁽⁴⁾

Share of Malta cigarettes consumption by type 2006-2012⁽¹⁾⁽²⁾



Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) PMI Empty Pack Surveys 2006 – 2012
 (3) LDS/IMS data provided by PMI
 (4) National Statistics Office – Malta, Departing Tourists December 2012, 31 January 2013

Malta legal domestic sales and non-domestic consumption 2006-2012^{(1)(2)(3)(a)}



Notes: (a) OTP data not available.

Despite increased inflows of Unspecified cigarettes, total inflows to Malta decreased by 8% in 2012, driven by decreased Duty Free volumes; outflows increased by 53% during the year

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)(b)}



Inflows to Malta								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Unspecified	0.000	0.000	0.000	0.000	0.022	0.028	0.041	46%
Duty Free	0.030	0.030	0.029	0.027	0.034	0.032	0.021	(36)%
Italy	0.005	0.005	0.005	0.004	0.001	0.001	0.001	>100%
Other countries	0.008	0.008	0.007	0.007	0.011	0.013	0.005	(62)%
Total inflows	0.042	0.042	0.041	0.039	0.069	0.074	0.068	(8)%

Outflows from Malta								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
UK	0.027	0.027	0.044	0.039	0.035	0.037	0.051	36%
Netherlands	0.004	0.004	0.000	0.004	0.000	0.006	0.002	(66)%
Ireland	0.004	0.000	0.001	0.001	0.002	0.002	0.002	(27)%
Other countries	0.001	0.010	0.007	0.026	0.008	0.000	0.016	-
Total outflows	0.035	0.040	0.053	0.071	0.045	0.046	0.071	53%

Outflows from Malta were largely driven by tourism outflows to more expensive markets, with flows to the UK representing the largest volume

- Flows to 'Other countries' also increased, mainly comprised of outflows to France, Italy, Germany and Greece

Unspecified inflow volumes increased by 46% in 2012

- However, this was offset by a 36% decline in flows from Duty Free

Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

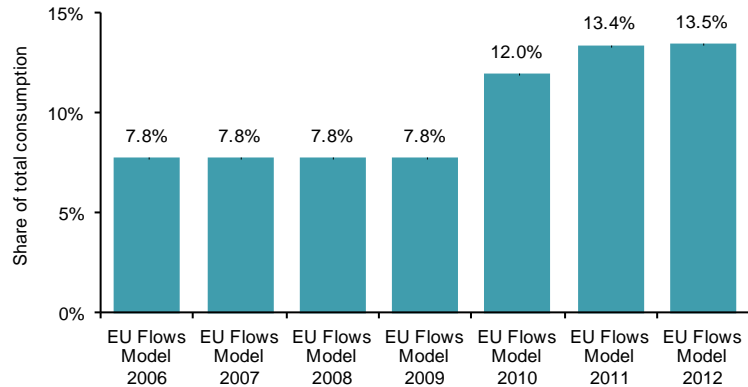
(b) Unspecified market variants are defined as those packs which do not bear any market-specific health warning or tax stamp, or mention of 'Duty Free' on the pack

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

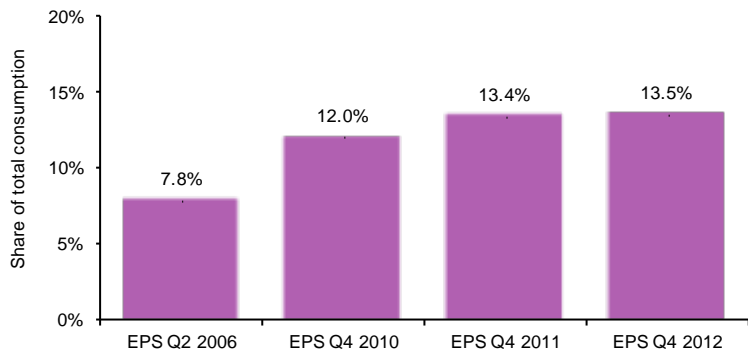
Total non-domestic incidence was estimated at 13.5% in 2012, a slight increase from the 2011 estimate of 13.4%

Non-domestic market estimates 2007-2012^{(1)(2)(a)}



The EU Flows Model estimate for non-domestic consumption in 2012 is based on the results of the Empty Pack Survey undertaken in the fourth quarter of 2012

Other non-domestic market estimates 2007-2012^{(2)(a)}



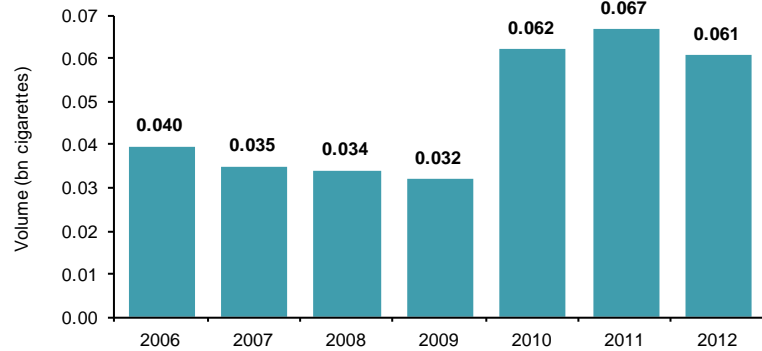
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2006 – 2012

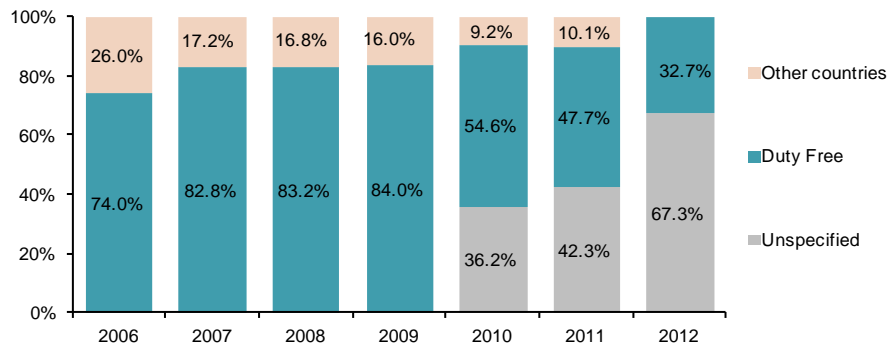
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

C&C in Malta declined in 2012, however the proportion attributable to Unspecified market variants increased to 67.3%

Total inflows of C&C
2006-2012^{(1)(2)(a)(b)}



Share of C&C by origin
2006-2012^{(1)(2)(a)(b)}

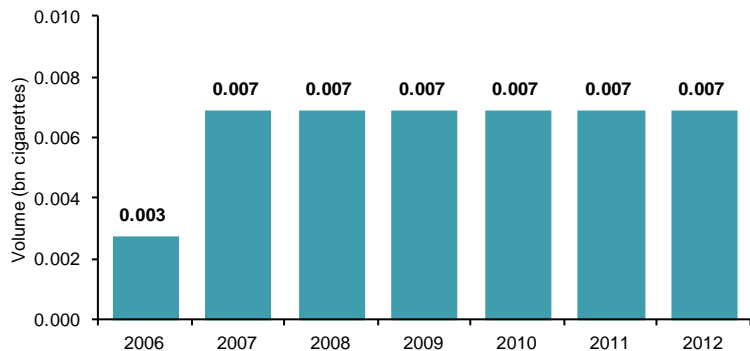


Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

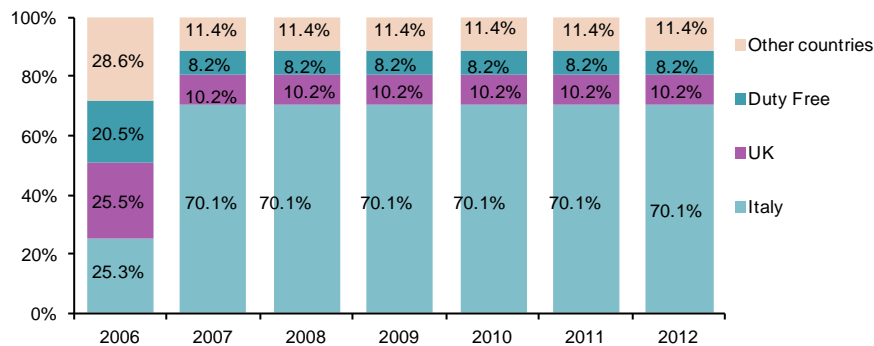
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.
(b) Unspecified market variants are those which do not bear any market-specific health warning or mention Duty Free on the label.

Non-domestic legal flows remained stable in 2012, with over 80% of inflows coming from Italy and the UK; PMI's share of ND(L) remained stable at 18.7% during the year

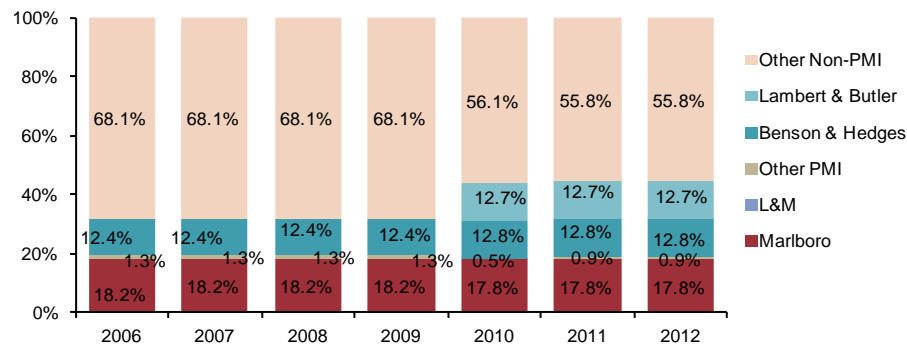
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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- Romania
- Slovakia
- Slovenia
- Spain
- Sweden
- United Kingdom

Netherlands – Consumption summary

C&C in the Netherlands increased by 4% in 2012, with non-domestic incidence growing to 21.4% of total consumption in 2012

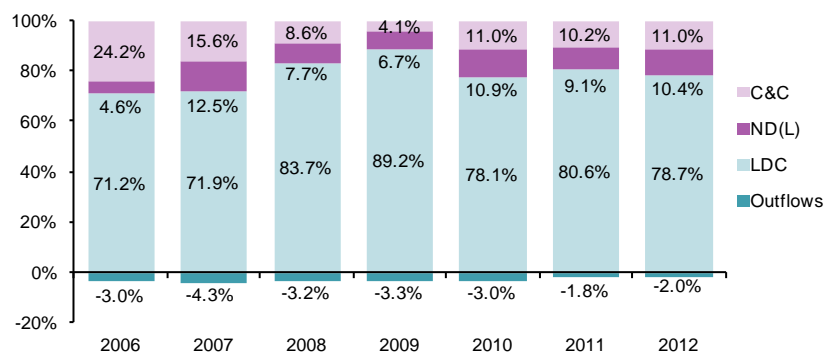
Total Netherlands consumption ⁽¹⁾⁽²⁾⁽³⁾								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	14.11	14.51	14.62	13.39	13.16	12.71	12.05	(5)%
Outflows	-0.57	-0.82	-0.53	-0.48	-0.49	-0.27	-0.29	9%
Legal domestic consumption (LDC)	13.54	13.69	14.09	12.91	12.67	12.44	11.75	(5)%
Non-domestic legal (ND(L))	0.87	2.38	1.30	0.97	1.77	1.41	1.55	10%
Counterfeit and contraband (C&C)	4.59	2.97	1.45	0.60	1.78	1.58	1.64	4%
Total non-domestic	5.46	5.36	2.75	1.56	3.55	2.98	3.19	7%
Total consumption	19.01	19.05	16.84	14.47	16.23	15.42	14.94	(3)%

Netherlands Other Tobacco Product market ^{(3)(a)}								
Billion cigarette equivalent	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
OTP (LDS)	14.41	14.24	13.68	15.49	14.67	14.01	14.09	1%

Total cigarette consumption in the Netherlands declined by 3% in 2012, with growing non-domestic inflows partially offsetting the 5% decline in legal domestic sales

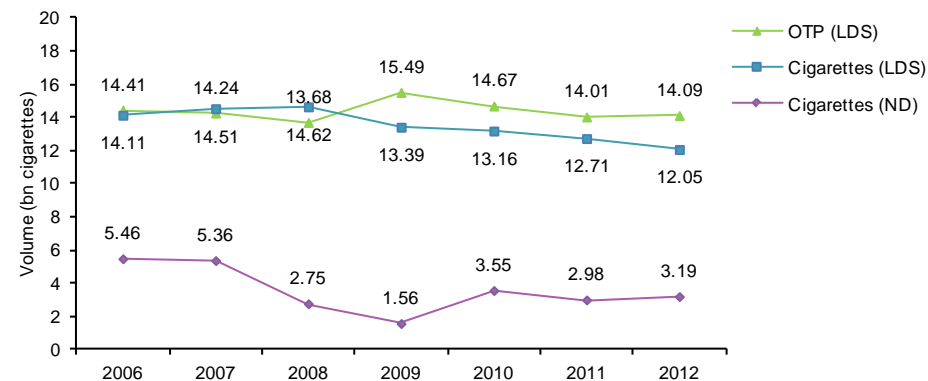
- Growth in non-domestic incidence was most significantly impacted by ND(L) inflows, which increased by 10% in 2012
- OTP represents a significant proportion of the Netherlands tobacco market with legal domestic sales totalling 14.09 bn cigarette equivalents in 2012
 - Legal domestic sales of OTP increased by only 1% in 2012

Share of Netherlands cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) PMI Empty Pack Surveys 2006 – 2012
 (3) LDS/IMS data provided by PMI

Netherlands legal domestic sales (cigarettes and OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

Non-domestic inflows to the Netherlands increased by 7% in 2012, driven largely by growing inflows from Germany and Belgium

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Inflows to Netherlands								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Germany	0.45	0.29	0.20	0.13	0.35	0.25	0.33	35%
Belgium	0.54	0.73	0.13	0.15	0.24	0.29	0.32	8%
Italy	0.65	0.45	0.25	0.06	0.21	0.18	0.17	(1)%
Other countries	3.82	3.88	2.17	1.22	2.75	2.27	2.36	4%
Total inflows	5.46	5.36	2.75	1.56	3.55	2.98	3.19	7%

Outflows from Netherlands								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
UK	0.08	0.17	0.12	0.06	0.04	0.02	0.07	>100%
France	0.14	0.26	0.08	0.14	0.09	0.08	0.07	(18)%
Germany	0.18	0.16	0.20	0.13	0.14	0.07	0.06	(13)%
Belgium	0.09	0.05	0.02	0.11	0.13	0.06	0.04	(21)%
Other countries	0.08	0.17	0.12	0.04	0.09	0.04	0.05	21%
Total outflows	0.57	0.82	0.53	0.48	0.49	0.27	0.29	9%

As the price of cigarettes in the Netherlands rose relative to neighbouring markets, non-domestic inflows grew in 2012

- Germany and Belgium represent the largest volumes, comprising over 20% of total inflows
 - German inflows increased most significantly during the year, growing by 35% in 2012. This is largely due to the increasing price differential between the two countries
- Outflows from the Netherlands increased by 9% during the year, driven by increasing flows to the UK

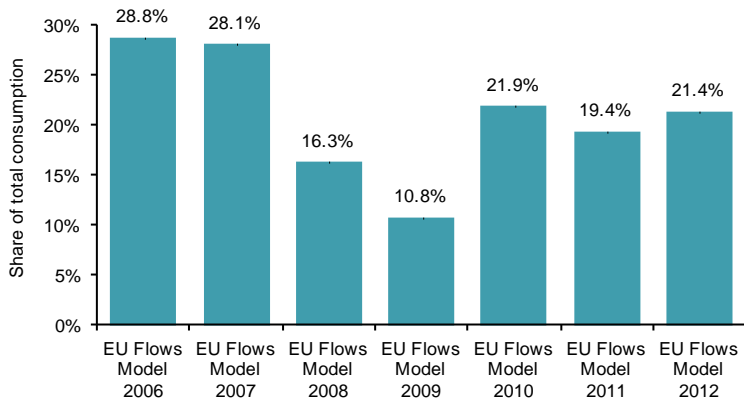
Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

Estimated non-domestic incidence based on EPS survey results increased from 19.4% in 2011 to 21.4% in 2012, with EU Flows model results stabilising in recent years

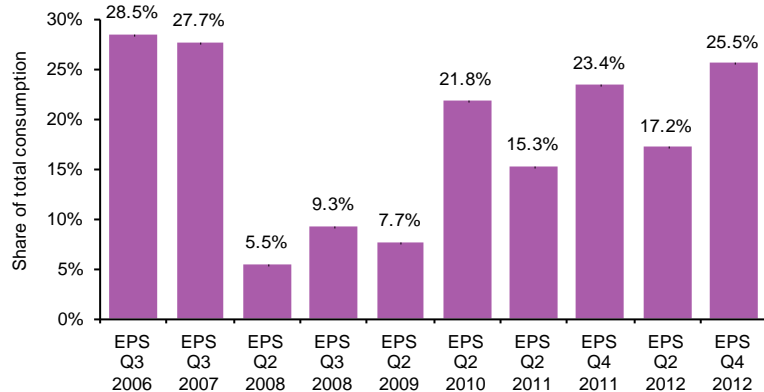
Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The EU Flows Model estimate for non-domestic consumption in 2012 is based on the results of the Empty Pack Surveys undertaken in the second and fourth quarters of 2012

- The EU flows model estimate is based on the arithmetic average results of the Q2 and Q4 EPS surveys, with no further adjustments made to the survey results

Other non-domestic market estimates 2006-2012^{(2)(a)}



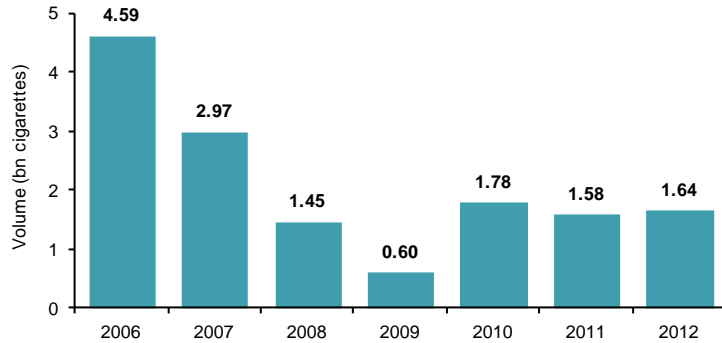
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2006 – 2012

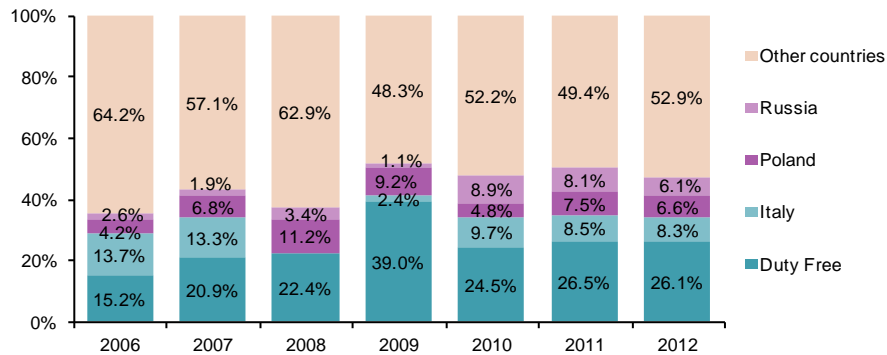
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

C&C inflows increased by 4% in 2012, with inflows from Russia and Poland declining relative to 2011

Total inflows of C&C
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(2)(a)}



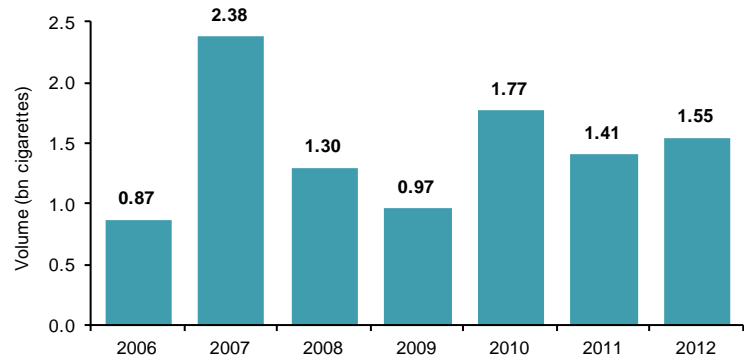
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

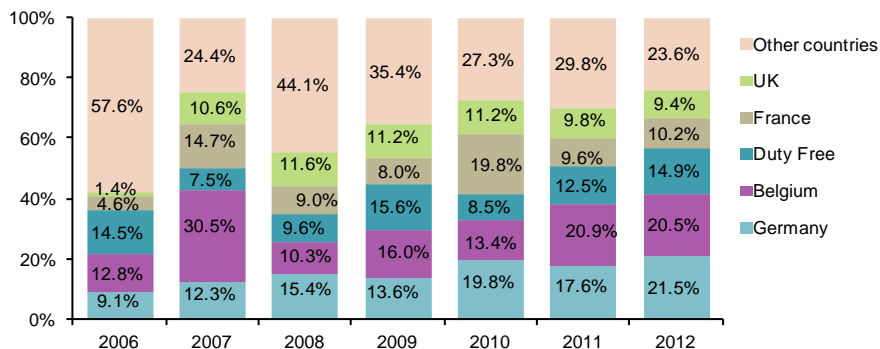
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

Non-domestic legal inflows increased by 10% in 2012, driven largely by an increase in German inflows, due to the widening price differential between the two countries; L&M increased to 14.6% of ND(L) originating mainly from Germany and Duty Free market variants

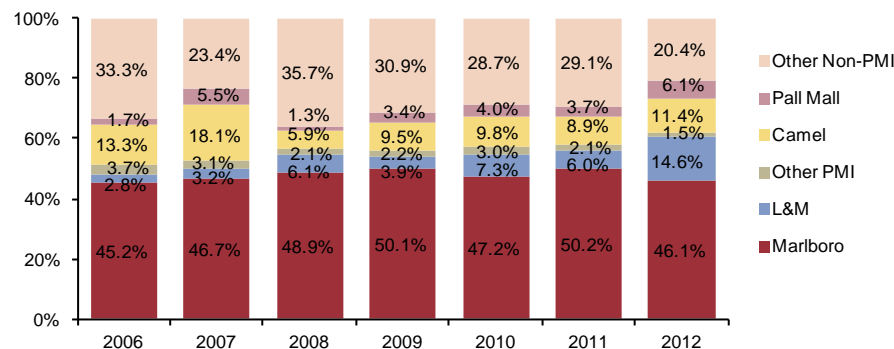
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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- Slovenia
- Spain
- Sweden
- United Kingdom

Whilst consumption of manufactured cigarettes decreased by 8% and legal sales of OTP decreased by 29%, a significant increase in green leaf tobacco consumption is likely to have accounted for the gap in consumption

Total Poland consumption (1)(2)(3)								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarettes								
Legal domestic sales (LDS)	72.44	69.91	63.14	61.12	57.32	55.55	52.15	(6)%
Outflows	-9.94	-9.47	-8.81	-9.43	-9.35	-10.80	-11.36	5%
Legal domestic consumption (LDC)	62.50	60.44	54.32	51.68	47.97	44.75	40.79	(9)%
Non-domestic legal (ND(L))	0.61	0.57	0.89	0.94	0.53	0.55	0.63	15%
Counterfeit and contraband (C&C)	3.80	4.69	4.92	7.07	5.77	6.68	6.20	(7)%
Total non-domestic	4.41	5.26	5.80	8.02	6.30	7.23	6.83	(5)%
Total consumption	66.92	65.70	60.13	59.70	54.27	51.97	47.62	(8)%

Poland Other Tobacco Product market (3)								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarette equivalent								
OTP (LDS)	0.94	0.80	0.68	3.95	4.69	5.31	3.75	(29)%

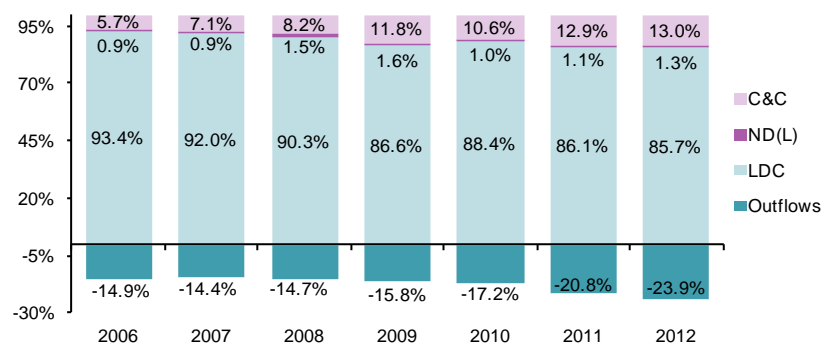
LDS fell by 6% as a result of the decrease in consumption and availability of alternative tobacco products in the form of illicit cigarettes and green leaf OTP

- C&C declined in volume terms but its share of consumption increased to 13%

OTP sales also declined by 29%; the decrease in total consumption appears to have been caused by large scale switching to the growing green leaf segment

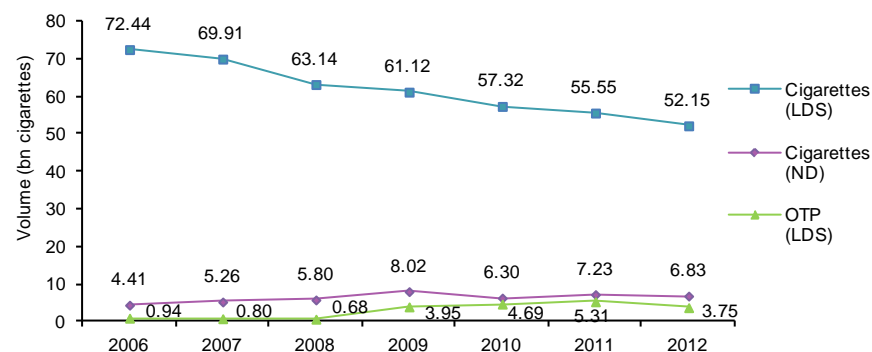
- In 2012 green leaf was estimated to account for over 6 billion cigarettes worth of consumption⁽⁴⁾
 - Green leaf was sold online and from corner shops as unprocessed tobacco and was not subject to excise tax⁽⁴⁾
- Green leaf is the most economical way of smoking in Poland, however it was exploiting a tax loophole which was closed as of January 1st 2013

Share of Poland cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)
 (3) LDS/IMS data provided by PMI
 (4) PMI estimates

Poland legal domestic sales (cigarettes and OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}

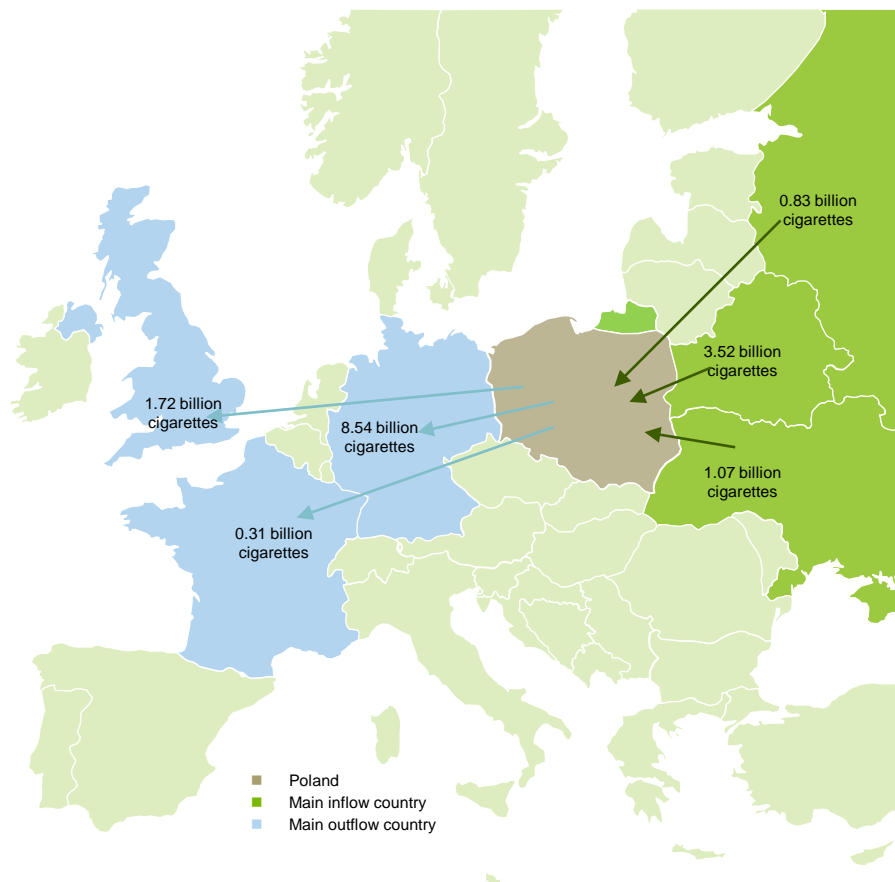


Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

Poland – Country flows summary

Total inflows to Poland declined in volume terms, however inflows from Belarus increased by 32%. Outflows to Germany remained stable, whilst outflows to the UK increased significantly

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)
 (3) European Commission, Anti-fraud strategy, June 2011
 (4) PMI Management and EU Tax Tables

Inflows to Poland								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Belarus	0.02	0.11	0.38	1.04	1.39	2.66	3.52	32%
Ukraine	1.67	2.58	3.42	4.71	2.96	1.70	1.07	(37)%
Russia	0.82	1.23	1.07	1.35	1.08	1.01	0.83	(17)%
Other countries	1.90	1.34	0.95	0.92	0.88	1.86	1.41	(24)%
Total inflows	4.41	5.26	5.80	8.02	6.30	7.23	6.83	(5)%

Outflows from Poland								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Germany	6.53	6.85	6.32	7.54	7.49	8.64	8.54	(1)%
UK	1.40	1.02	0.93	1.01	0.86	0.96	1.72	80%
France	0.41	0.32	0.41	0.28	0.30	0.55	0.31	(42)%
Other countries	1.60	1.27	1.16	0.61	0.69	0.66	0.78	17%
Total outflows	9.94	9.47	8.81	9.43	9.35	10.80	11.36	5%

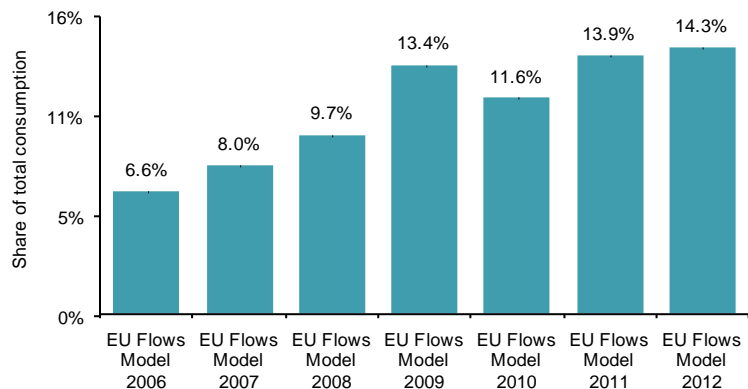
Whilst inflows from Ukraine and Russia reduced significantly, inflows from Belarus increased by 32%

- The EU27 have improved border controls with Ukraine, along with investing large amounts of money in sophisticated surveillance methods, including x-ray machines and sniffer dogs⁽³⁾
- A higher price differential⁽⁴⁾ and the lack of an association agreement between EU27 and Belarus⁽³⁾ has led to it becoming one of the most attractive source countries for illicit cigarette smuggling mainly through the Baltic States

Outflows to Germany remained stable, whilst outflows to the UK almost doubled

Non-domestic incidence in Poland rose by 0.4 percentage points in 2012, from 13.9% to 14.3%

Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The EU flows model calculates non-domestic incidence by inputting the empty pack surveys results from each quarter

- For Poland, each EPS quarterly wave is weighted equally, as there were no inconsistencies or specific issues that required any additional weighting
- No additional re-weighting or analysis was undertaken

Other non-domestic market estimates 2006-2012^{(2)(a)}



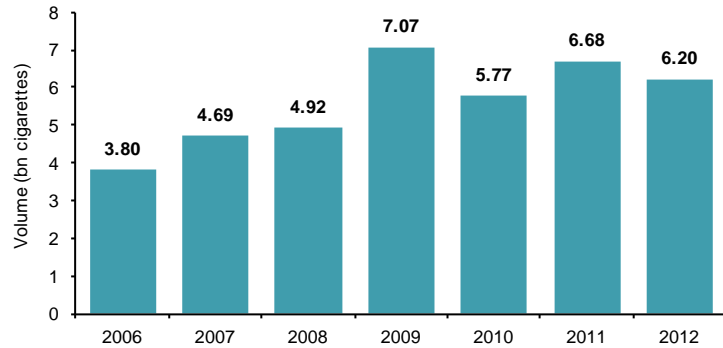
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2006 – 2012

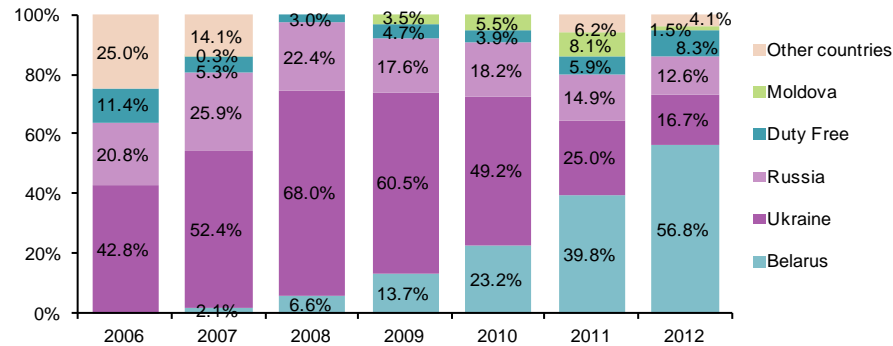
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

Whilst total C&C has declined by 7%, there has been a significant increase in flows from Belarus

Total inflows of C&C
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(2)(a)}

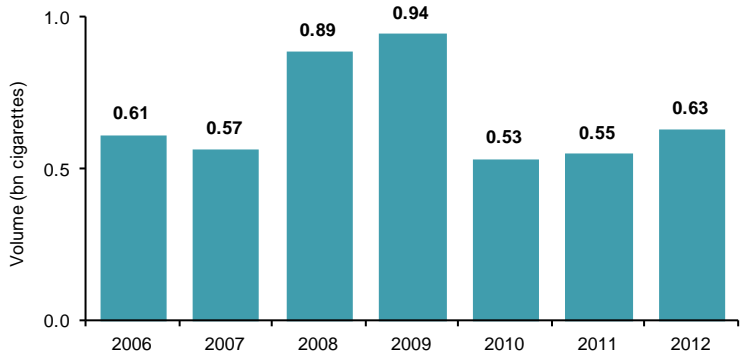


Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

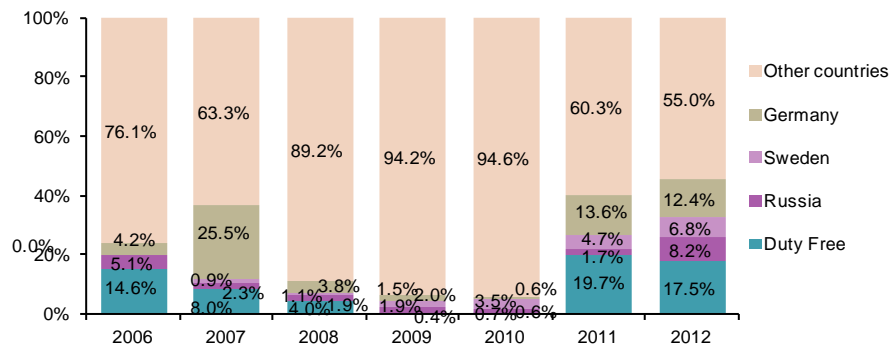
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

The main source countries for ND(L) were Russia, Sweden and Germany, along with a high level of Duty Free sales; PMI's brand share remained stable at around 47%

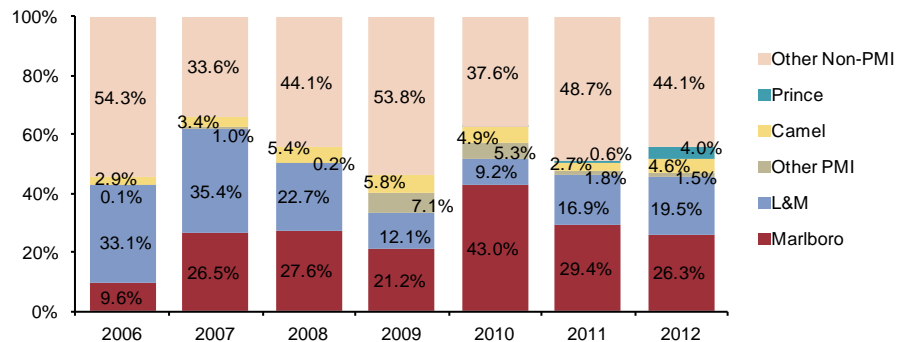
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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- Slovenia
- Spain
- Sweden
- United Kingdom

Non-domestic consumption in Portugal declined by 20% in 2012, driven by declining ND(L) and C&C during the year, while outflows increased by 7%

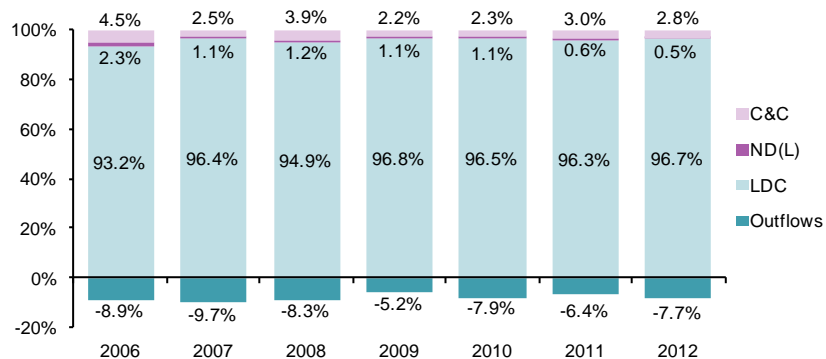
Total Portugal consumption ⁽¹⁾⁽²⁾⁽³⁾								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	14.33	14.03	12.48	12.37	11.86	11.23	10.13	(10)%
Outflows	-1.24	-1.28	-1.00	-0.63	-0.89	-0.70	-0.75	7%
Legal domestic consumption (LDC)	13.08	12.75	11.48	11.73	10.97	10.53	9.38	(11)%
Non-domestic legal (ND(L))	0.32	0.14	0.15	0.13	0.13	0.07	0.05	(35)%
Counterfeit and contraband (C&C)	0.63	0.33	0.47	0.26	0.26	0.33	0.27	(17)%
Total non-domestic	0.95	0.48	0.62	0.39	0.39	0.40	0.32	(20)%
Total consumption	14.04	13.23	12.10	12.13	11.36	10.93	9.70	(11)%

Portugal Other Tobacco Product market ^{(3)(a)}								
Billion cigarette equivalent	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
OTP (LDS)	-	0.73	0.59	0.89	1.16	2.18	2.38	9%

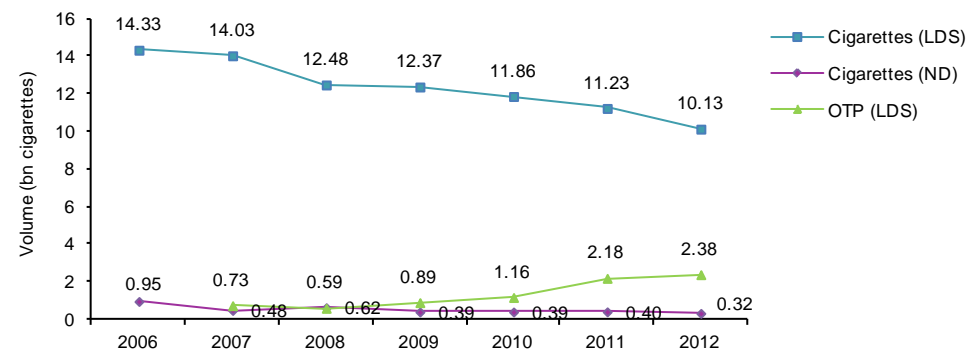
Both legal domestic sales and non-domestic consumption declined in 2012, indicating a drop in overall cigarette consumption of 11%

- Non-domestic incidence in Portugal remains low, at 3.3% of total consumption in 2012; prices in Portugal remained stable during the year
- The decline in non-domestic inflows was mainly driven by ND(L) which decreased by 35% during the year
 - C&C inflows also declined, due to a significant decrease in PMI counterfeit volumes
- Legal domestic sales of OTP increased by 9% in 2012, indicating consumers switching at the bottom end of the market

Share of Portugal cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Portugal legal domestic sales (cigarettes and OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) PMI Empty Pack Surveys 2006 – 2012
 (3) LDS/IMS data provided by PMI

Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports..

The decline in non-domestic inflows into Portugal was driven by decreasing volumes from Duty Free, Unspecified market variants and Spain, while outflows to France and the UK increased

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)(b)}



Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow
 (b) Unspecified market variants are those which do not bear any market-specific health warning or mention Duty Free on the label.
 Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

Inflows to Portugal								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Duty Free	0.10	0.06	0.06	0.06	0.05	0.08	0.06	(23)%
Unspecified	0.00	0.00	0.00	0.00	0.00	0.07	0.06	(11)%
Spain	0.70	0.20	0.45	0.13	0.11	0.04	0.02	(44)%
Other Countries	0.15	0.21	0.11	0.20	0.23	0.21	0.17	(18)%
Total inflows	0.95	0.48	0.62	0.39	0.39	0.40	0.32	(20)%

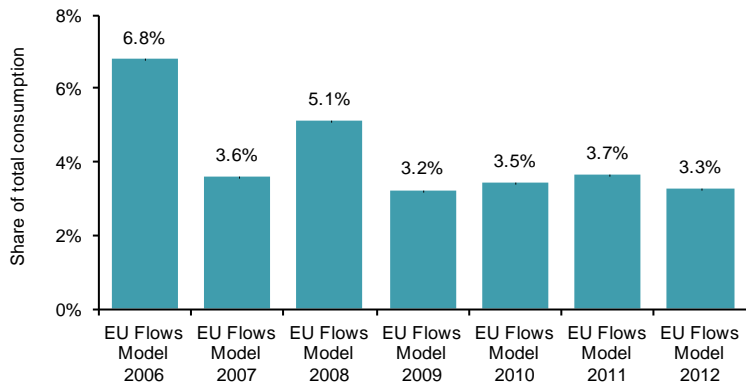
Outflows from Portugal								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012 Sticks	Change 11/12 %
France	0.56	0.48	0.47	0.27	0.51	0.41	0.44	6%
UK	0.31	0.51	0.34	0.12	0.10	0.11	0.15	43%
Spain	0.18	0.12	0.06	0.14	0.08	0.03	0.04	28%
Other Countries	0.20	0.17	0.14	0.09	0.19	0.15	0.12	(19)%
Total outflows	1.24	1.28	1.00	0.63	0.89	0.70	0.75	7%

Non-domestic inflows to Portugal declined by 20% in 2012, with volumes from Spain decreasing due a reversal in the price differential between the two countries

- Outflows from Portugal increased by 7%, due largely to increased outflows to the UK and France
 - This is largely due to tourism flows and an increasing price differential between these two countries

Non-domestic incidence in Portugal decreased from 3.7% in 2011 to 3.3% in 2012

Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The EU Flows Model estimate for non-domestic consumption in 2012 is based on the results of the Empty Pack Survey undertaken in the second quarter of 2012

- The EU flows model estimate is based on the results of the Q2 EPS survey, with no further adjustments made to the survey results

Other non-domestic market estimates 2006-2012^{(2)(a)}



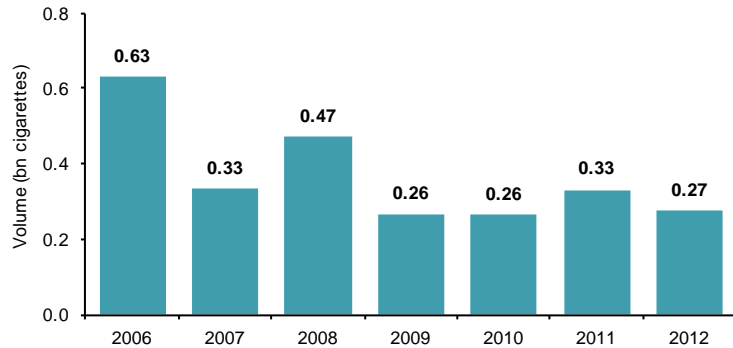
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2006 – 2012

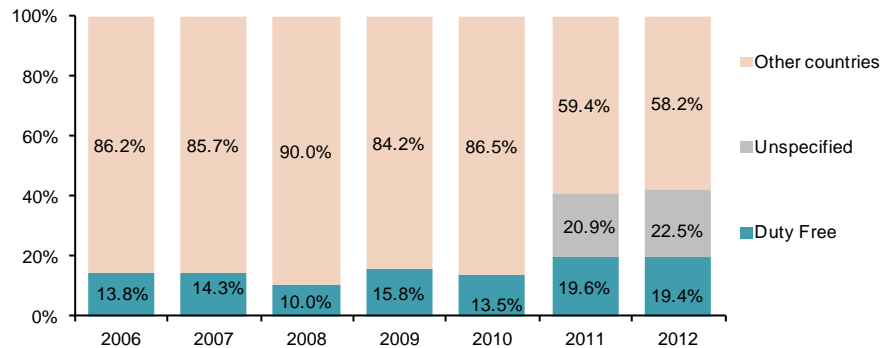
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

C&C declined by 17% during the year, while the proportion attributable to unspecified cigarettes increased to from 20.9% in 2011 to 22.5% in 2012

Total inflows of C&C 2006-2012^{(1)(2)(a)(b)}



Share of C&C by origin 2006-2012^{(1)(2)(a)(b)}

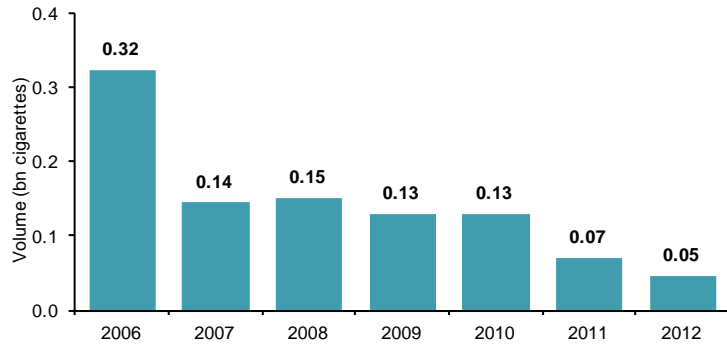


Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.
 (b) Unspecified market variants are those which do not bear any market-specific health warning or mention Duty Free on the label.
 Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

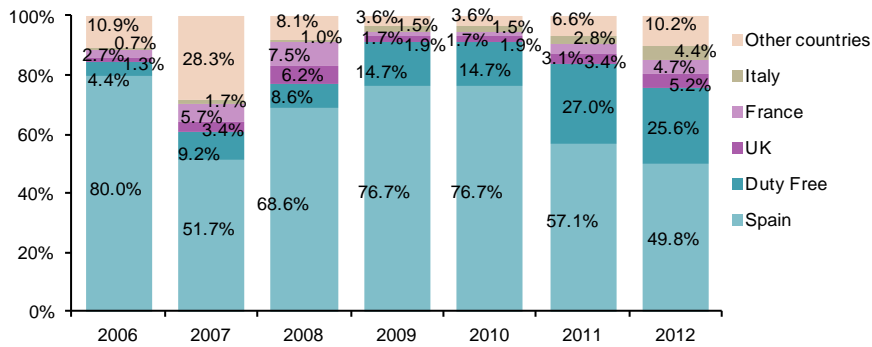
Portugal – ND(L) summary

Non-domestic legal inflows declined by 35% in 2012, largely due to decreasing flows from Spain which dropped to 49.8% of total ND(L); Marlboro’s share of ND(L) increased to 45.6%

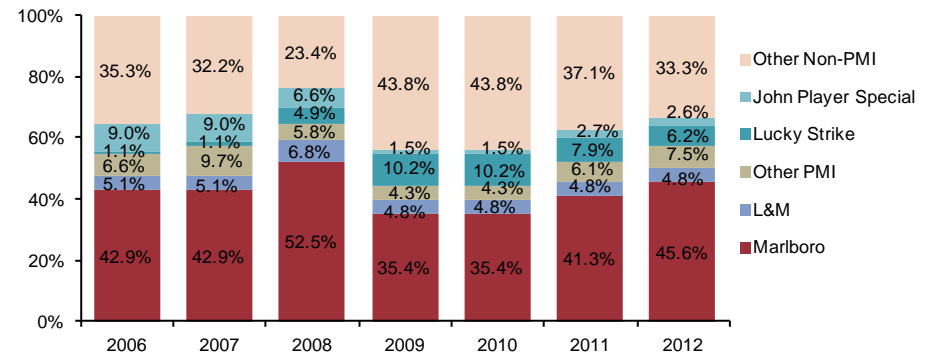
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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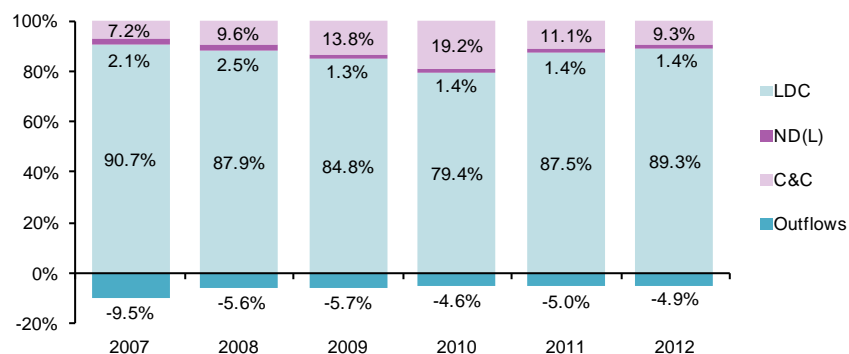
Overall consumption of manufactured cigarettes decreased by 2%, largely accounted for by a decline in C&C

Total Romania consumption ⁽¹⁾⁽²⁾⁽³⁾							
Billion cigarettes	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	31.15	30.57	29.81	23.10	25.58	25.54	(0)%
Outflows	-2.94	-1.83	-1.89	-1.26	-1.37	-1.33	(3)%
Legal domestic consumption (LDC)	28.21	28.75	27.92	21.84	24.21	24.21	0%
Non-domestic legal (ND(L))	0.66	0.82	0.44	0.38	0.38	0.38	0%
Counterfeit and contraband (C&C)	2.22	3.13	4.55	5.30	3.08	2.52	(18)%
Total non-domestic	2.89	3.95	4.99	5.67	3.46	2.90	(16)%
Total consumption	31.10	32.70	32.91	27.52	27.67	27.11	(2)%

The total cigarettes consumption decreased in Romania in 2012 due to a decrease in C&C

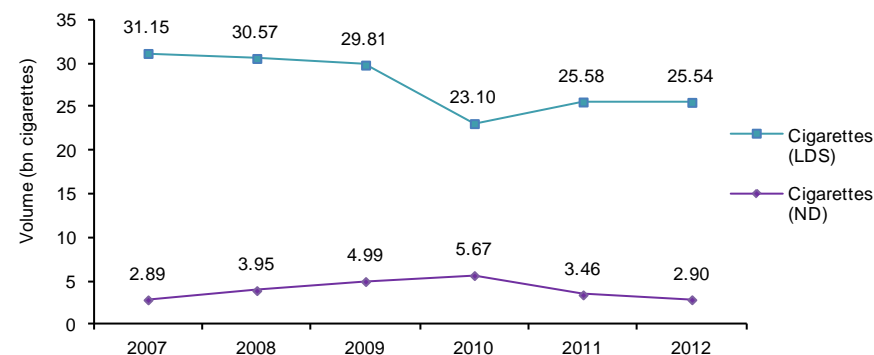
- The legal domestic sales remained stable
- The smoking incidence declined from 40.2% to 39.7% between 2011 and 2012, whilst the number of cigarettes smoked per day declined from 16.3 to 15.7⁽⁴⁾
- Improved border controls resulted in a significant decline in C&C

Share of Romania cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)
 (3) LDS/IMS data provided by PMI
 (4) Global Consumer Tracking Survey provided by PMI

Romania legal domestic sales and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Notes: (a) OTP data not available

Non-domestic incidence declined in 2012; in addition, outflows decreased with significantly lower volumes to the UK

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Inflows to Romania							
Billion cigarettes	2007	2008	2009	2010	2011	2012	Change 11/12 %
Moldova	0.60	1.64	2.01	1.90	1.10	0.95	(13)%
Serbia	0.02	0.01	0.07	0.95	0.75	0.69	(9)%
Ukraine	0.90	1.36	0.98	1.07	0.59	0.55	(8)%
Other countries	1.37	0.94	1.92	1.75	1.02	0.72	(29)%
Total Inflows	2.89	3.95	4.99	5.67	3.46	2.90	(16)%

Outflows from Romania							
Billion cigarettes	2007	2008	2009	2010	2011	2012	Change 11/12 %
France	1.30	0.61	0.62	0.32	0.56	0.62	11%
UK	0.14	0.25	0.30	0.37	0.32	0.19	(40)%
Italy	0.68	0.29	0.51	0.18	0.12	0.09	(24)%
Other countries	0.82	0.68	0.47	0.38	0.37	0.42	13%
Total Outflows	2.94	1.83	1.89	1.26	1.37	1.33	(3)%

Romania experienced significantly lower inflows in 2012 from its surrounding and more cheaply priced countries

- Increased sophistication applied to customs check-points and the policing of green borders (areas between 2 checkpoints which are not patrolled) has led to a reduction in total inflows of 16%⁽³⁾

Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

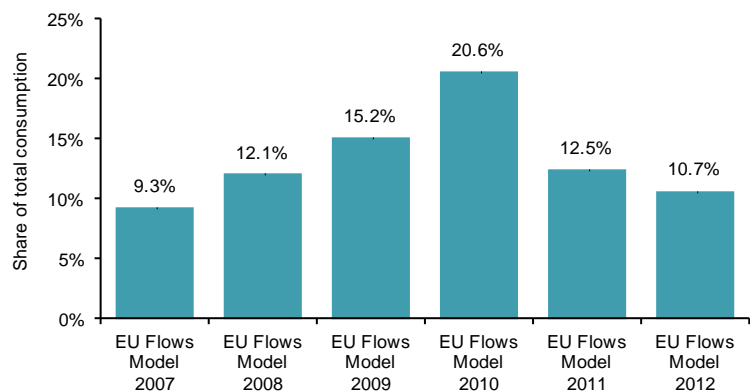
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

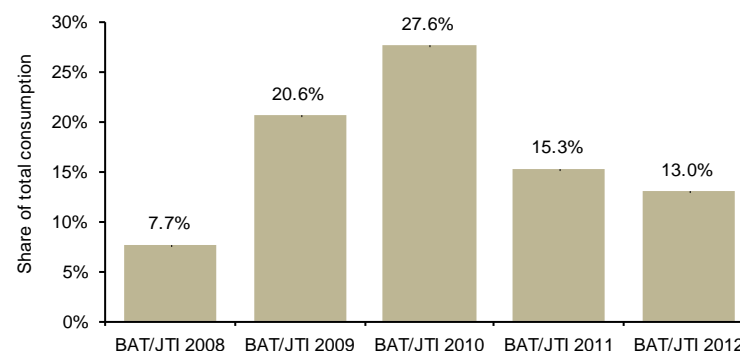
(3) World Customs Journal, Tackling Cigarette Smuggling with Enforcement, Jan 2013

Non-domestic incidence in Romania fell by 1.8 percentage points in 2012 from 12.5% to 10.7%

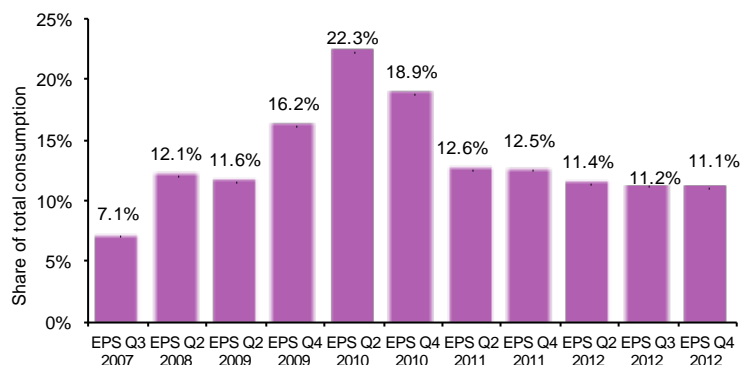
**Non-domestic market estimates
2007-2012^{(1)(2)(a)}**



**Other non-domestic market estimates
2007-2012⁽³⁾**



**Other non-domestic market estimates
2007-2012^{(2)(a)}**



The EU flows model calculates non-domestic incidence by inputting the empty pack surveys results from each quarter

- Each quarterly wave was weighted equally
- The data was additionally weighted to better represent the population size in each region

Sources: (1) KPMG EU Flows Model 2006 - 2012

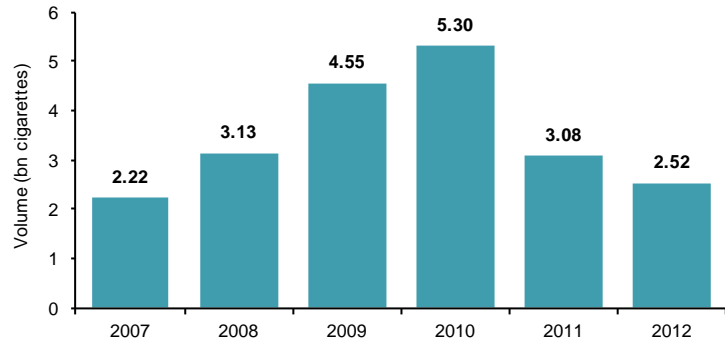
(2) PMI Empty Pack Surveys 2006 – 2012

(3) Consumer survey carried out 6 times a year by Novel Research for BAT and JTI

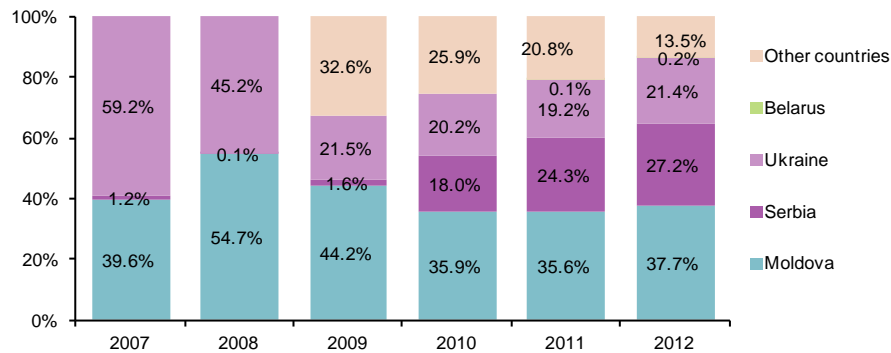
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section

C&C from non-EU border countries continued to account for a large proportion of consumption in Romania despite lower flows in 2012

Total inflows of C&C
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(2)(a)}



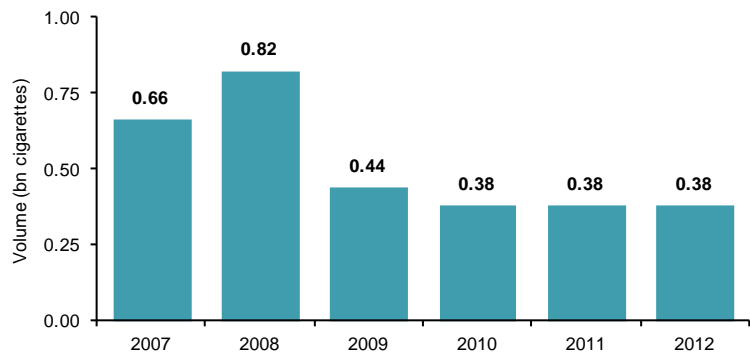
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

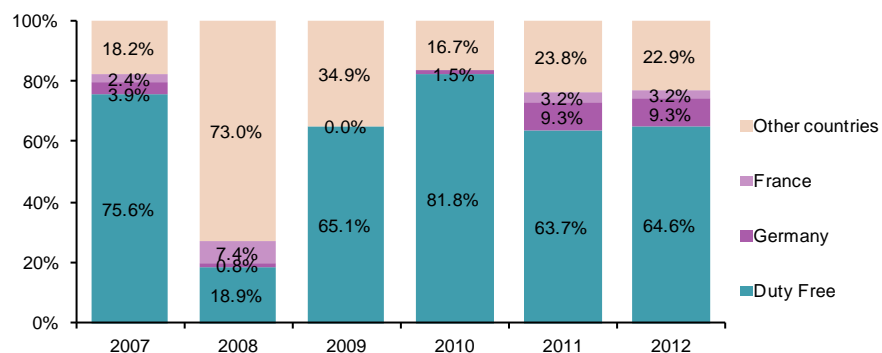
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

ND(L) accounted for a very small amount of non-domestic consumption, mainly from countries with higher priced cigarettes

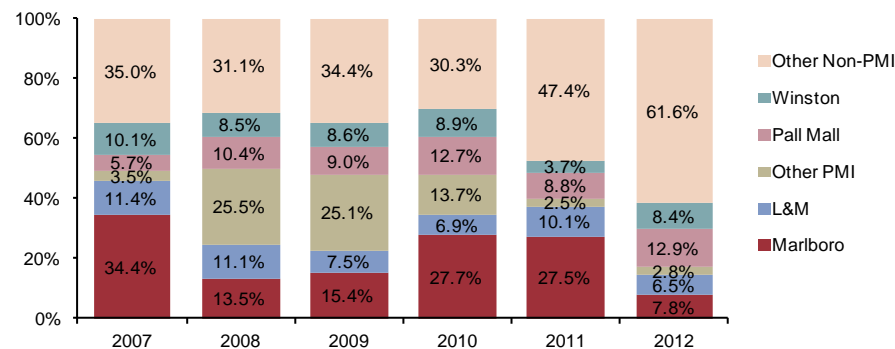
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share of ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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Slovakia – Consumption summary

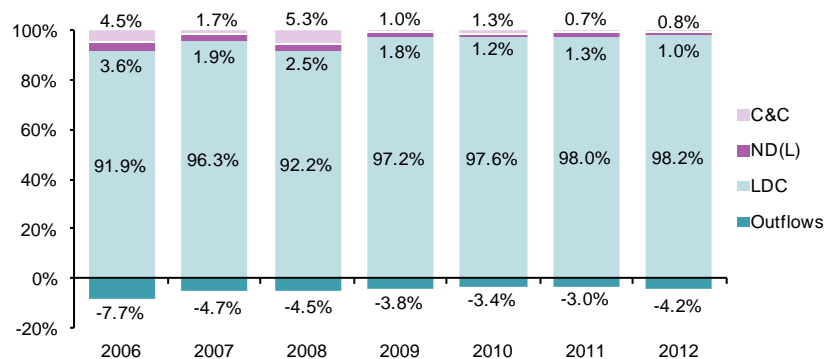
Overall consumption of manufactured cigarettes decreased by 4%, reflecting a decline in legal domestic sales and a decrease in inflows, while outflows to other markets increased

Total Slovakia consumption ⁽¹⁾⁽²⁾⁽³⁾								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	7.01	7.74	8.03	7.69	7.48	7.36	7.19	(2)%
Outflows	-0.54	-0.36	-0.37	-0.29	-0.25	-0.22	-0.29	37%
Legal domestic consumption (LDC)	6.47	7.38	7.66	7.40	7.23	7.15	6.89	(4)%
Non-domestic legal (ND(L))	0.25	0.15	0.21	0.14	0.09	0.10	0.07	(26)%
Counterfeit and contraband (C&C)	0.32	0.13	0.44	0.07	0.09	0.05	0.06	7%
Total non-domestic	0.57	0.28	0.65	0.21	0.18	0.15	0.13	(14)%
Total consumption	7.04	7.66	8.31	7.62	7.41	7.30	7.02	(4)%

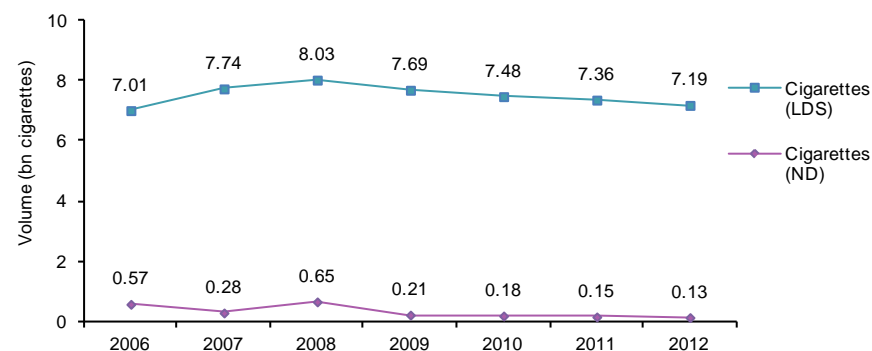
The decrease in total consumption reflected a decrease in legal domestic sales and non-domestic incidence

- The decline in legal domestic sales is broadly in line with expectations around overall consumption based on smoking incidence⁽⁴⁾

Share of Slovakia cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Slovakia legal domestic sales and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



- Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)
 (3) LDS/IMS data provided by PMI
 (4) Global Consumer Tracking Survey provided by PMI

Notes: (a) OTP data not available

Slovakia has low levels of both inflows and outflows; the largest inflow to Slovakia comes from Hungary, representing 23% of total inflows, whilst Germany is the largest outflow market

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Inflows to Slovakia								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Hungary	0.00	0.00	0.01	0.06	0.03	0.04	0.03	(14)%
Ukraine	0.29	0.15	0.39	0.08	0.05	0.05	0.01	(82)%
Other countries	0.28	0.13	0.25	0.08	0.10	0.06	0.09	43%
Total inflows	0.57	0.28	0.65	0.21	0.18	0.15	0.13	(14)%

Outflows from Slovakia								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Germany	0.07	0.06	0.04	0.04	0.04	0.04	0.07	63%
Austria	0.08	0.06	0.06	0.04	0.03	0.04	0.04	0%
Hungary	0.06	0.03	0.04	0.03	0.01	0.03	0.01	(53)%
Other countries	0.34	0.20	0.23	0.17	0.16	0.11	0.17	55%
Total outflows	0.54	0.36	0.37	0.29	0.25	0.22	0.29	33%

Lower levels of inflows came from Hungary and Ukraine

- The inflow from Ukraine declined at the same time as investment in border security increased and cooperation between the EU and Ukrainian border police improved⁽⁴⁾
- The inflow from Hungary declined as tax changes throughout the year reduced the price differential (for Marlboro from €1.03 to €0.60)⁽³⁾

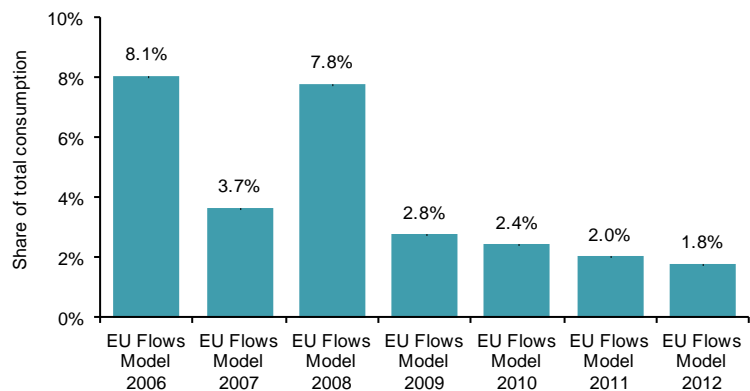
Outflows from Slovakia to Germany and Austria are mainly accounted for by shopping visitors and migrant workers taking advantage of cheaper cigarettes⁽⁵⁾

Notes: (a) Map shows flows over 1% of consumption, or top flow if none are greater than 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

- Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)
 (3) KPMG analysis of PMI tax tables
 (4) European Commission, Anti-fraud strategy, June 2011
 (5) Interviews with PMI management

Non-domestic incidence in Slovakia fell by 0.2 percentage points in 2012 from 2.0% to 1.8%

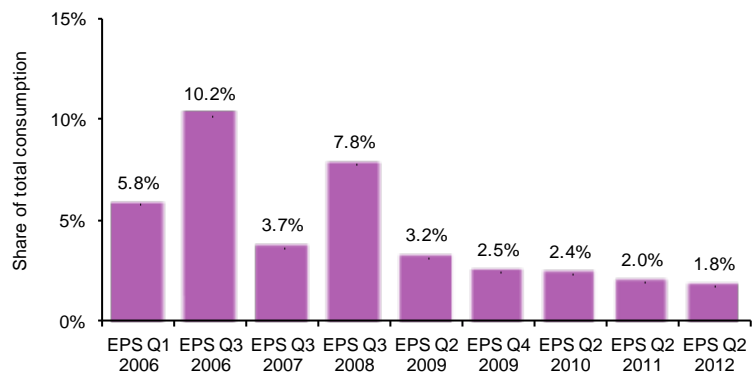
Non-domestic market estimates 2007-2012^{(1)(2)(a)}



The EU flows model calculates non-domestic incidence by inputting the empty pack surveys results from each quarter

- One survey was conducted during the year

Other non-domestic market estimates 2007-2012^{(2)(a)}



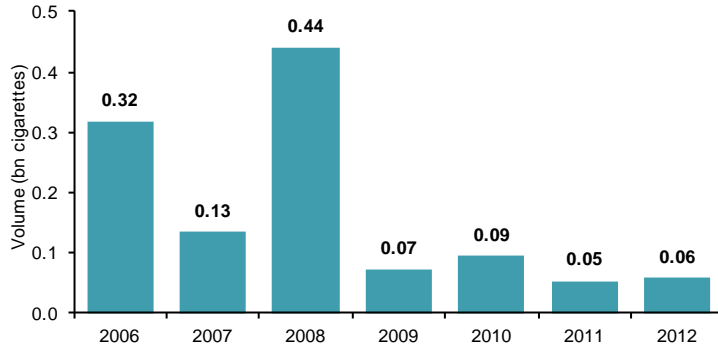
Sources: (1) KPMG EU Flows Model 2007 - 2012

(2) PMI Empty Pack Surveys 2007 – 2012

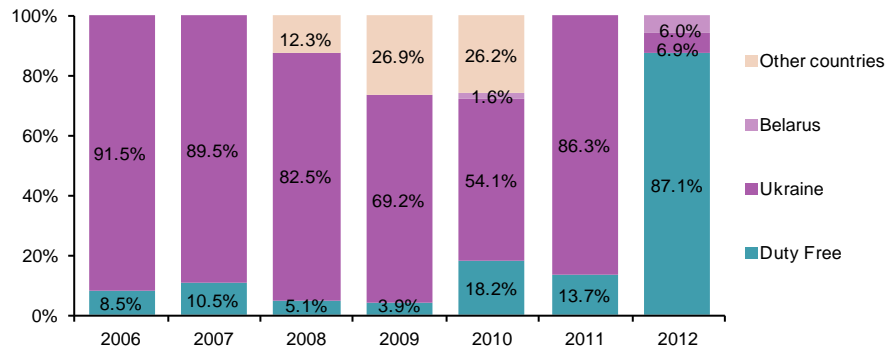
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

C&C in Slovakia was driven by increasingly high levels of cigarettes which were marked as if they were destined for Duty Free sale

Total inflows of C&C
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

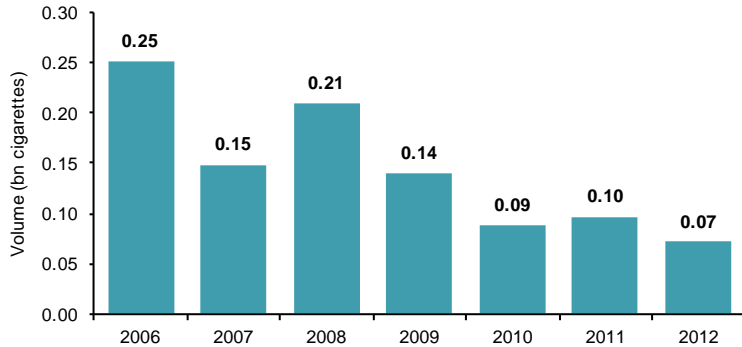
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

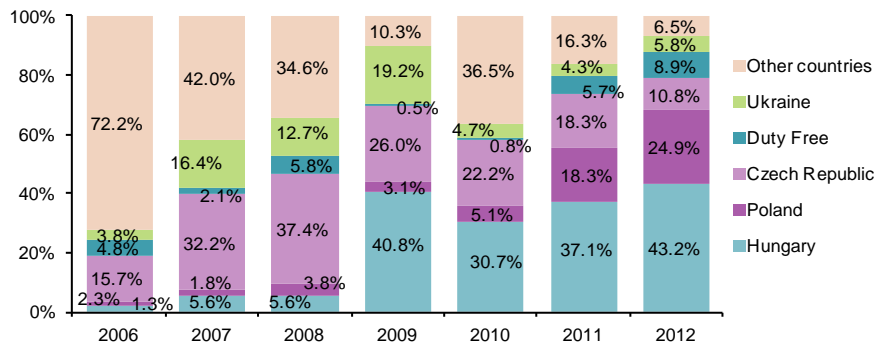
Slovakia – ND(L) summary

The majority of Slovak ND(L) came from surrounding countries with similar price points such as Hungary, Poland and the Czech Republic

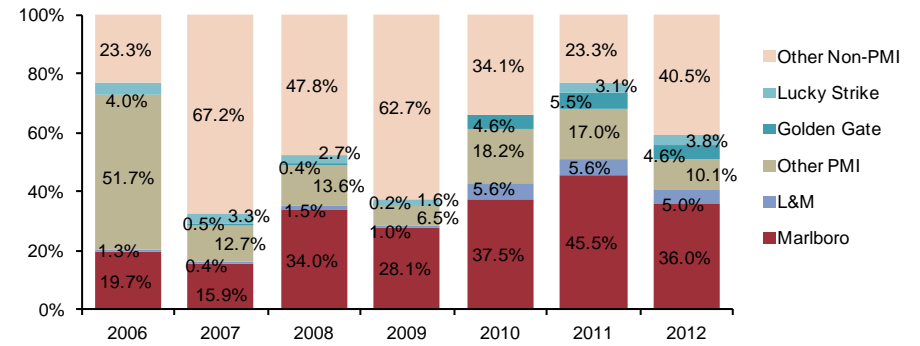
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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- Sweden
- United Kingdom

Slovenia – Consumption summary

Total cigarette consumption in Slovenia increased by 2%, driven by an increase in inflows that offset the decline in LDS and outflows

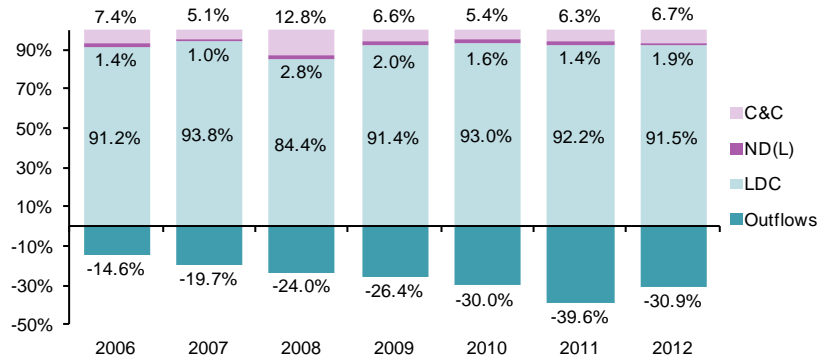
Total Slovenia consumption ⁽¹⁾⁽²⁾⁽³⁾								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Legal domestic sales (LDS)	4.52	4.78	5.11	4.98	4.87	4.84	4.57	(5)%
Outflows	-0.62	-0.83	-1.13	-1.11	-1.19	-1.45	-1.16	(21)%
Legal domestic consumption (LDC)	3.90	3.95	3.98	3.86	3.68	3.39	3.41	1%
Non-domestic legal (ND(L))	0.06	0.04	0.13	0.08	0.06	0.05	0.07	31%
Counterfeit and contraband (C&C)	0.32	0.22	0.60	0.28	0.21	0.23	0.25	7%
Total non-domestic	0.38	0.26	0.74	0.36	0.28	0.29	0.32	12%
Total consumption	4.27	4.21	4.72	4.23	3.96	3.67	3.73	2%

The decrease in outflows can be explained by price increases and lesser attractiveness of Slovenian products to Austrians

- The Slovenian government imposed price increases of 12.5% on Slovenian smokers, whilst the price in Austria remained the same; as a result, the price differential (based on 20 Marlboros) reduced from €1.30 to €0.90 which made it less likely that Austrian smokers would cross the border to buy cigarettes⁽⁴⁾

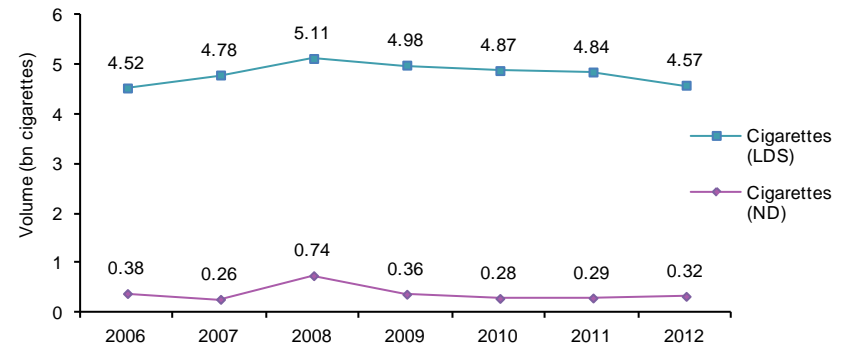
Non-domestic legal consumption grew as greater volumes were seen from Serbia and Bosnia and Herzegovina

Share of Slovenia cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)
 (3) LDS/IMS data provided by PMI
 (4) KPMG analysis of tax tables provided by PMI

Slovenia legal domestic sales and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Notes: (a) OTP data not available

Despite a 21% decline in outflows to Austria, it remains the Slovenian market's greatest outflow country

Key inflows and outflows^{(1)(2)(a)}



Inflows to Slovenia								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Bosnia and Herzegovina	0.15	0.12	0.44	0.26	0.16	0.19	0.19	4%
Serbia	0.04	0.02	0.01	0.02	0.05	0.02	0.04	<100%
Italy	0.03	0.00	0.02	0.02	0.00	0.00	0.01	<100%
Other countries	0.16	0.12	0.26	0.06	0.07	0.08	0.07	(3)%
Total inflows	0.38	0.26	0.74	0.36	0.28	0.29	0.32	12%

Outflows from Slovenia								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Austria	0.23	0.53	0.73	0.79	0.85	1.04	0.83	(21)%
Germany	0.06	0.07	0.10	0.14	0.16	0.13	0.16	19%
Italy	0.25	0.14	0.19	0.13	0.09	0.21	0.10	(50)%
Other countries	0.08	0.08	0.11	0.05	0.09	0.07	0.07	(1)%
Total outflows	0.62	0.83	1.13	1.11	1.19	1.45	1.16	(21)%

Slovenia's largest outflow market is Austria, where border sales are extremely common

- The recent price rises in Slovenia, coupled with no price rises in Austria, have resulted in lower flows to Austria
 - Kärnten, the Austrian region on the border with Slovenia, still has a non-domestic incidence of 40%, most of which is Slovenian inflows

Inflows from Serbia and Bosnia and Herzegovina have increased, as prices rises have been lower in these countries than the two price rises experienced in Slovenia in the past year

- Price increases in Slovenia have resulted in a pack of Marlboro being twice as expensive as in Bosnia and Herzegovina

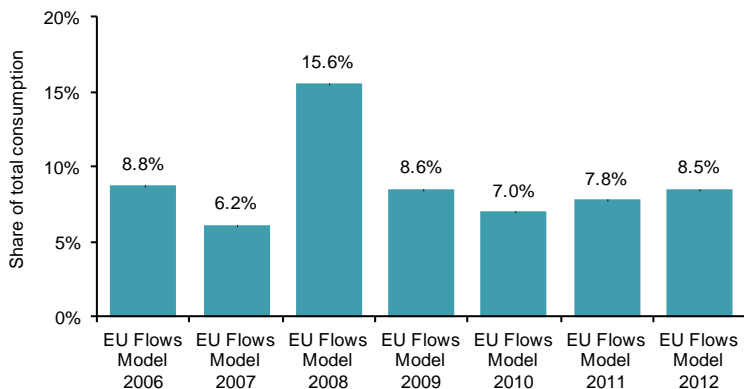
Notes: (a) Map shows flows over 1% of consumption, or top flow if none are greater than 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2006 - 2012 (Ipsos acquired Synovate in 2011)

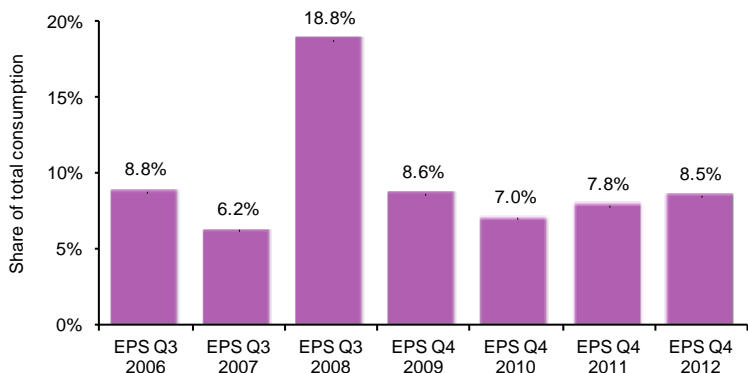
Non-domestic incidence in Slovenia rose by 0.7 percentage points in 2012, from 7.8% to 8.5%

Non-domestic market estimates 2007-2012^{(1)(2)(a)}



EU Flows model is based on the empty pack survey results

Other non-domestic market estimates 2007-2012^{(2)(a)}



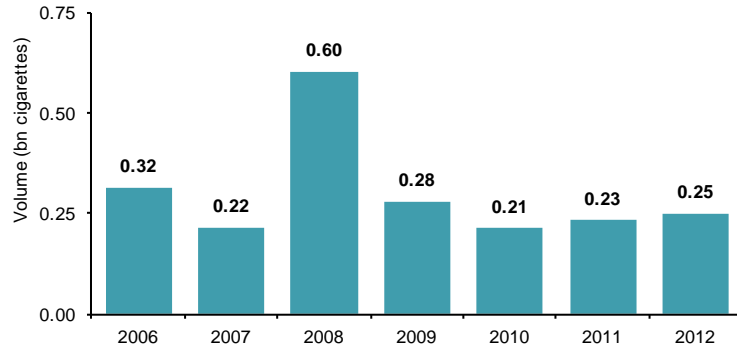
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI Empty Pack Surveys 2006 - 2012

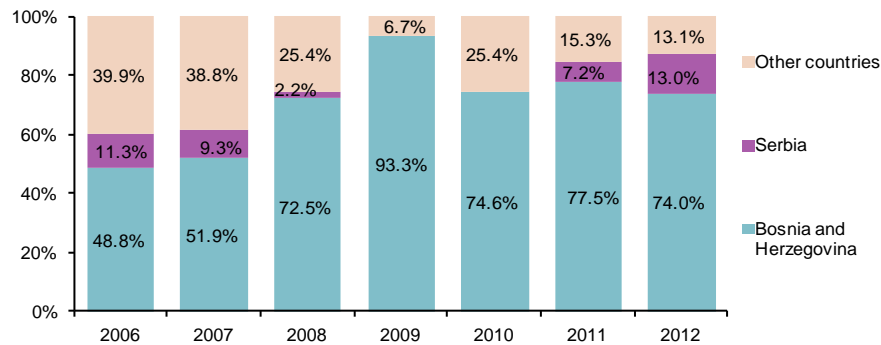
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

Bosnia is the largest C&C source country representing three quarters of the C&C flows over the past three years

Total inflows of C&C
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(2)(a)}



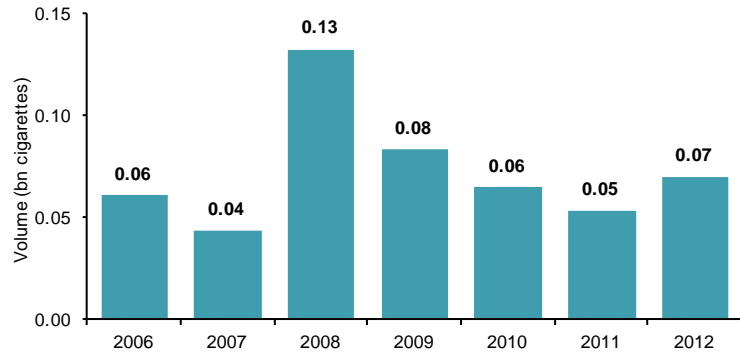
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

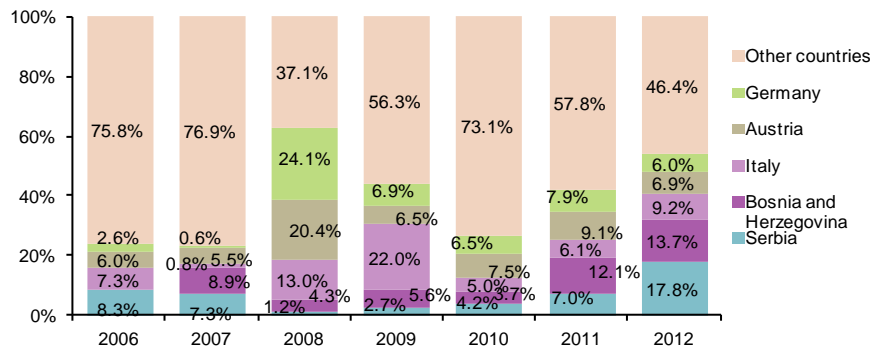
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

The majority of ND(L) comes from neighbouring countries, although there appears to be a growing propensity to purchase from Serbia and Bosnia and Herzegovina

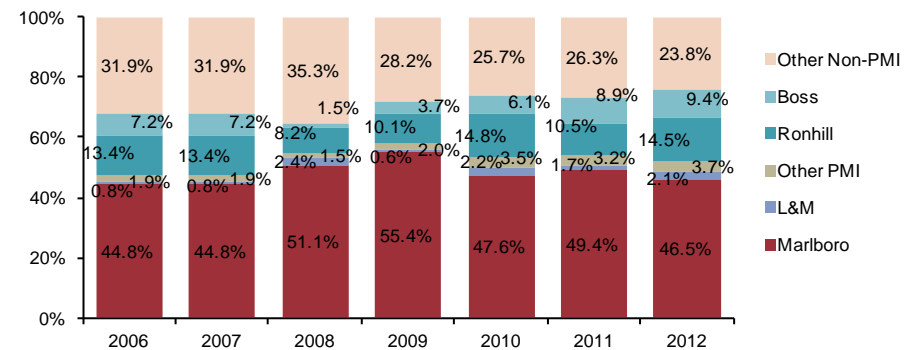
Total inflows of ND(L)
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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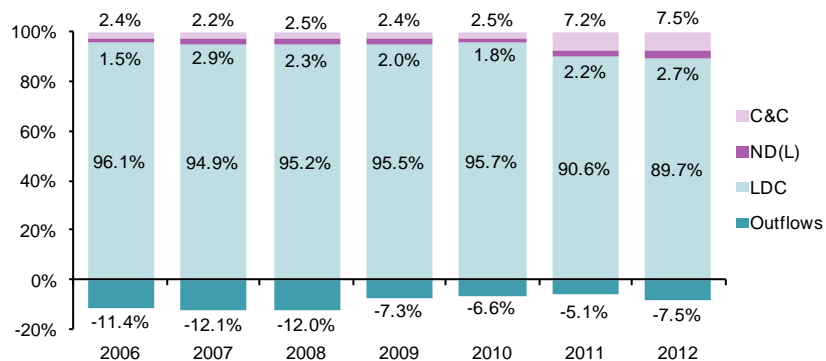
Spain – Consumption summary

Legal domestic sales in Spain declined by 13% in 2012, impacted by price increases and worsening macroeconomic conditions

Total Spain consumption ^{(1)(2)(3)(a)}								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarettes								
Legal domestic sales (LDS)	90.69	89.51	89.74	81.67	72.70	61.52	53.50	(13)%
Outflows	-9.61	-10.10	-10.04	-5.76	-4.68	-3.30	-4.14	26%
Legal domestic consumption (LDC)	81.08	79.41	79.70	75.91	68.01	58.21	49.35	(15)%
Non-domestic legal (ND(L))	1.23	2.43	1.91	1.60	1.30	1.41	1.51	7%
Counterfeit and contraband (C&C)	2.06	1.85	2.13	1.94	1.76	4.64	4.13	(11)%
Total non-domestic	3.29	4.28	4.03	3.54	3.06	6.05	5.64	(7)%
Total consumption	84.37	83.69	83.73	79.45	71.07	64.27	55.00	(14)%

Spain Other Tobacco Product market ^{(3)(b)}								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarette equivalent								
OTP (LDS)	-	4.69	7.56	9.47	9.57	9.47	12.08	28%

Share of Spain cigarette consumption by type 2006-2012 ^{(1)(2)(a)(b)}

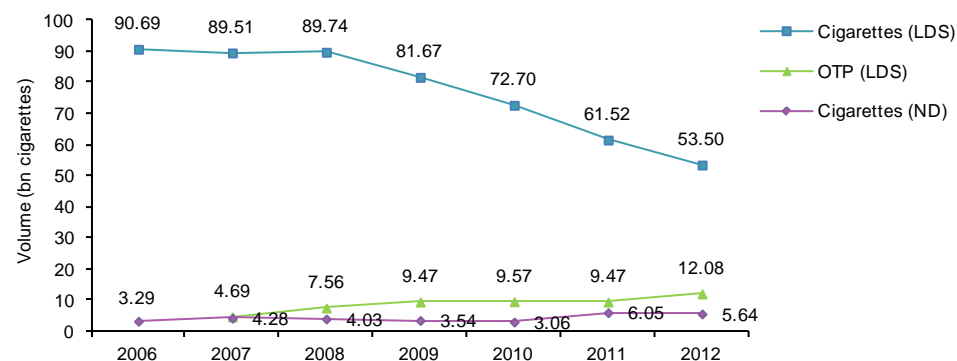


Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) PMI Empty Pack Surveys 2006 - 2012
 (3) LDS/IMS data provided by PMI

While total non-domestic volumes declined by 7% during the year, non-domestic legal inflows increased by 7% from 2011

- A price increase which took effect in October 2012 had a significant impact on cheaper brands, encouraging switching to lower priced non-domestic products and OTP
- Outflows also rose significantly during the year, with volumes increasing by 26%
- Legal domestic sales of OTP, including cigarillos, continued to increase in 2012, growing by 28% during the year

Spain legal domestic sales (cigarettes and OTP) and non-domestic consumption, 2006-2012 ^{(1)(2)(3)(a)(b)}



Notes: (a) 2012 model results exclude cigarillos from EPS results. 2011 EPS results indicate that the non-domestic incidence in 2011 would have been 0.5% lower on average had cigarillos been excluded
 (b) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

Non-domestic inflows into Spain decreased in 2012 despite a rise in inflows from the Canary Islands; outflows from Spain increased by 26% to 4.14 bn cigarettes

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)(b)}



Inflows to Spain								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Canary Islands	0.00	0.44	0.64	0.79	1.11	1.39	1.61	16%
Duty Free	1.07	1.65	1.29	1.55	1.30	1.86	1.51	(19)%
Unspecified	0.00	0.00	0.00	0.02	0.02	1.31	0.97	(26)%
Andorra	0.00	0.00	0.00	0.35	0.15	0.79	0.81	3%
Other countries	2.22	2.18	2.10	0.83	0.48	0.70	0.74	5%
Total inflows	3.29	4.28	4.03	3.54	3.06	6.05	5.64	(7)%

Outflows from Spain								
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
France	3.42	3.25	4.38	2.40	2.08	1.57	2.33	48%
UK	4.07	4.22	3.17	1.91	1.15	0.81	1.04	29%
Germany	1.10	0.92	0.73	0.52	0.44	0.35	0.26	(26)%
Other countries	1.03	1.71	1.76	0.94	1.00	0.57	0.51	(11)%
Total outflows	9.61	10.10	10.04	5.76	4.68	3.30	4.14	26%

Non-domestic inflows to Spain declined by 7% during the year, while inflows from the Canary Islands increased by 16%

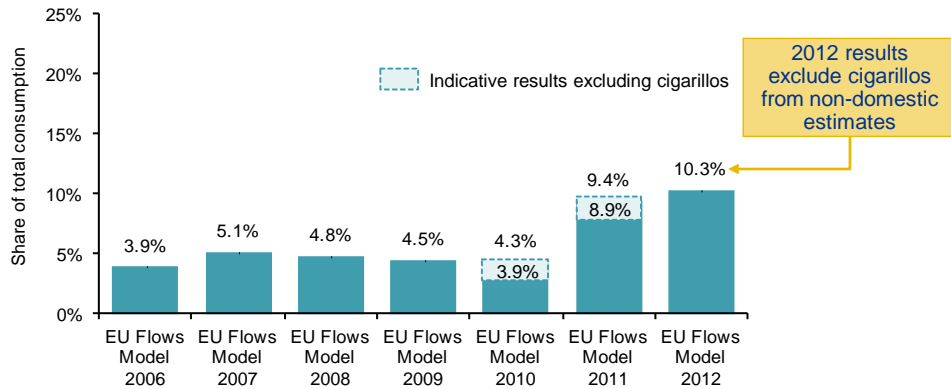
- This decline was mainly driven by a decrease in Unspecified and Duty Free volumes
- Outflows increased by 26%, mainly driven by outflows to France and the UK, which grew by 48% and 29%, respectively
 - This was driven by the widening of the price differential between Spain and both the UK and France in 2012, and increased tourism flows

Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow
 (b) Unspecified market variants are defined as those packs which do not bear any market-specific health warning or tax stamp, or mention of 'Duty Free' on the pack

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
 (2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

Non-domestic incidence in Spain grew to 10.3% in 2012, up from 9.4% in 2011

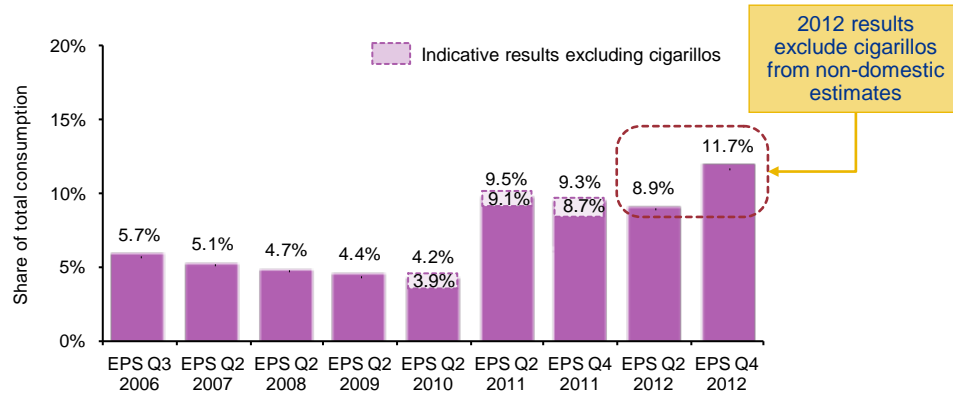
Non-domestic market estimates 2007-2012^{(1)(2)(a)}



The EU Flows Model estimate for non-domestic consumption in 2012 is based on the results of the Empty Pack Surveys undertaken in the second and fourth quarters of 2012, with two adjustments made to EPS results

- Cigarillos, which normally do not have a tax stamp, have had an increasing impact on non-domestic incidence in recent years and have therefore been excluded from EPS results in 2012
 - Had cigarillos been excluded in prior years, non-domestic incidence would have been lower, at 3.9% and 8.9% in 2010 and 2011, respectively

Other non-domestic market estimates 2006-2012^{(2)(a)}



Sources: (1) KPMG EU Flows Model 2006 - 2012

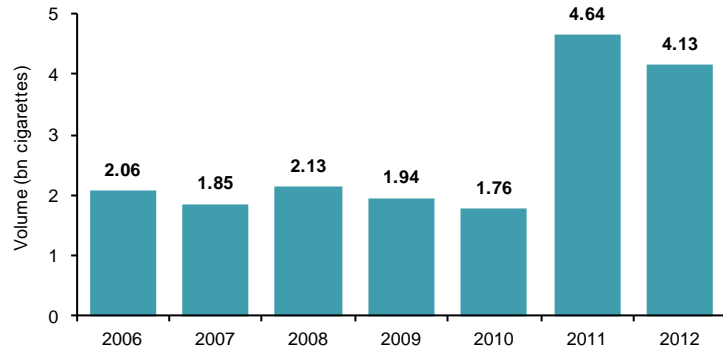
(2) PMI Empty Pack Surveys 2006 – 2012

Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

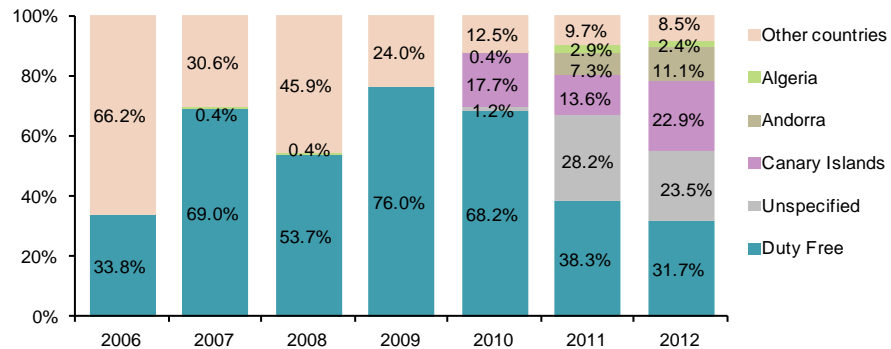
Spain – C&C origin

C&C in Spain declined by 11% in 2012, driven by a decline in Duty Free volumes, which was partly offset by increased C&C from the Canary Islands

Total inflows of C&C 2006-2012^{(1)(2)(a)}



Share of C&C by origin 2006-2012^{(1)(2)(a)}



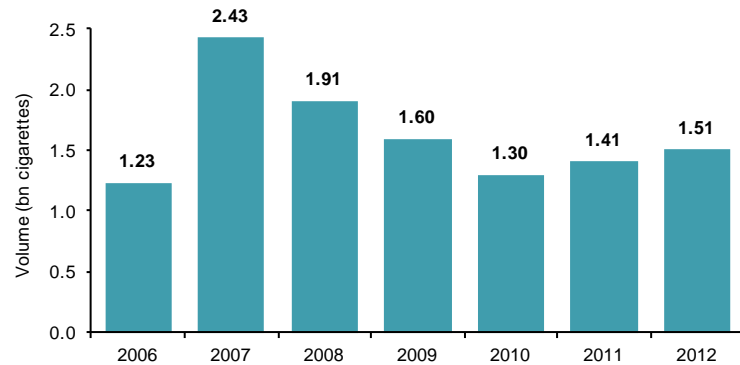
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

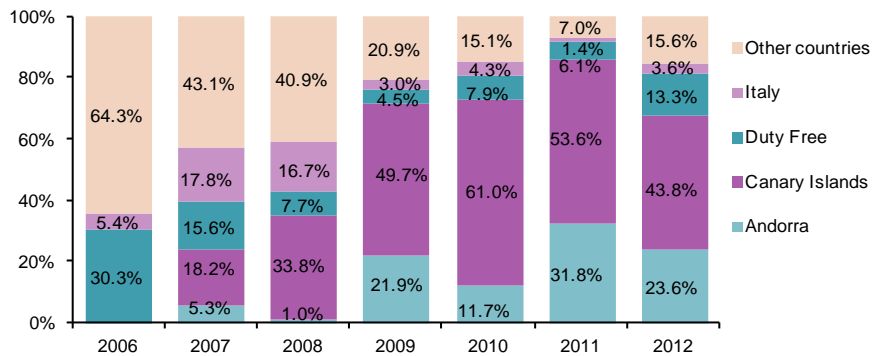
Spain – ND(L) summary

ND(L) increased by 7% in 2012, due largely to increased purchases from Duty Free; Marlboro's share of ND(L) increased to 27.5% in 2012

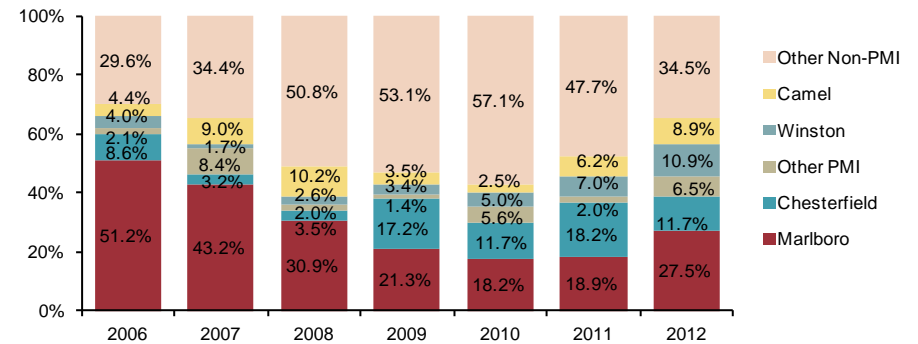
Total inflows of ND(L) 2006-2012^{(1)(2)(a)}



Share of ND(L) by origin 2006-2012^{(1)(2)(a)}



Share ND(L) by brand 2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2012 (Ipsos acquired Synovate in 2011)

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- Slovenia
- Spain
- Sweden
- United Kingdom

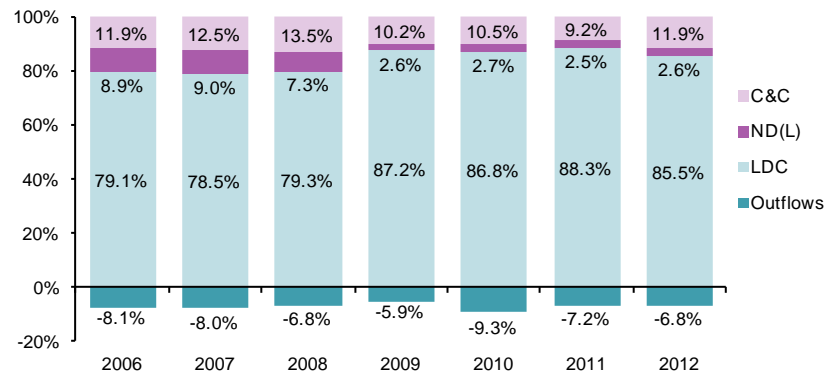
Sweden – Consumption summary

Total consumption of manufactured cigarettes declined by 1% in 2012, mainly due to decreasing legal domestic sales

Total Sweden consumption ⁽¹⁾⁽²⁾⁽³⁾								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarettes								
Legal domestic sales (LDS)	6.93	6.33	6.00	6.22	6.18	6.33	6.04	(5)%
Outflows	-0.64	-0.58	-0.47	-0.39	-0.60	-0.48	-0.44	(8)%
Legal domestic consumption (LDC)	6.29	5.74	5.52	5.83	5.58	5.85	5.59	(4)%
Non-domestic legal (ND(L))	0.71	0.66	0.51	0.17	0.17	0.17	0.17	1%
Counterfeit and contraband (C&I)	0.95	0.92	0.94	0.68	0.68	0.61	0.78	28%
Total non-domestic	1.66	1.58	1.44	0.85	0.85	0.78	0.95	22%
Total consumption	7.95	7.32	6.97	6.68	6.43	6.63	6.55	(1)%

LDS Other Tobacco Product market ^{(3)(a)}								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarette equivalent								
OTP (LDS)	-	0.84	0.32	0.47	0.47	0.47	0.34	(27)%

Share of Sweden cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) PMI Empty Pack Surveys 2006 - 2012
 (3) LDS/IMS data provided by PMI

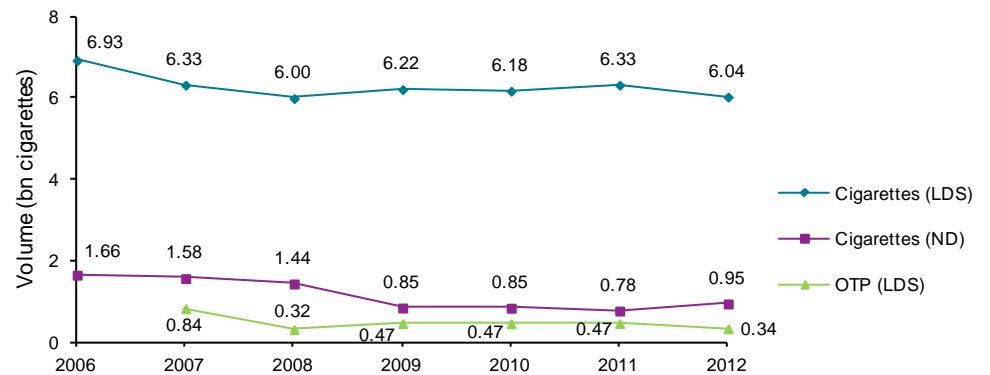
A fall in legal domestic sales has been partially offset by increased non-domestic incidence, leading to a fall in total consumption of 1%

- Legal domestic sales fell by 5% in 2012
- Non-domestic inflows increased by 22%, driven by increased flows from Poland and Russia
- The overall decrease in total consumption is supported by Global Consumer Tracking Survey data, which shows both a declining number of regular smokers, and a reduction in the average number of cigarettes smoked daily⁽⁴⁾

OTP volumes decreased by 27% in 2012

- The OTP LDS market stated below does not include snus, which is popular in Sweden

Sweden legal domestic sales (cigarettes & OTP) and non-domestic consumption, 2006-2012^{(1)(2)(3)(a)}



Note: (4) Global Consumer Tracking Survey provided by PMI
 (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

Non-domestic incidence in Sweden increased in 2012, mainly driven by increasing Polish inflows

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Inflows to Sweden								Change
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	11/12 %
Duty Free	0.50	0.53	0.52	0.26	0.33	0.23	0.24	5%
Poland	0.27	0.23	0.19	0.04	0.05	0.06	0.13	>100%
Russia	0.16	0.15	0.15	0.18	0.07	0.06	0.08	36%
Other countries	0.73	0.66	0.58	0.36	0.41	0.42	0.49	17%
Total inflows	1.66	1.58	1.44	0.85	0.85	0.78	0.95	22%

Outflows from Sweden								Change
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	11/12 %
Norway	0.50	0.37	0.31	0.23	0.30	0.32	0.28	(11)%
Denmark	0.10	0.10	0.10	0.05	0.17	0.11	0.04	(64)%
Netherlands	0.00	0.02	0.00	0.01	0.05	0.03	0.02	(22)%
Other countries	0.04	0.09	0.06	0.10	0.08	0.02	0.10	>100%
Total outflows	0.64	0.58	0.47	0.39	0.60	0.48	0.44	(8)%

Inflows to Sweden increased by 22% in 2012, mainly driven by Polish inflows

- Polish inflows increased by 109% from 2011, making it Sweden's largest source country in 2012

Outflows to Norway, Denmark and the Netherlands all showed significant decreases in 2012

- Total outflows fell by 8% in 2012, however, despite falls in the largest three outflow markets, outflows to other countries, including France, Greece and Finland, showed a marked increase

Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

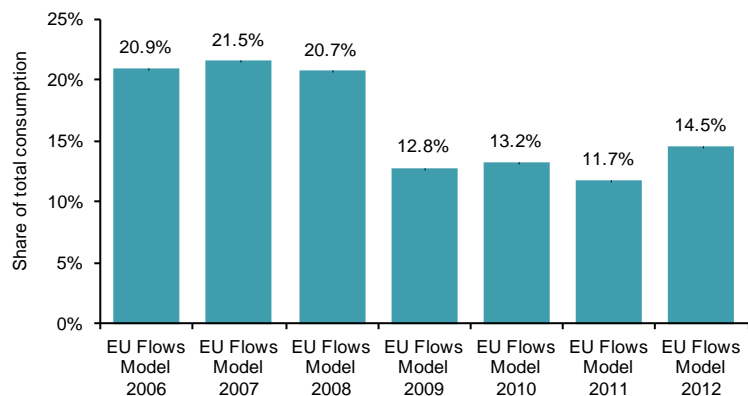
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

Sweden – Comparison of external sources for non-domestic estimates

Non-domestic incidence increased by 2.8 percentage points in 2012 from 11.7% to 14.5%

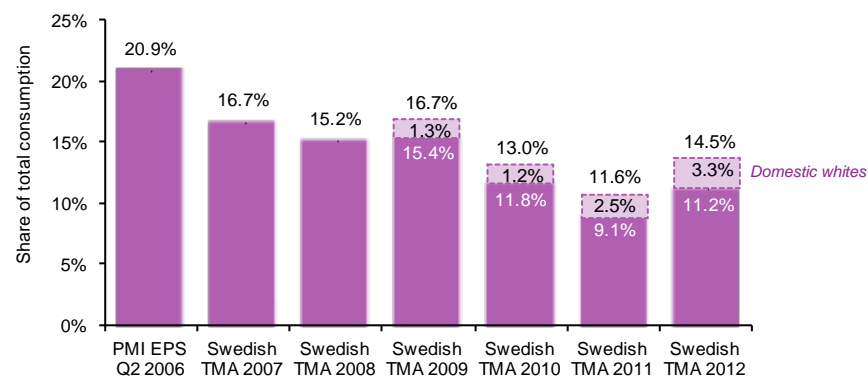
Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The EU flows model calculates non-domestic incidence by inputting the EPS results for each quarter

- The EPS results for 2009, 2010, 2011 and 2012 were adjusted to reclassify the status of Domestic Whites; those packs priced below the minimum tax yield
- These products are treated as having not been legally sold in Sweden and have been reclassified as non-domestic;
 - This adjustment resulted in an increase in non-domestic inflows of 0.21 billion cigarettes in 2012, compared to 0.18 billion 2011, and 0.06 billion in 2010

Other non-domestic market estimates 2006-2012^{(2)(a)}



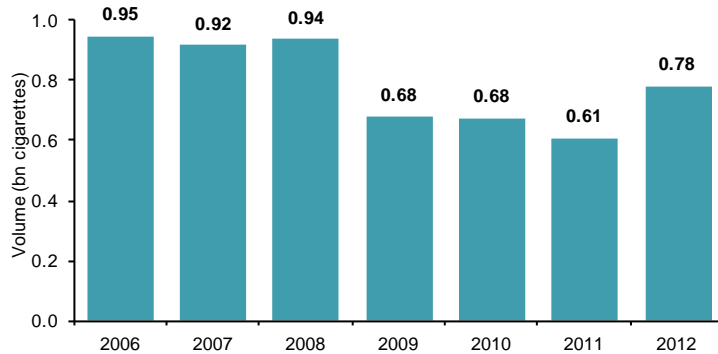
Sources: (1) KPMG EU Flows Model 2006 - 2012

(2) PMI/TMA Empty Pack Surveys 2006 – 2012

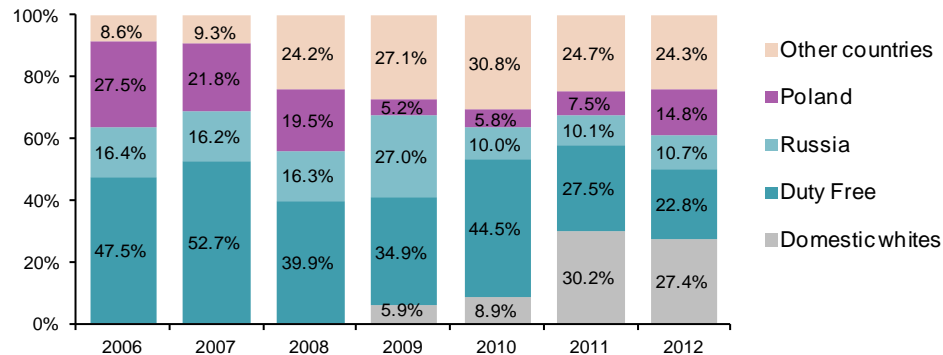
Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

C&C flows increased by 28% in 2012, driven mainly by increases in domestic whites and Polish cigarettes

Total inflows of C&C by origin
2006-2012^{(1)(2)(a)}



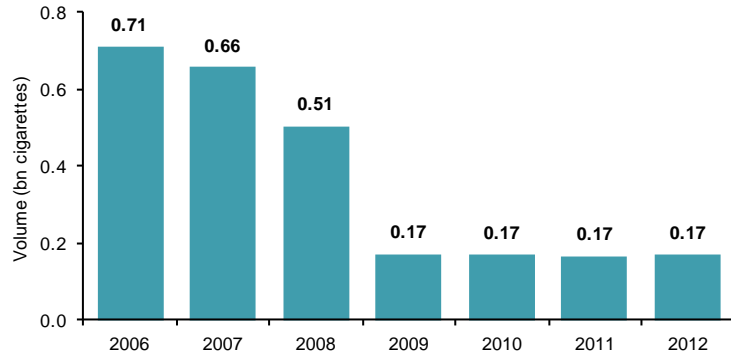
Share of C&C by origin
2006-2012^{(1)(2)(a)}



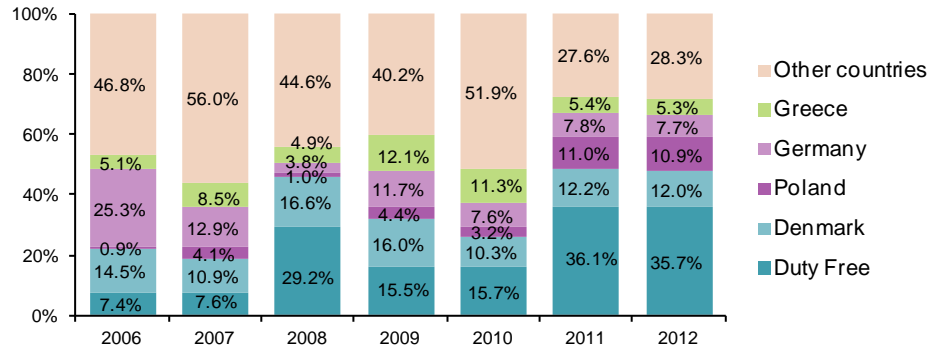
Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

Duty Free continued as the largest source of ND(L) in 2012; Marlboro remained the most popular brand

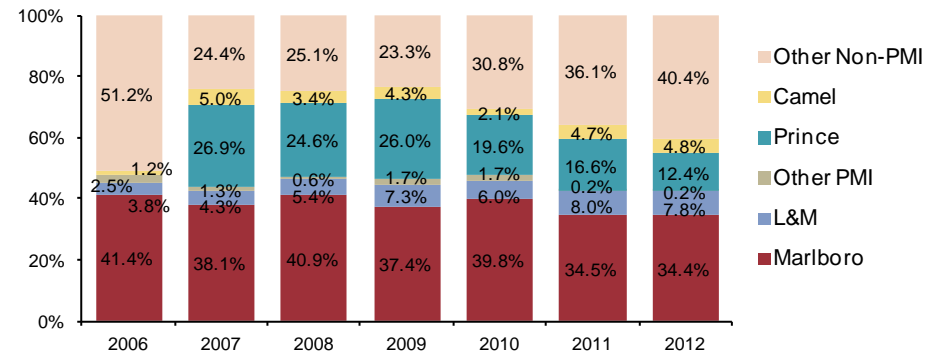
ND(L) by origin
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share of ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

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- Slovenia
- Spain
- Sweden
- United Kingdom

UK – Consumption summary

Overall consumption of manufactured cigarettes remained flat in 2012, as decreases in legal domestic sales were offset by increased non-domestic incidence

Total UK consumption ⁽¹⁾⁽²⁾⁽³⁾								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarettes								
Legal domestic sales (LDS)	49.01	46.99	44.97	45.27	44.85	43.89	40.55	(8)%
Outflows	-0.48	-1.05	-0.47	-0.57	-0.50	-0.49	-0.37	(25)%
Legal domestic consumption (LDC)	48.53	45.94	44.50	44.70	44.35	43.40	40.19	(7)%
Non-domestic legal (ND(L))	3.37	4.08	1.91	2.10	1.35	1.32	1.36	3%
Counterfeit and contraband (C&C)	7.77	9.39	8.55	6.75	5.38	5.01	8.18	63%
Total non-domestic	11.14	13.47	10.46	8.85	6.73	6.33	9.54	51%
Total consumption	59.67	59.41	54.96	53.54	51.08	49.74	49.72	(0)%

LDS Other Tobacco Product market ^{(3)(a)}								
	2006	2007	2008	2009	2010	2011	2012	Change 11/12 %
Billion cigarette equivalent								
OTP (LDS)	-	4.86	5.54	8.09	8.98	9.79	10.63	9%

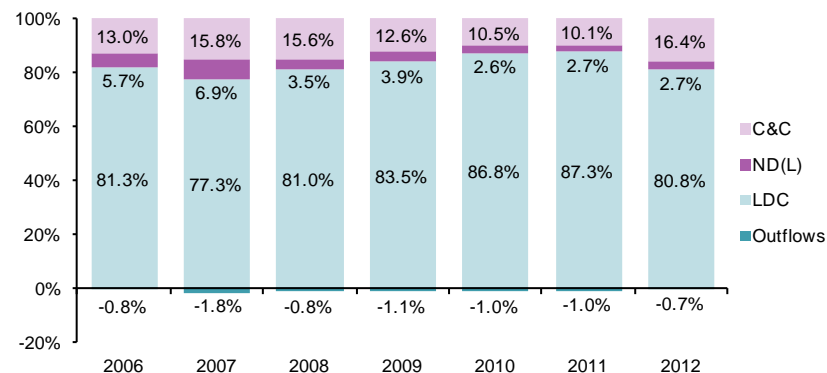
Total consumption in the UK remained flat between 2011 and 2012

- However, a 3.3bn cigarette decrease in legal domestic sales was offset by a 3.2bn cigarette increase in non-domestic consumption

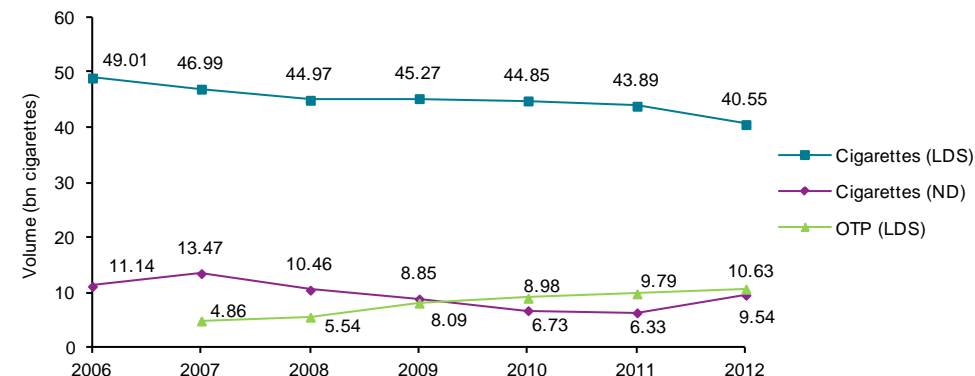
OTP volumes have increased by 9% to 10.6bn cigarettes equivalent in 2012

- This suggests that smokers in the UK may be switching from manufactured cigarettes to OTP as a lower priced alternative

Share of UK cigarette consumption by type 2006-2012⁽¹⁾⁽²⁾



UK legal domestic sales (cigarettes & OTP) and non-domestic consumption 2006-2012^{(1)(2)(3)(a)}



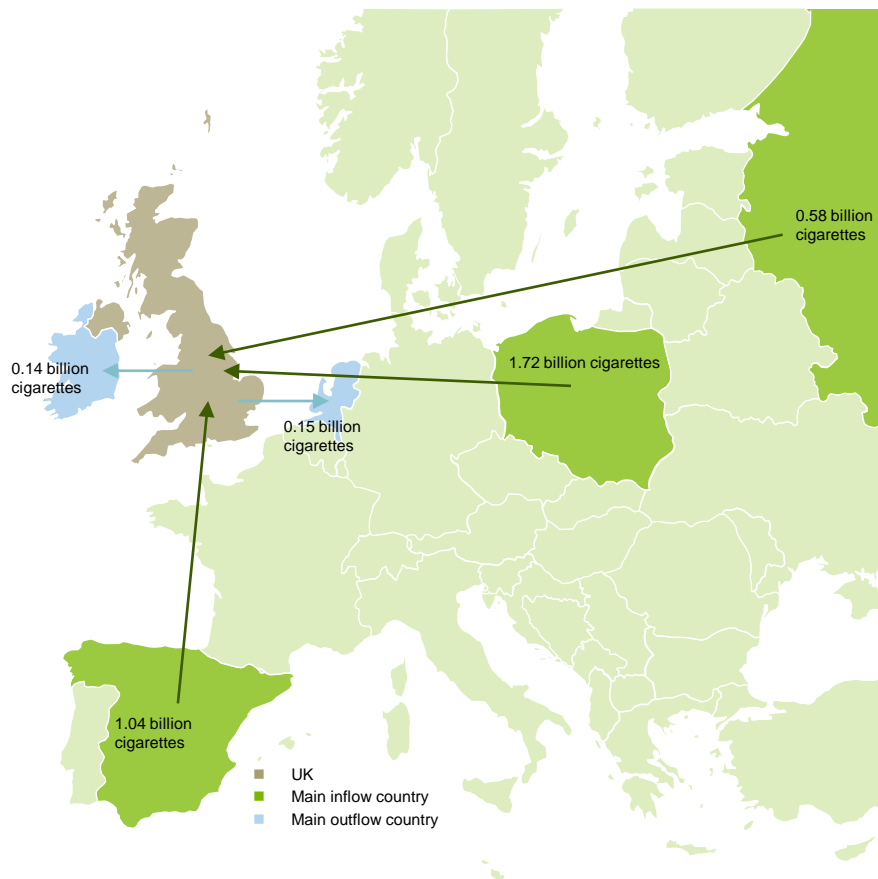
Sources: (1) KPMG EU Flows Model 2006 - 2012
 (2) PMI Empty Pack Surveys 2006 - 2012
 (3) LDS/IMS data provided by PMI

Note: (a) OTP is defined as MYO, MYO volume tobacco, RYO tobacco and cigarillos as appropriate, whose cigarette equivalents are defined as 0.73g of tobacco per cigarette for MYO and 0.6g per cigarette for RYO and MYO volume tobacco. This definition and conversion rates have been applied for Project Star 2012 and may differ in previous reports.

UK – Country flows summary

Inflows to the UK increased by 51% in 2012, driven largely by increasing volumes from Poland, Spain and Russia

Key inflows and outflows (billion cigarettes)^{(1)(2)(a)}



Inflows to UK								Change
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	11/12 %
Poland	1.40	1.02	0.93	1.01	0.86	0.96	1.72	80%
Spain	4.07	4.22	3.17	1.91	1.15	0.81	1.04	29%
Russia	0.08	0.08	0.15	0.20	0.43	0.30	0.58	93%
Other countries	5.60	8.14	6.21	5.72	4.29	4.27	6.19	45%
Total inflows	11.14	13.47	10.46	8.85	6.73	6.33	9.54	51%

Outflows from UK								Change
Billion cigarettes	2006	2007	2008	2009	2010	2011	2012	11/12 %
Netherlands	0.20	0.25	0.15	0.11	0.20	0.14	0.15	6%
Ireland	0.03	0.14	0.19	0.35	0.20	0.24	0.14	(44)%
France	0.20	0.49	0.00	0.03	0.04	0.04	0.02	(56)%
Other countries	0.05	0.16	0.12	0.08	0.06	0.07	0.07	(1)%
Total outflows	0.48	1.05	0.47	0.57	0.50	0.49	0.37	(25)%

In 2012, Poland continued to be the major source of non-domestic cigarettes in the UK, with inflows increasing by 80% from 2011 levels

Overall outflows fell by 25% in 2012, driven mainly by decreased outflows to Ireland

- In 2012, the price of cigarettes in the UK increased above that in Ireland, reducing outflows

Notes: (a) Map shows flows over 1% of consumption. Countries which are both source and destination countries are coded according to the larger flow

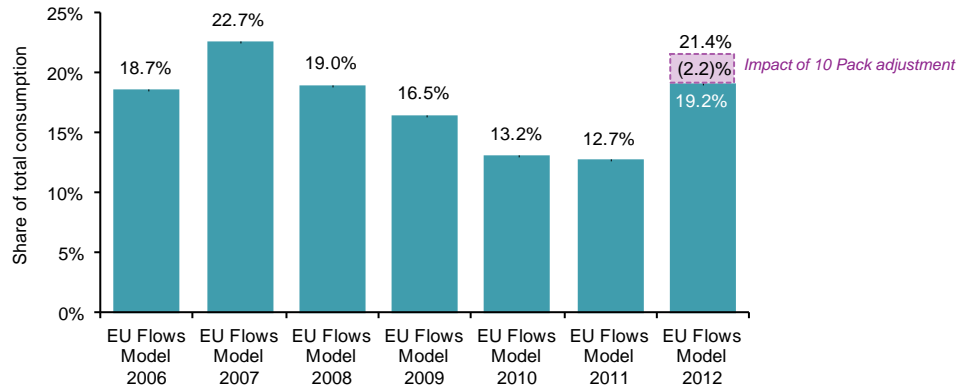
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

UK – Comparison of external sources for non-domestic estimates

Non-domestic incidence rose by 6.5 percentage points in 2012, from 12.7% to 19.2%

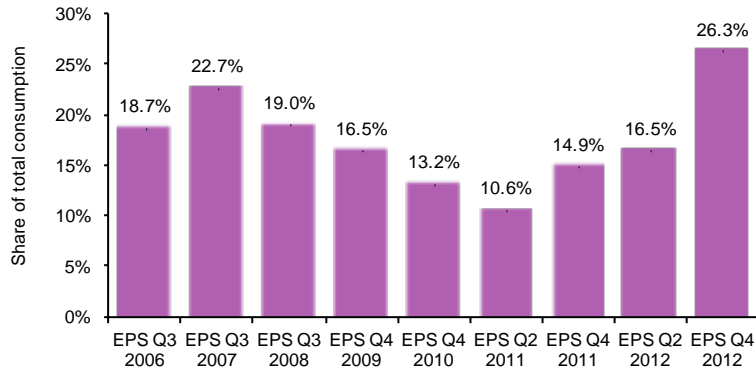
Non-domestic market estimates 2006-2012^{(1)(2)(a)}



The EU flows model calculates non-domestic incidence by inputting the EPS results for each quarter

- UK EPS quarterly results were weighted equally between Q2 and Q4
- Other adjustments made to the UK data include:
 - Uplifting Spanish, Maltese and Cypriot inflows to the UK to reflect the increased incidence of flows from these countries due to UK holidaymakers in Summer months
 - An adjustment was made to adjust for oversampling of 10 packs in the EPS
 - 10 packs make up 19% of packs sold in the UK, according to IMS data, but represent 33% of packs collected in the EPS
 - Therefore, domestic 10 packs were reweighted in line with IMS data, with the weighting of domestic 20 packs increased proportionally, reducing the non-domestic incidence estimate by 2.2 percentage points

Other non-domestic market estimates 2006-2012^{(2)(a)}

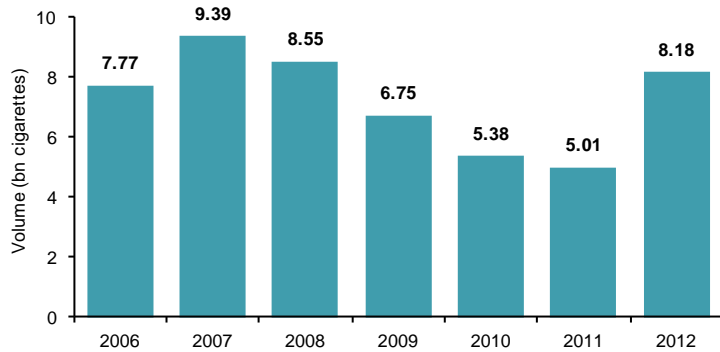


Sources: (1) KPMG EU Flows Model 2006 - 2012

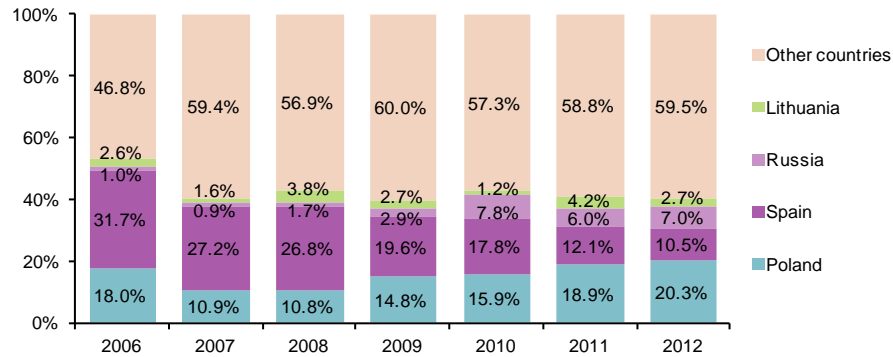
(2) PMI Empty Pack Surveys 2006 – 2012

Notes: (a) Non-domestic incidence for the 2012 EPS and EU flows model results has been calculated on a cigarettes basis. For more detail please see Appendix : Methodology section.

Total inflows of C&C by origin
2006-2012^{(1)(2)(a)}



Share of C&C by origin
2006-2012^{(1)(2)(a)}

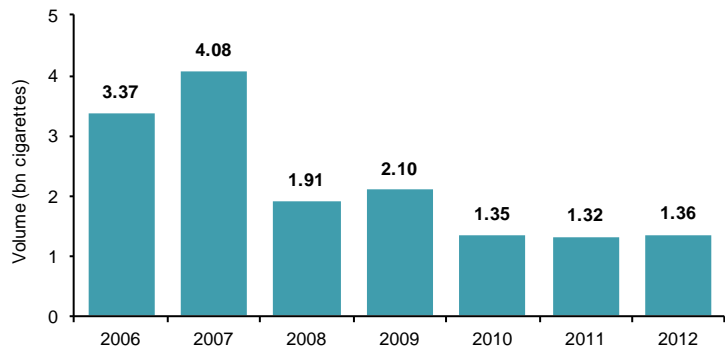


Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.
Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management
(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

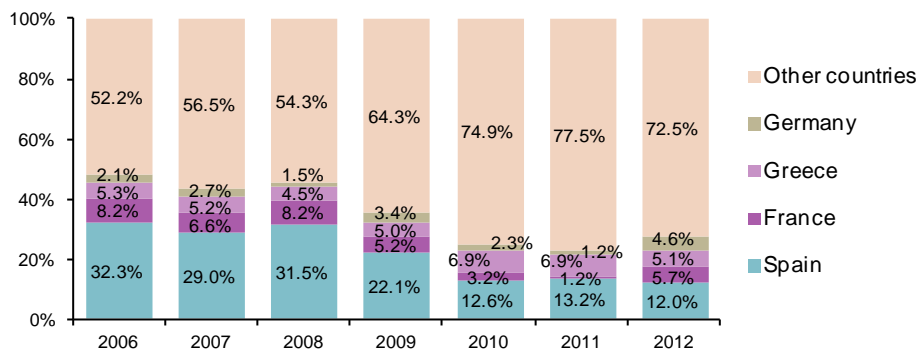
UK – ND(L) summary

Non-domestic legal increased slightly by 3% in 2012

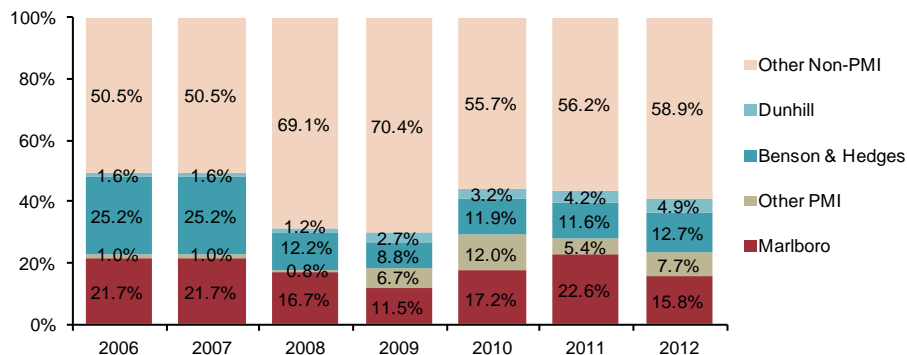
ND(L) by origin
2006-2012^{(1)(2)(a)}



Share of ND(L) by origin
2006-2012^{(1)(2)(a)}



Share of ND(L) by brand
2006-2012^{(1)(2)(a)}



Notes: (a) KPMG calculates the split between C&C and ND(L) by analysing consumer research which records the volume and brands purchased legally from other countries.

Sources: (1) KPMG EU Flows Model and interviews with PMI Local Management

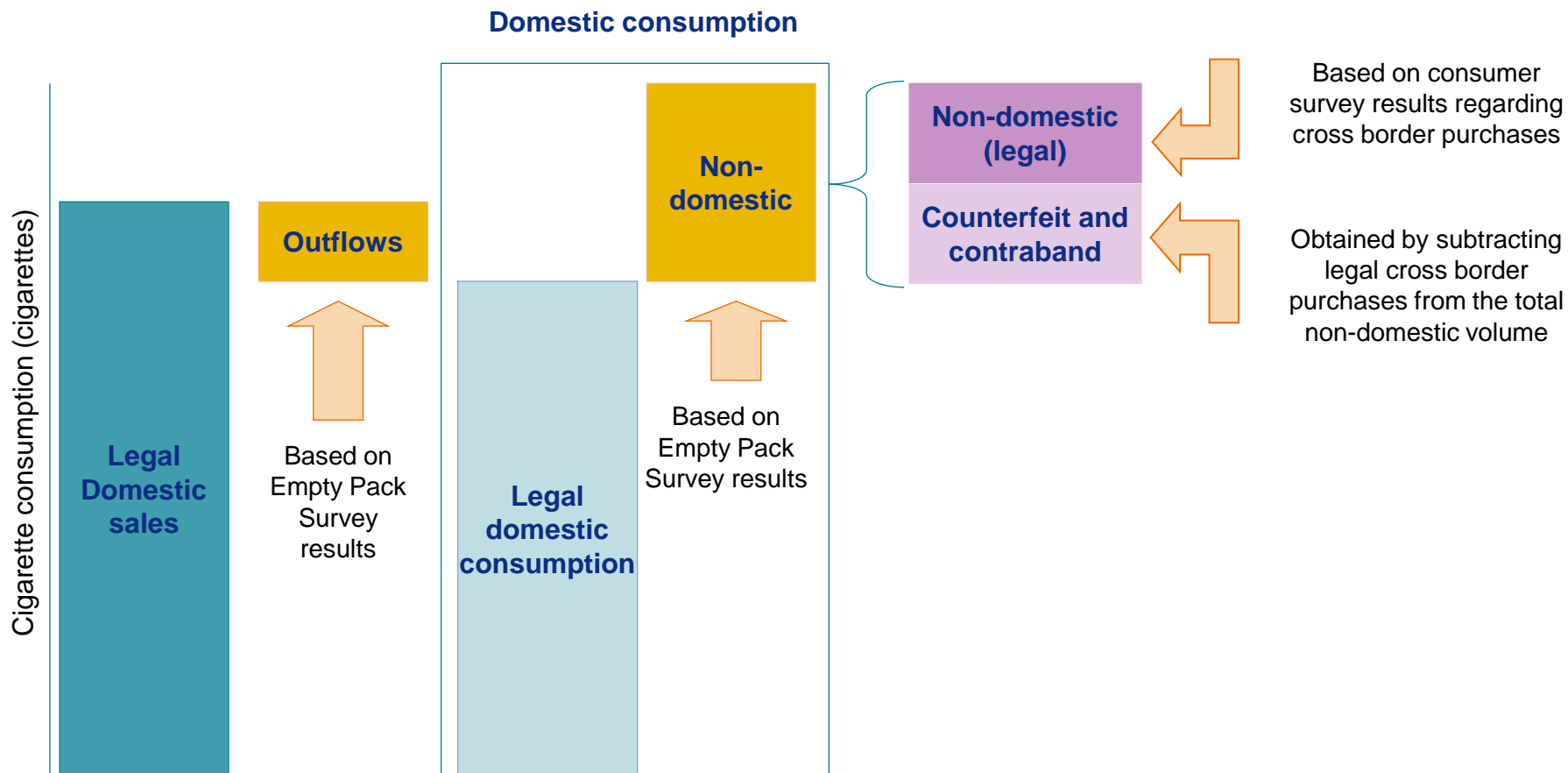
(2) Synovate/Ipsos ND(L) research 2006-2012 (Ipsos acquired Synovate in 2011)

- European Market Overview
- Appendices
 - Methodology
 - Overview
 - Limitation of results
 - Summary of Country Flow Refinements
 - Sources
 - Scope of work

Methodology Overview

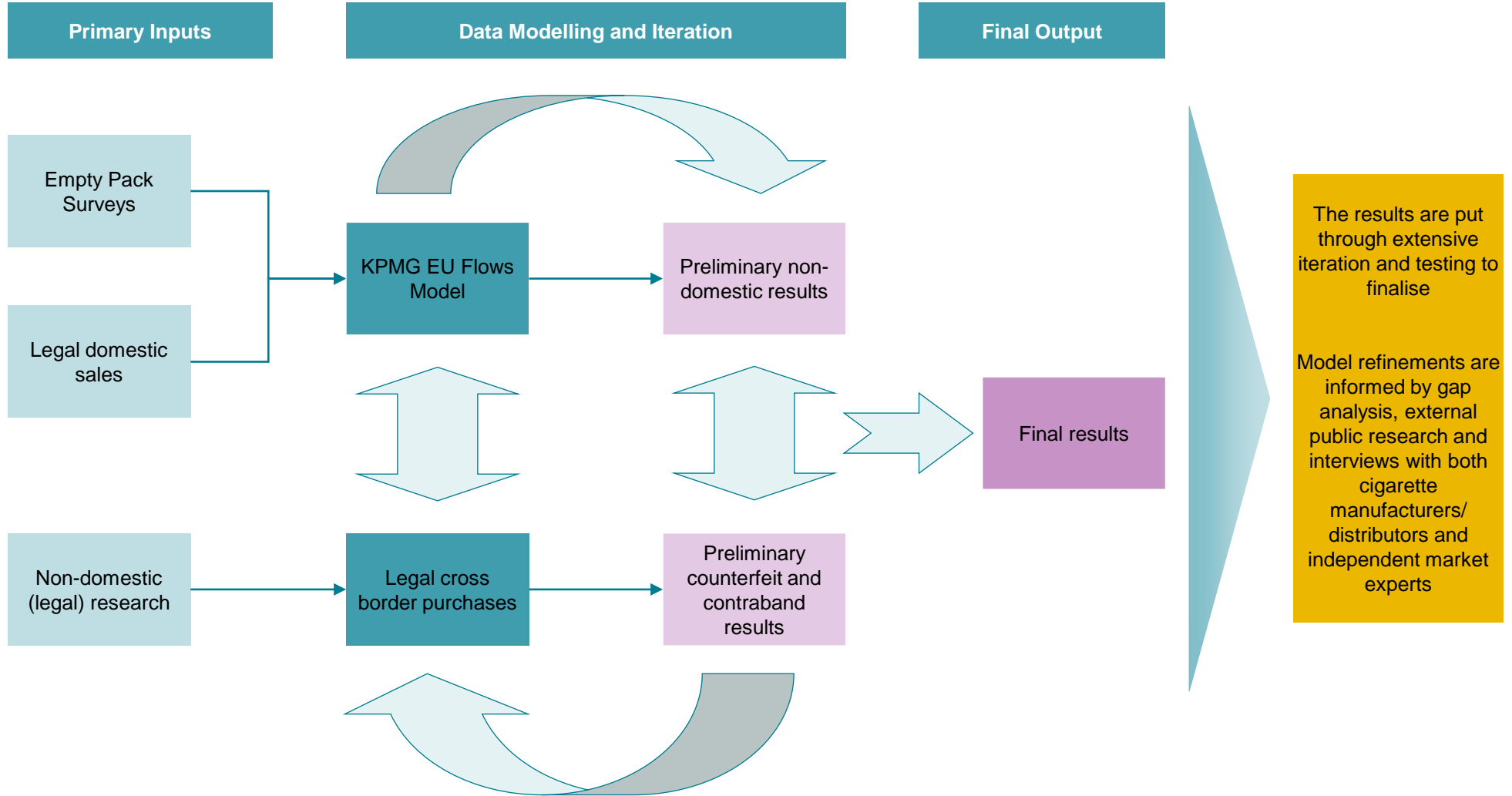
<p>We have developed a methodology for quantifying counterfeit and contraband incidence across the 27 EU markets</p>	<p>The methodology has been tested extensively and refined to ensure that it can deliver the most robust and defensible results possible</p> <ul style="list-style-type: none"> ■ Our approach comprises four steps: initial information assessment, preliminary methodology design, pilot and refinement, and then implementation ■ Our approach integrates multiple sources and custom-built analytical tools
<p>The methodology is based primarily on objective evidence from legal domestic sales and Empty Pack Survey results</p>	<p>The EU Flows Model is a dynamic, iterative model that is principally based on legal domestic sales and Empty Pack Survey results</p> <ul style="list-style-type: none"> ■ The EU Flows model is an iterative data driven model that uses legal domestic sales, Empty Pack Survey results and consumer research to calculate the volume of non-domestic inflows and outflows to and from each EU Member State and to quantify the non-domestic (legal) and counterfeit and contraband cigarettes consumed in each country and the EU as a whole ■ Legal domestic sales are the starting point of the methodology, from which outflows of legal sales to other countries are then subtracted to determine legal domestic consumption ■ Empty Pack Survey results provide the most credible indication of the incidence of non-domestic and PMI counterfeit packs by country of origin
<p>Primary market research was used to quantify legal non-domestic cigarette purchases</p>	<p>The key objective of the market research programme is to quantify genuine, legal non-domestic tobacco purchases (cross border shopping) in each market</p> <ul style="list-style-type: none"> ■ ND(L) data for 2012 Project Star results is based upon approximately 160,000 full interviews and over 14,000 gross respondents. This research was updated in 10 Member States during 2012 where 63,000 interviews were conducted ■ Primary research is critical to deliver robust results as no other sources of sufficient detail and accuracy are available for legal cross border shopping <p>In addition to the research programme, ND(L) data is adjusted to reflect inbound visitor inflows from higher cost markets</p>
<p>There are some specific limitations to the results that our methodology delivers</p>	<p>Given the innate complexity of measuring C&C, some limitations to accurate quantification are to be expected</p> <ul style="list-style-type: none"> ■ There are broadly two types of limitations: scope exclusions and source limitations, which are covered in more detail in this section <ul style="list-style-type: none"> – scope exclusions include areas which cannot or have not been accounted for in our approach, such as geographic, brand (non-PMI counterfeit), category exclusions (OTP) and legal domestic product flows out of the EU – source limitations cover potential errors inherent with any data sources such as sampling criteria, coverage issues and seasonality factors
<p>In order to maximise the accuracy of results, some minor refinements were necessary at a country level</p>	<p>Triangulation of results from alternative sources identified a few markets where country-to-country flows required minor adjustment</p> <ul style="list-style-type: none"> ■ In nearly all instances, overall country results and flows from the EU Flows Model appeared reasonable ■ However, in a limited number of instances, specific adjustments were made to country-to-country flows on the basis of sound supporting evidence

Project Star uses legal domestic sales, Empty Pack Survey results and consumer research to quantify the volume of C&C cigarettes consumed in the EU



The Project Star methodology was developed by KPMG and approved by OLAF. It has been deployed on a consistent basis since 2006, enabling comparisons to be made between counterfeit and contraband volumes from year to year

Our approach integrates multiple sources with custom-built analytical tools



Methodology

To corroborate our results, we triangulate our findings against alternative sources wherever possible

Methodology steps and key information sources

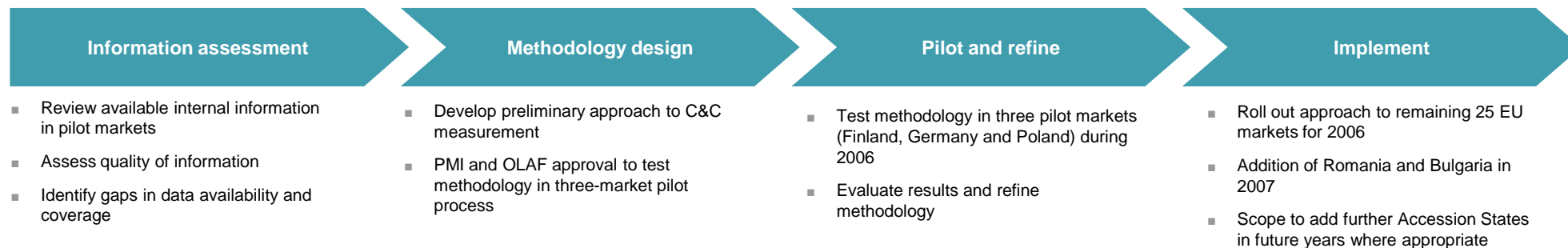
Calculation step	1.	2.	3.	4.	5.	6.
	Measure legal domestic sales in all markets	Adjust legal domestic sales for product outflows	Add total non-domestic consumption to adjusted legal domestic sales to derive estimated total consumption	Deduct legal non-domestic purchases from total non-domestic volume to arrive at illicit purchase volume	Deduct PMI counterfeit volumes from total illicit purchase volume	Deduct PMI contraband volume from remaining illicit volume to arrive at non-PMI C&C
Primary source	Directly measured from In Market Sales (IMS) data or equivalent	Directly measured from 'on the ground' empty packs by country of origin in 27 country flow model	Legal domestic consumption plus EU Flows Model	ND(L) market research programme	Measured from Empty Pack Survey results	Directly calculated by the KPMG methodology
Corroboratory source	<ul style="list-style-type: none"> Tax stamp receipts Federal statistics 	<ul style="list-style-type: none"> PMI management estimates Border sales surveys 	<ul style="list-style-type: none"> Consumption trends based on smoking prevalence and average daily consumption data from GCTS 	<ul style="list-style-type: none"> PMI Duty Free market estimates External research Expert interview programme 	<ul style="list-style-type: none"> Expert interview programme Seizure data 	<ul style="list-style-type: none"> Expert interview programme Seizure data

Preliminary results are subject to testing and review with local PMI management in each of the 27 EU markets

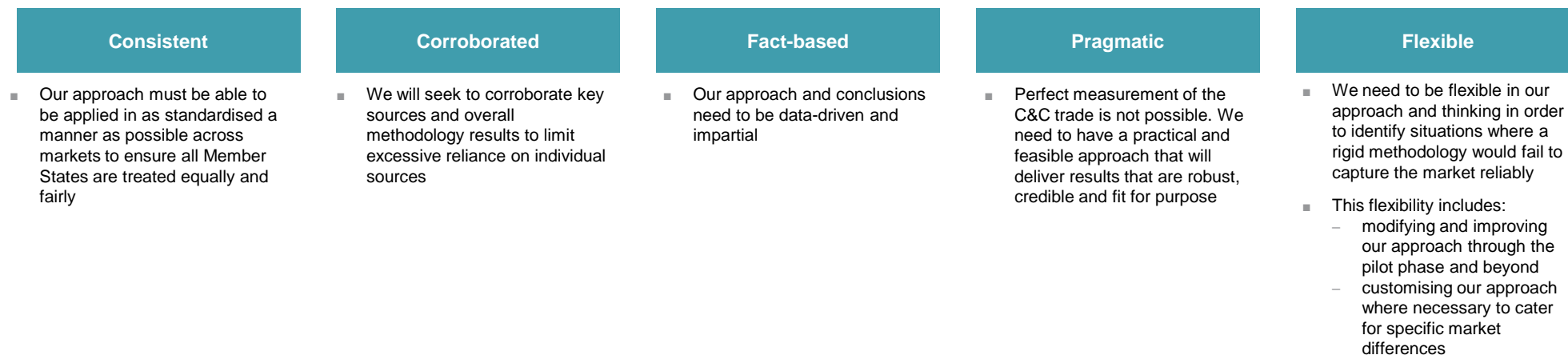
Project overview and timing

Design and development of the methodology

Methodology design steps



Methodology design principles



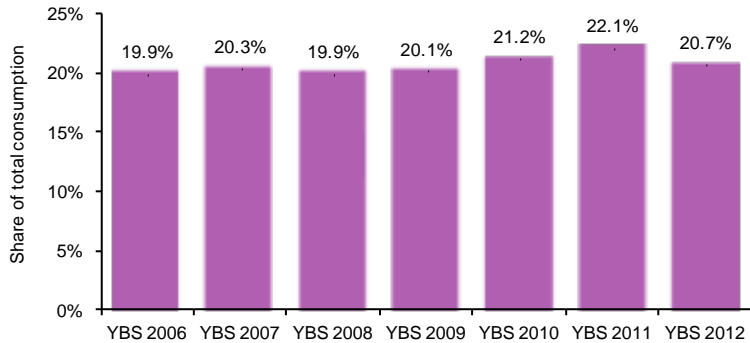
Primary information sources and tools – Empty Pack Surveys (1 of 2)

<p>Overview</p>	<p>Empty Pack Surveys are a system of collecting discarded empty cigarette packs, the results of which are used to estimate the share of non-domestic and counterfeit packs in each of the markets</p> <ul style="list-style-type: none"> ■ Results are based on a large sample of packs collected in various cities throughout the countries, although the collection plan differs by country. Accuracy and credibility of results is driven by sound design of the sampling plan ■ Results are not subject to respondent behaviour and are therefore less prone to sampling errors than many other alternative methodologies ■ Evidence is based on collected packs: no discrepancies or scope for respondent confusion ■ Data reflects actual overall non-domestic share and provides good snapshot of brands consumed
<p>Process</p>	<p>Empty Pack Surveys measure shares of total consumption and avoids potential errors associated with estimating volumes</p> <ul style="list-style-type: none"> ■ Once packs are collected, they are sorted by manufacturer and the number of packs with domestic versus non-domestic tax stamps are counted to determine the proportion of packs that did not originate from that jurisdiction (including Duty Free variants) <ul style="list-style-type: none"> – in cases where tax stamps are not shown on a packet, health warning and packaging characteristics are used to define the source market ■ In markets where collection is handled centrally, packs are sent to the manufacturers for analysis to determine which are genuine and which are counterfeit. Only the manufacturers can determine this, based on inks, paper and other characteristics. Results of these analyses are not released to competitors ■ Empty Pack Surveys can also be used to extrapolate overall consumption in the market by projecting legal domestic sales net of outflows, using the percentage of non-domestic cigarettes in the market as found through Empty Pack Surveys
<p>Coverage</p>	<p>Empty Pack Surveys are designed to be fit for purpose and the coverage per market is tailored by the size of the market, the likelihood of high non-domestic incidence and PMI's share of the legal market</p> <ul style="list-style-type: none"> ■ Large surveys (10,000 packs or more collected): Germany, Poland, Austria, Denmark, UK, Hungary, Czech, France, Italy, Spain, Romania, Greece, Lithuania, Sweden, Bulgaria, Ireland, Netherlands ■ Medium surveys (5,000-9,999 packs collected): Belgium, Latvia, Estonia, Finland, Slovakia. ■ Small surveys (300-4,999 packs collected): Portugal, Slovenia, Malta, Cyprus, Luxembourg

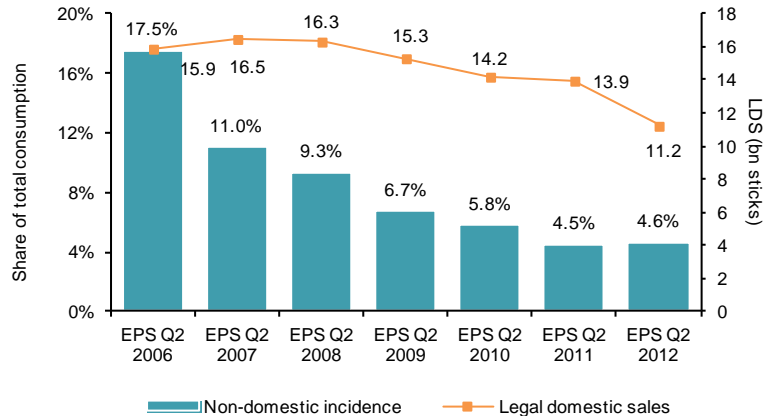
Empty Pack Surveys provide a highly objective and robust view of the population samples and, notwithstanding some scope constraints, represent the most credible indication of the incidence of non-domestic and counterfeit packs.

Primary information sources and tools – Empty Pack Surveys (2 of 2)

Germany historical Empty Pack Survey results⁽¹⁾



Hungary historical Empty Pack Survey results⁽²⁾



Source: (1) "Yellow Bag" survey, an Empty Pack Survey undertaken by the German Cigarette Industry
 (2) GfK Empty Pack Surveys, 2004 to 2012

The low level of variance in German results highlights the validity of using Empty Pack Surveys to monitor trends in cigarette consumption

- Empty Pack Surveys based on the Yellow Bag approach are conducted in Germany on an ongoing basis using the country's network of recycling centres
- Packs are collected monthly, with the results released on a quarterly basis
- The emergence and low level of variance in the trend for non-domestic consumption has been apparent in each survey at both national and regional levels

There is a strong correlation between changes in the German results and other sources including legal domestic sales, PMI shipment data and the observations of government bodies with respect to cross border flows

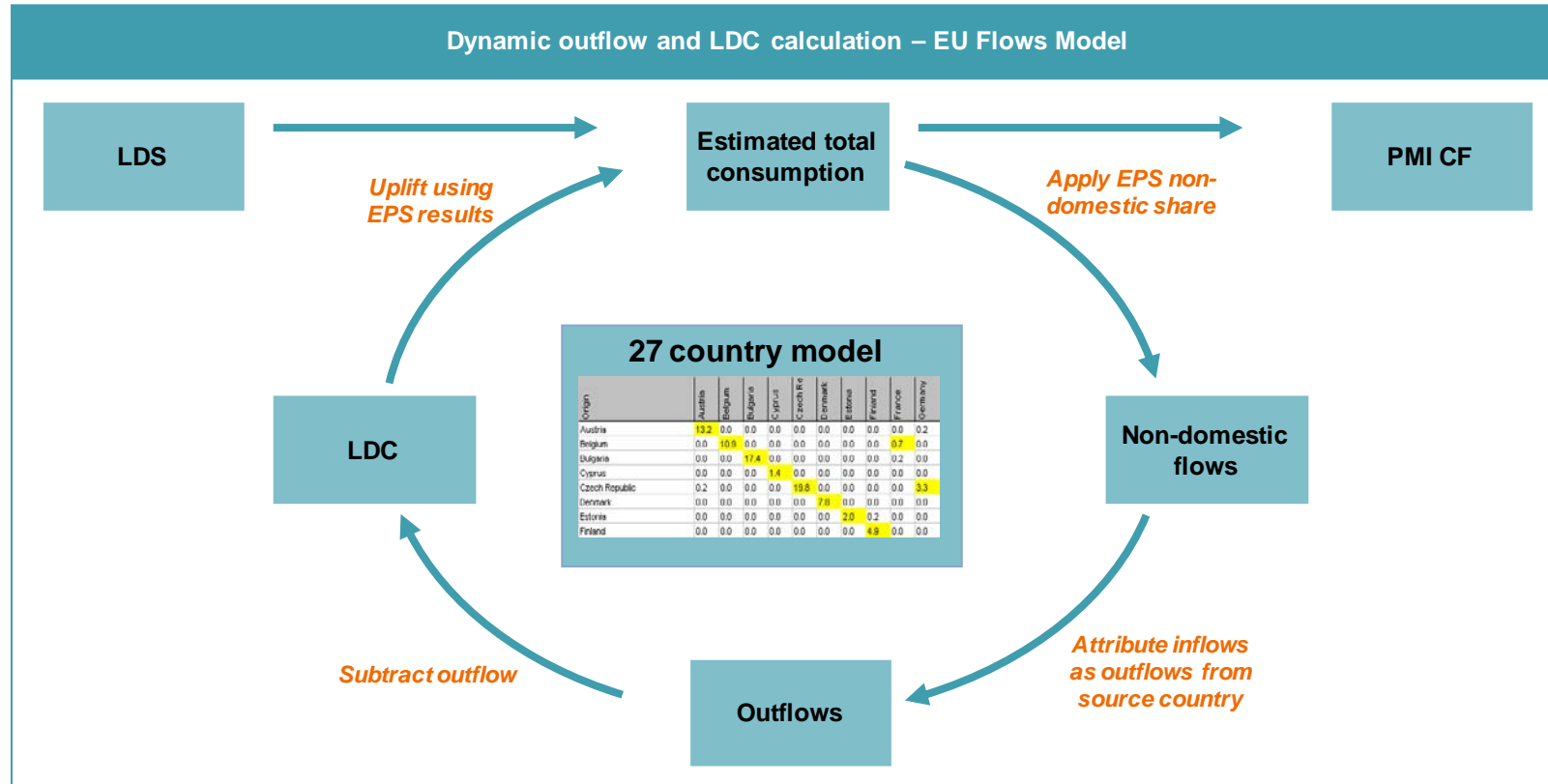
- Underlying trends in terms of country of origin and brand of cigarette are consistent with expectations and corroborated by external sources

Empty Pack Surveys conducted in Hungary have identified and quantified the rise and subsequent fall in non-domestic incidence since 2004

- The increase in non-domestic incidence to 2005 corresponded with an increase in excise taxes of 93.5% between 2002 and 2004:
 - The impact of this tax change was a price increase of 63%
- In 2006, increased domestic sales and stricter border controls corresponded to a significant decline in non-domestic incidence:
 - New enforcement measures implemented by Hungarian Customs included tightened border controls, vehicle confiscation powers, additional sniffer dogs and increasing the administrative burden of importing cigarettes.

EPS results since 2005 show a continued decline in non-domestic incidence until 2012

- This reduction is in line with the understanding of Hungarian Customs. Changes in border controls may have contributed to lower non-domestic flows in the past four years:
 - For example, in 2008 individuals bringing in more than 40 cigarettes from outside the EU were required to complete a declaration for the cigarettes imported.
- The rise in non-domestic incidence in 2012 can be linked with a significant fall in legal domestic sales, which corresponded with a 28% price increase in 2012



The EU Flows Model is a dynamic, iterative model that is principally based on legal domestic sales and Empty Pack Survey results

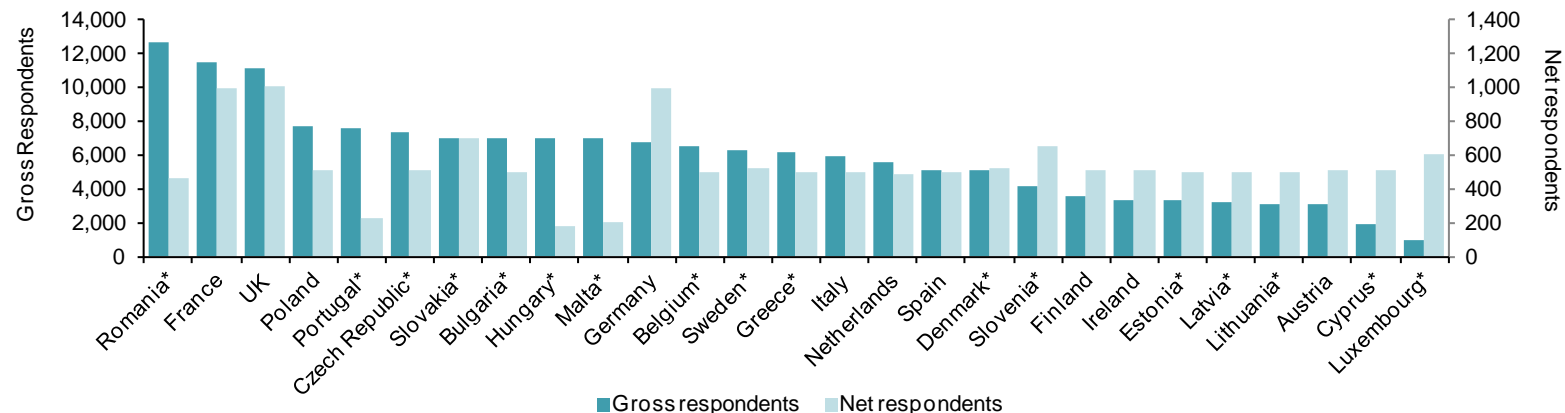
- Legal domestic sales are the starting point of the model from which outflows of legal sales to other countries are then subtracted to determine legal domestic consumption in a market
- EPS results provide a measurement of the share of non-domestic packs by country of origin in all markets
 - EPS results provide a consistent source across all 27 markets of non-domestic packs by country of origin from which we can calculate total product outflow from each market to the other 26 markets
- We have then iterated the model to refine estimates for legal domestic consumption

Primary information sources and tools – non-domestic legal analysis (1 of 2)

<p>Approach</p>	<ul style="list-style-type: none"> ■ Our approach was to measure the number and volume of tobacco purchase occasions from a complete, nationally representative sample of males and females, aged 19 years and over who have travelled abroad in the past 12 months <ul style="list-style-type: none"> – these results were then weighted and projected by age and gender to a national level to estimate the volume of legal non-domestic cigarettes brought back into each market by travellers returning from overseas – during 2012 research was updated in 10 markets
<p>Sample</p>	<ul style="list-style-type: none"> ■ The sample was drawn from the most complete, nationally representative database available and was representative of both urban and rural areas, age and gender <ul style="list-style-type: none"> – a fully random sample approach was used to ensure results were as ‘certifiable’ as possible and could be projected to the total target population ■ A target of 7,000 gross contacts (i.e. agreed to be interviewed and aged 19 years and over) or 500 net contacts (i.e. travelled abroad and purchased tobacco products in the past year) was set <ul style="list-style-type: none"> – these targets were considered sufficient to derive accurate volume estimates once projected to the national population and set based on past experience from the research agencies and findings from the pilot process ■ The number of net contacts was increased to 1,000 for France and Germany in 2008, and for the UK in 2009 to improve accuracy of volume estimates
<p>Data collection</p>	<ul style="list-style-type: none"> ■ Computer Aided Telephone Interviewing (CATI) was the data collection method in each market ■ The interview script was consistent across all markets, translated into local language and translated back into English for quality control purposes
<p>Validation tools</p>	<ul style="list-style-type: none"> ■ Numerous validation tools were built into the script to enhance the accuracy of responses, for example: <ul style="list-style-type: none"> – respondents were asked to recall all trips abroad in the past year and purchase volumes and brands for each trip – for each trip, the purpose of visit was also recorded to ensure final results appear logical and within a reasonable range
<p>Results capping</p>	<ul style="list-style-type: none"> ■ To ensure that we were recording legal personal purchases only, results were capped at an individual respondent level <ul style="list-style-type: none"> – total annual purchases were limited to a maximum of 1,000 packs per person as this was considered the absolute upper level for a heavy smoker who makes all of their purchases abroad – purchases from non-EU destinations were limited to a maximum of 10 packs per trip in line with Duty Free purchase restrictions

Non-domestic (legal) research: gross and net respondents

2012^{(1)(a)}



The key objective of the market research programme is to quantify genuine, legal non-domestic purchases of cigarettes in each market

- The 2012 market research programme incorporated an extensive interview programme across the 10 markets, using recognised market research specialists AC Nielsen and Ipsos/Synovate and totalling over 6,500 full interviews from over 63,000 gross respondents contacted during the second half of the year
 - research for the remaining 17 Member States was conducted during previous years by either AC Nielsen or Ipsos/Synovate and not updated in 2012
- ND(L) data for countries where research was not carried out during 2012 was updated in line with overall non-domestic trends for each country
 - in some examples further adjustments were made on the basis of additional corroborating sources such as tourist and border crossing data
- In the EU 27 countries, ND(L) results are based on a total of 160,196 contacted respondents and 14,605 successful interviews with adults (age 19+) who had travelled abroad and purchased manufactured cigarettes in the preceding twelve months.

In addition to the research programme, ND(L) data is adjusted to reflect inbound visitor inflows

- Non-domestic product found in Empty Pack Surveys from high cost inbound tourist/visitor countries is likely to represent an incidental inflow and is therefore categorised as legal
 - flows attributable to inbound tourism and visitors can not be identified in the market research programme

Note: (a) * denotes country where ND(L) research was not updated in 2012
 Source: (1) AC Nielsen, Ipsos/Synovate

Methodology comparison		
	Methodology one	Methodology two
Description	Brand share of total non-domestic x Total consumption gap	Non-domestic share of brand x Domestic sales by brand
Key assumption	<ul style="list-style-type: none"> Brand share of non-domestic in the EPS is representative of the national picture <ul style="list-style-type: none"> any overstatement of domestic share of premium brands in EPS is not reflected in their non-domestic shares 	<ul style="list-style-type: none"> Non-domestic share of a brand in the EPS is representative of the national picture: any overstatement of premium brands' domestic and non-domestic share is proportional
Strengths	<ul style="list-style-type: none"> Brand totals tally to overall total of non-domestic Can track flows by brand and country Can calculate non-domestic volumes where no legal sales are present <ul style="list-style-type: none"> e.g. Jin Ling in Germany and Priluki in Hungary 	<ul style="list-style-type: none"> More robust for brands which are overweight in the EPS samples at a non-domestic brand share level
Limitations	<ul style="list-style-type: none"> Some potential to overstate premium brands due to concentration on cities in EPS <ul style="list-style-type: none"> e.g. Marlboro and L&M Small IMS share / large EPS share discrepancies <ul style="list-style-type: none"> e.g. Marlboro in UK 	<ul style="list-style-type: none"> Totals by brand will not necessarily match total overall: most effective as an estimate of share of non-domestic for major brands Small IMS share / high EPS non-domestic level discrepancies

Two parallel methodologies for calculating non-domestic brand share were used to ensure that the most reliable and realistic results were achieved

- While results at an overall market level were all highly robust and credible, smaller sample sizes at a brand level have the potential to introduce distortions at this lower level
- In order to maximise the accuracy of brand results, a dual methodology was used to estimate non-domestic brand-level results in each market
- The results from both approaches were then compared to both IMS and ND(L) brand results for corroboration
- In almost all markets and for the vast majority of brands the results for the two approaches were highly consistent
- In a few markets there were some brand-level discrepancies. In these markets, adjustments were made based on the weight of evidence from both approaches and the IMS and ND(L) findings to determine the most credible non-domestic brand share

Brand share methodology two was used in a limited number of instances to ensure that the results were both as reliable and realistic as possible

- Methodology one is the most universally applicable and was therefore used where both approaches were consistent. Where an adjustment from methodology one was required, a combination of both approaches or methodology two was applied as appropriate
- For Marlboro inflows in a few countries, a combination of both approaches or methodology two was used as it appears to give more reliable and robust results
 - methodology two was used for Marlboro in France and Ireland
 - a combination of both approaches was used for Marlboro in Spain and Belgium

External public research

- We have undertaken extensive research into external data sources in each of the 27 EU markets
- Research covered a wide variety of data sources, including:
 - third party information available within PMI
 - press articles
 - retail trade and tobacco industry associations
 - universities and other academic institutions
 - ministries of health and social affairs
 - customs departments
 - other government and policy-making institutions
 - market research publications
 - industry related journals and publications
 - federal statistics
- We have reviewed, collated and used the information available to cross-check and test our research results
 - we tested the reasonableness of our research results against a range of quantitative estimates obtained on the size and scale of C&C in each market

Expert interviews

- In addition, we have undertaken structured interviews with industry specialists to canvas their opinions on C&C in each of the 27 EU markets where possible
- Our contacts were identified from multiple sources, including:
 - PMI recommendations
 - OLAF recommendations
 - KPMG external search
 - other interviewee recommendations
- We have interviewed specialists across a broad spectrum of areas and backgrounds, including:
 - governmental and policy-making organisations
 - Operational Customs and enforcement staff
 - trade and industry associations
 - PMI management, both centrally and at a country level
- We devised a structured interview process for each interview category which underwent multiple iterations to ensure consistency and accuracy of both questioning and capturing results

Conclusions

- Analysis of external research has been highly effective in:
 - improving our understanding of local market dynamics, trends and the nature of C&C in each country
 - facilitating our judgement on the potential limitations of our findings
- However, external data is not sufficiently detailed on its own to obtain a credible estimate of the size and scale of C&C as:
 - basis for estimates is often unknown and may not be objective
 - data sources and estimates across countries lack consistency
 - data is often sparse and patchy
- External expert interview programme has provided good soft corroboration of trends and issues
 - however, it has been less effective in delivering quantitative results

Calculation of non-domestic incidence on a stick basis in 2012

<p>Overview</p>	<p>Traditionally the KPMG EU Flows Model assumed that all packs collected were the same size (20 cigarettes). In 2012 the model was updated to take into account different pack sizes</p> <ul style="list-style-type: none"> ■ This decision was taken in order to give a more accurate result for the flows between EU countries, as pack sizes vary on a country to country basis
<p>Process</p>	<p>Empty Pack Survey results were re-weighted to take into account the size of packs collected</p> <ul style="list-style-type: none"> ■ Therefore, for example, a pack containing 10 cigarettes was given half the weighting of a pack containing 20 cigarettes
<p>Impact</p>	<p>Non-domestic incidence was affected by this change on a country by country basis, dependant upon whether the typical domestic pack size was greater or less than the typical non-domestic pack size</p> <ul style="list-style-type: none"> ■ Non-domestic packs usually contain 20 cigarettes, as this is the most common size of pack ■ In countries where the average domestic pack size was less than 20 cigarettes (for example, most legal domestic sales in the UK and Italy are of 10 or 20 cigarette packs, giving an average domestic pack size of less than 20 cigarettes, and in Denmark domestic cigarettes are sold in packs of 19), then the conversion to a sticks basis is likely to decrease the proportion of domestic cigarettes in the EPS sample, giving a higher non-domestic incidence compared to the old methodology ■ In countries where the average domestic pack size is greater than 20 cigarettes (for example in Luxembourg domestic packs typically contain 20, 25 or 30 cigarettes), then the conversion to a sticks basis is likely to increase the proportion of domestic cigarettes in the EPS sample, giving a lower non-domestic incidence compared to the old methodology

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Limitation of Results Overview

Scope limitations

- There are specific scope exclusions which cannot be or have not been accounted for in our approach:
 - geographic exclusions
 - brand exclusions – non-PMI counterfeit
 - category exclusions – OTP
 - LDS product flows out of the EU

Source limitations

- Limitations are, of necessity, present with any primary information source
- This primarily affects EPS, LDS and ND(L) sources
- For example, limitations can arise from:
 - sampling criteria
 - coverage issues
 - timing/seasonality factors
 - specific regional or demographic exclusions

We have designed a methodology that is as robust and inclusive as we believe could practicably have been delivered. However, given the innate complexity of C&C, our methodology does have limitations.

Limitation of Results

Scope limitations

Limitation	Detail	Impact	Adjustment
Geographic coverage	<ul style="list-style-type: none"> ■ We have limited our geographic coverage in some markets where extension would significantly impair confidence levels in the ND(L) research for the further territories included ■ In some instances (e.g. Greek islands), In Market Sales (IMS) data is also insufficient for the purposes of this study 	<ul style="list-style-type: none"> ■ Spanish results only cover mainland Spain and do not include the Canary Islands, Balearic Islands or Ceuta & Melilla ■ French results cover only mainland France and do not include Corsica ■ Portuguese results only cover mainland Portugal and do not include Madeira or the Azores ■ Greek results only cover mainland Greece and do not include the Greek islands ■ UK results only cover Great Britain and Northern Ireland and do not include the Channel Islands 	Not adjusted for
Non-PMI counterfeit	<ul style="list-style-type: none"> ■ Empty Pack Survey results do not identify non-PMI brand counterfeit packs <ul style="list-style-type: none"> – only the manufacturer / trademark owner can confirm whether their brand pack is genuine 	<ul style="list-style-type: none"> ■ In some instances, the volume of legal domestic consumption may be overstated where domestic counterfeit variants are identified <ul style="list-style-type: none"> – this may lead to minimal understatements of C&C volumes for non-PMI brands ■ Moreover, we cannot distinguish between non-PMI brand counterfeit (non-domestic variants) and contraband product, although this will not impact the overall volume of C&C 	Not adjusted for
OTP	<ul style="list-style-type: none"> ■ Empty Pack Surveys collect cigarette packs only ■ Non-domestic consumption for OTP cannot be measured via Empty Pack Survey results 	<ul style="list-style-type: none"> ■ Anecdotal reports in a number of countries suggest that non-domestic consumption of OTP may have been growing in recent years. These observations are supported by Customs organisations in some countries including the UK and Ireland 	Not adjusted for
Non-EU outflows	<ul style="list-style-type: none"> ■ In order to calculate consumption, we have assumed no outflows of LDS outside the EU, with the exception of outflows from Sweden to Norway (see country-specific refinements) 	<ul style="list-style-type: none"> ■ Net outflows besides those from Sweden to Norway are believed to be minimal, supported by both anecdotal evidence and from non-EU EPS surveys (including Switzerland and Turkey) ■ Non-EU LDS outflows are not considered to be material due to the high prices relative to other parts of the world and Duty Free import restrictions ■ Potential minimal overstatement of EU consumption 	Partially adjusted for

Limitation of Results

Source limitations (1 of 2)

Source	Limitation
Empty Pack Surveys	<ul style="list-style-type: none"> ■ In some geographies, the results may not be absolutely representative of total consumption because of the sample size, or, more likely, practical limitations to collection locations <ul style="list-style-type: none"> – depending on the source of packs collected, either homes and workplaces or public spaces (in Germany) are not covered – the sample is more heavily weighted towards populous, urban areas and therefore may not be fully representative of consumption habits in rural regions ■ Results from Germany are based on a monthly analysis of approximately 10,000 packs collected at recycling centres and so are not directly comparable with the EPS results from other countries due to the difference in methodology ■ Empty Pack Surveys are only conducted at set periods and results may be influenced by seasonal factors such as tourist inflows <ul style="list-style-type: none"> – in some instances the timing of an EPS has changed between years. In order to ensure comparability of results, monthly LDS figures, consumption trends and visitor data are all analysed and adjustments made where appropriate ■ Brand and market variant share can only be extrapolated with a degree of statistical accuracy for brands where a sufficiently large number of packs have been collected ■ EPS results are analysed to identify any outliers that may impact results, such as geographic concentrations of a specific brand or market variant. Brand specific data is also compared to known sales in the source market to identify whether results are credible <ul style="list-style-type: none"> – where data suggests a sampling or data capture error may have occurred at a specific location, results are adjusted and the remainder of the survey is re-weighted accordingly ■ In some specific instances, it is not possible to differentiate between Duty Free and Duty Paid variants from the empty packs collected as the tear tape on the packet is required in order to make the necessary distinction ■ However, EPS represents the most consistent source of non-domestic share across markets. We believe, especially at a total market level, that these results are credible and robust. Brand trends and analysis of country flows from EPS results further supports this conclusion ■ When allied to other methods of corroboration, such as consumption index modelling, we believe the results are fully fit for purpose

Source limitations (2 of 2)

Source	Limitation
<p>Legal domestic sales</p>	<ul style="list-style-type: none"> ■ In Market Sales (IMS) data is the most reliable source for legal domestic sales in a market. However, in some markets it is not available. In the absence of IMS data, we have used either AC Nielsen Retail Audit data or tax stamp data as available <ul style="list-style-type: none"> – In some cases tax stamp data may not correspond to the calendar year and may also be distorted by inventory holdings in advance of increases in taxation. In these instances we have used the LDS source considered by local PMI management to be the most representative of smoker consumption during the calendar year ■ AC Nielsen Retail Audit data is derived from retail sales information but may exclude particular sales channels or retailers <ul style="list-style-type: none"> – In markets where we have used Retail Audit data, PMI local management have calculated the appropriate uplift to derive total market sales, including volumes not accounted for in Retail Audit data ■ Slight timing variances may arise between the date the product was shipped and actual consumption but, following discussions with local management, this is not considered significant and the full year LDS information we have is considered to be a fair and accurate representation in each market
<p>ND(L)</p>	<ul style="list-style-type: none"> ■ As with any CATI-based market research approach, our samples may potentially exclude certain demographic segments, in particular, those without a permanent home, registered address or telephone line ■ The nature of the market research programme requires that people can recall, with a high degree of accuracy, trip and purchase volumes undertaken over the past year. However, pilot and roll-out results give us confidence that this is not a significant issue for respondents ■ Respondents are asked to recall purchase volumes in packs and we assume 20 cigarettes per pack for our pack to cigarette conversion ■ To ensure that we record legal imports only, we have capped total individual purchases and applied a cap to imports from certain source countries where import restrictions apply ■ Due to the nature of the survey, market research does not capture non-domestic (legal) product arising from inbound tourism. However, these flows are likely to be limited in nature and, in many cases, can be adjusted within the ND(L) methodology through the use of corroborating sources ■ It is not possible to reliably distinguish between Duty Free and Duty Paid variant in the ND(L) research due to the consumer confusion when buying cigarettes abroad, particularly in airports when travelling intra-EU. We have however attempted to estimate legal Duty Free purchases by using ND(L) inflows from non-EU markets as an approximation. This approach assumes that EU nationals purchase Duty Free variants when they travel to non-EU markets and buy cigarettes as measured by the ND(L) research <ul style="list-style-type: none"> – this assumption is predicated on the fact that Duty Free variants are typically available at a lower prices than legal tax-paid cigarettes in non-EU destination countries

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Country results refinements (1 of 5)

Country	Rationale	Description	Impact
Austria	<ul style="list-style-type: none"> ■ Inflows from Slovenia appeared to be overstated given tourism flows and relative price changes 	<ul style="list-style-type: none"> ■ Increases in inflows of Slovenian variant packs from the Empty Pack Survey exceeded market expectations, travel trends and price fluctuation analysis ■ The increase in Slovenian flows was limited once the Austrian EPS results were re-weighted to better reflect the population of the region where the packs were picked up 	<ul style="list-style-type: none"> ■ Total non-domestic inflows of Slovenian variant cigarettes decreased by 20% in 2012 after this adjustment was made. The previous figure was closer to 1.5 billion sticks
Belgium	<ul style="list-style-type: none"> ■ Non-domestic Marlboro brand share appeared to be overstated 	<ul style="list-style-type: none"> ■ An average of brand share methodology one and brand share methodology two has been used which is more in line with ND(L) results and domestic brand share <ul style="list-style-type: none"> – Non-domestic Marlboro volumes calculated using methodology one were 0.58 billion cigarettes, compared to methodology two volumes of 0.29 billion in 2012 	<ul style="list-style-type: none"> ■ Average of methodology one and methodology two brand share applied to total non-domestic volume for Marlboro resulting in ND of 0.43bn ■ Adjustments made to 'Other Non-PMI' to compensate for changes to Marlboro volumes
Cyprus	<ul style="list-style-type: none"> ■ The implied decline in outflows to the UK arising from the EPS results did not appear realistic given tourism flows and changes to relative prices 	<ul style="list-style-type: none"> ■ The outflow from Cyprus to the UK was increased in line with year-on-year trends in tourist arrivals from the UK 	<ul style="list-style-type: none"> ■ Outflows to UK increased from 43 million cigarettes to 192 million cigarettes
Denmark	<ul style="list-style-type: none"> ■ The implied decline in inflows from Germany did not appear realistic given increasing cross border traffic and cigarette purchases 	<ul style="list-style-type: none"> ■ The inflow from Germany to Denmark was increased in line with cross border cigarette trade data 	<ul style="list-style-type: none"> ■ Inflows to Demark from Germany increased from 0.02 billion cigarettes to 0.06 billion cigarettes

Limitations of results

Country results refinements (2 of 5)

Country	Rationale	Description	Impact
Finland	<ul style="list-style-type: none"> Implied flows from Russia appeared to be understated given relative pricing and cross border statistics for 2012 	<ul style="list-style-type: none"> Cross border travel statistics for 2012 indicated a comparable level of travel to and from Russia compared to 2011, 2010, 2009 and 2008 <ul style="list-style-type: none"> This was corroborated by further travel trend analysis from several different sources Russian inflows uplifted by 0.36 billion cigarettes to 0.82 billion: <ul style="list-style-type: none"> This has been estimated by applying the change in both travel and seizure volumes between 2012 and 2011 to the Russian inflow 	<ul style="list-style-type: none"> Russian inflows increased by 0.36 billion cigarettes. This resulted in a 0.36 billion increase to counterfeit and contraband levels in Finland
	<ul style="list-style-type: none"> Implied flows from Estonia appeared to be overstated given tourism flows 	<ul style="list-style-type: none"> Increased inflows of Estonian variant packs from the Empty Pack Survey exceeded market expectations and travel trends The increase in Estonian inflows have been limited to the increase in travel between Estonia and Finland 	<ul style="list-style-type: none"> Estonian inflows decreased by 0.13 billion cigarettes to 0.21 billion
France	<ul style="list-style-type: none"> Non-domestic Marlboro brand share appeared to be overstated 	<ul style="list-style-type: none"> Brand share methodology two has been used which is more in line with ND(L) results and domestic brand share (methodology one non-domestic Marlboro volumes were 6.23 billion cigarettes compared to methodology two volumes of 3.60 billion in 2012) 	<ul style="list-style-type: none"> Brand Share methodology two applied to total non-domestic volume for Marlboro Adjustments made to 'Other Non-PMI' to compensate for changes to Marlboro volumes
	<ul style="list-style-type: none"> 2012 EPS results showed a significant increase in non-domestic incidence in Q4, driven largely by a price increase which took effect in October 2012 	<ul style="list-style-type: none"> This increased level of non-domestic incidence was deemed to be representative of four months of the year only, taking into account increased non-domestic incidence in the month before the anticipated price rise and during the rest of Q4 Therefore, the Q4 EPS results have been weighted to represent 4 months of the year, while Q2 results have been weighted to represent the remaining 8 months 	<ul style="list-style-type: none"> Without this adjustment non-domestic incidence for 2012 would have been 24.6%

Country results refinements (3 of 5)

Country	Rationale	Description	Impact
Italy	<ul style="list-style-type: none"> Increased non-domestic incidence was not deemed to be representative of the wider Southern region of Italy 	<ul style="list-style-type: none"> An adjustment was made to reduce the weight of Naples to represent 17.3% of the Southern region, in line with the population of the province of Naples The weighting of other cities in the region was increased proportionately 	<ul style="list-style-type: none"> The total impact of the adjustment was a decline in the overall non-domestic incidence of 1.2%
	<ul style="list-style-type: none"> An adjustment was made to account for oversampling of 10 packs in the EPS survey 	<ul style="list-style-type: none"> 10 packs made up 20.4% of packs sold in Italy in 2012, according to IMS data, but represented 34.9% of packs collected in the EPS Therefore, domestic 10 packs were reweighted in line with IMS data, with the weighting of domestic 20 packs increased proportionally 	<ul style="list-style-type: none"> The total impact of the adjustment being a decline in the overall non-domestic incidence of 0.8%
Ireland	<ul style="list-style-type: none"> Spanish legal sales of UK and Irish Virginia brands suggest there is a shortfall in outflows to Ireland as measured by the Irish EPS 	<ul style="list-style-type: none"> Inflows from Spain to Ireland were uplifted by 0.06 billion cigarettes to 0.14 billion: See Spain country section for detail 	<ul style="list-style-type: none"> Inflows from Spain increased by 0.06 billion cigarettes Total non-domestic volumes remained unadjusted
	<ul style="list-style-type: none"> Non-domestic Marlboro brand share appeared to be overstated 	<ul style="list-style-type: none"> As per 2011 brand share methodology two has been used which is more in line with ND(L) results and domestic brand share 	<ul style="list-style-type: none"> Brand Share methodology two applied to total non-domestic volume for Marlboro Adjustments made to 'Other Non-PMI' to compensate for changes to Marlboro volumes

Limitations of results

Country results refinements (4 of 5)

Country	Rationale	Description	Impact
Luxembourg	<ul style="list-style-type: none"> Empty Pack Survey results did not accurately capture outflows 	<ul style="list-style-type: none"> Outflows of legal domestic sales were not accurately captured in destination market Empty Pack Survey results, leading to an unrealistic implied consumption level 	<ul style="list-style-type: none"> Net outflow (modelled to outside of the EU) declined slightly from 2.97 billion cigarettes in 2011 to 2.72 billion in 2012
	<ul style="list-style-type: none"> The 2012 EU Flows Model uses the results of NMA Empty Pack Surveys conducted in Luxembourg and Esch-sur-Alzette Sampling in the Q2 and Q4 NMA Empty Pack Surveys was not collected proportionally to the population of the two cities and therefore may not fully reflect the national non-domestic incidence levels 	<ul style="list-style-type: none"> Empty Pack Survey results have been reweighted to more accurately reflect the relative population of both cities 	<ul style="list-style-type: none"> Non-domestic incidence increased from 5.9% to 6.6% in 2012
Malta	<ul style="list-style-type: none"> The implied large decline in outflows to the UK arising from the Empty Pack Survey does not appear realistic given tourism flows and changes to relative prices 	<ul style="list-style-type: none"> Increased the outflow from Malta to the UK in line with year-on-year increases in arrivals from the UK 	<ul style="list-style-type: none"> Outflows to UK increased from 19 million cigarettes per the implied Empty Pack Survey level to 38 million cigarettes
Romania	<ul style="list-style-type: none"> PMI Management's assumption that EPS was not capturing high enough inflows from Serbia 	<ul style="list-style-type: none"> The survey was re-weighted to reflect a more rural population in regions near Serbia 	<ul style="list-style-type: none"> Inflows from Serbia increased by 0.15 billion sticks
Spain	<ul style="list-style-type: none"> Analysis of Spanish legal sales of UK/Irish Virginia brands indicated a shortfall in outflows to the UK and Ireland as measured by the UK and Irish Empty Pack Surveys 	<ul style="list-style-type: none"> Outflows to the UK and Ireland were increased to reflect actual sales of UK/Irish Virginia brands in Spain net of estimated consumption by UK and Irish nationals resident in Spain and tourist consumption whilst in Spain 	<ul style="list-style-type: none"> Spanish outflows increased by 0.5 billion resulting in a net reduction in consumption and therefore total C&C volume
	<ul style="list-style-type: none"> Non-domestic Marlboro brand share appeared to be overstated 	<ul style="list-style-type: none"> An average of brand share methodology one and brand share methodology two has been used which is more in line with ND(L) results and domestic brand share (methodology one non-domestic Marlboro volumes were 0.75 billion cigarettes compared to methodology two volumes of 0.73 billion) 	<ul style="list-style-type: none"> Average of methodology one and methodology two brand share applied to total non-domestic volume for Marlboro Adjustments made to 'Other Non-PMI' to compensate for changes to Marlboro volumes

Limitations of results

Country results refinements (5 of 5)

Country	Rationale	Description	Impact
Spain (cont.)	<ul style="list-style-type: none"> Cigarillos, which normally do not have a tax stamp, have had an increasing impact on non-domestic incidence in recent years 	<ul style="list-style-type: none"> As cigarillos are considered to be OTP, we have excluded from EPS results in 2012 	<ul style="list-style-type: none"> Total non-domestic incidence was reduced from 10.9%, including cigarillos, to 10.3%, excluding cigarillos
Sweden	<ul style="list-style-type: none"> The Empty Pack Survey results highlighted the presence of domestic packs being sold at the minimum tax yield price: <ul style="list-style-type: none"> These brands are not legally distributed for sale in Sweden 	<ul style="list-style-type: none"> Below tax-yield brands were reclassified as illicit product including the following: <ul style="list-style-type: none"> ATU, Basic, Blue Jeans, Colts, Elixir, Extreme, GeosBell, Goal, Jin Ling, Kent, King, Look, Maryland, Matrix, Next, Paramount, Red Eagle, Royal Crown, Tamar, Vegas, Vito and Xtreme 	<ul style="list-style-type: none"> Total non-domestic inflows and C&C inflows uplifted by 0.21 billion cigarettes
UK	<ul style="list-style-type: none"> Spanish legal sales of UK Virginia brands suggest there is a shortfall in outflows to the UK as measured by the Empty Pack Survey 	<ul style="list-style-type: none"> For Spanish flows, see Spain for detail: <ul style="list-style-type: none"> Inflows from Spain uplifted by 0.41 billion to 1.04 billion cigarettes 	<ul style="list-style-type: none"> Inflows from Spain increased by 0.41 billion cigarettes
	<ul style="list-style-type: none"> Implied inflows from Cyprus appeared to be understated given 2011 tourism statistics 	<ul style="list-style-type: none"> Inflows from Cyprus increased by 149 million cigarettes to reflect the 2011-2012 trend in UK tourists arriving in Cyprus 	<ul style="list-style-type: none"> Non-domestic Duty Free volumes reallocated to Spanish, Cyprus and Malta non-domestic
	<ul style="list-style-type: none"> Implied inflows from Malta appeared to be understated given 2011 tourism statistics 	<ul style="list-style-type: none"> Inflows from Malta increased by 19 million cigarettes to reflect the 2011-2012 trend in UK tourists arriving in Malta 	<ul style="list-style-type: none"> Total non-domestic level unchanged
	<ul style="list-style-type: none"> An adjustment was made to adjust for oversampling of 10 packs in the EPS 	<ul style="list-style-type: none"> 10 packs make up 19% of packs sold in the UK, according to IMS data, but represent 33% of packs collected in the EPS Therefore, domestic 10 packs were reweighted in line with IMS data, with the weighting of domestic 20 packs increased proportionally 	<ul style="list-style-type: none"> Total non-domestic incidence in the UK was reduced by 2.2 percentage points

Significant adjustments to non-domestic (legal) research

Nature of significant adjustment	Impact
<p>Corroboration with total non-domestic volumes^(a)</p> <ul style="list-style-type: none"> Some discrepancies may exist between the ND(L) data and total non-domestic volumes which leads to a negative counterfeit and contraband level 	<ul style="list-style-type: none"> Italy and France to Germany to Poland: 0.25 billion cigarette reallocation from ND(L) <ul style="list-style-type: none"> ND(L) research overstated flows to Germany. Volumes were capped at 0.25 billion sticks, all of which was non-domestic legal as the surrounding countries had similar or higher price points – none was allocated to C&C to offset any negative impact
<p>Cross-referencing with tourist and border crossing data^(a)</p> <ul style="list-style-type: none"> The number of trips made is a key driver of ND(L) volumes, particularly where there is a large differential between cigarette pricing and stringent import restrictions between neighbouring countries 	<ul style="list-style-type: none"> Canary Islands to Spain flow: 0.44 billion cigarette reallocation from C&C to ND(L) <ul style="list-style-type: none"> Flow volume calculated by adjusting prior year ND(L) volumes for changes in tourism trends between Spain and the Canary Islands Andorra flows to Spain and France: 0.20 billion and 0.27 billion cigarette reallocation from C&C to ND(L), respectively <ul style="list-style-type: none"> Visitor numbers reported during research programme were understated versus actual data Flow volume recalculated based on actual visitor numbers Czech Republic to Germany flow: 1.39 billion cigarette reallocation from C&C to ND(L): <ul style="list-style-type: none"> Visitor numbers reported during research programme were understated versus actual data Flow volume recalculated based on actual visitor numbers Poland to Germany flow: 1.41 billion cigarette reallocation from C&C to ND(L): <ul style="list-style-type: none"> Visitor numbers reported during research programme were understated versus actual data Flow volume recalculated based on actual visitor numbers
<p>Review of indicators for specific flows^(a)</p> <ul style="list-style-type: none"> Results for a small number of flows into various destination countries suggest under/over reporting of pack purchases given the price differentials between the source and destination markets 	<ul style="list-style-type: none"> Belgian flows to France: 0.4 billion reallocation from C&C to ND(L) <ul style="list-style-type: none"> ND(L) proportion adjusted upwards to reflect increased price differential between these two countries and geographical distribution of packs, in line with previous years

Note: (a) Significant adjustments to ND(L) have been defined as those with an impact of greater than 0.2bn sticks in priority markets.

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External data sources (1 of 3)

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Scope of work (1 of 2)

1. This study will report on the estimated size and composition of the total cigarette market (including counterfeit and contraband products), as detailed below, for each of the 27 EU Member States.
2. The findings from the reports on the 27 EU Member States will be used to produce a concise report of approximately 150 pages covering the overall view of the total EU market. We will also comment on counterfeit and contraband flows at a Member State level.
3. KPMG will facilitate three country clustered workshops with PMI country leaders from 11 priority countries to build a shared understanding of: data sources and their limitations; indicative results and their possible implications for the country's anti-illicit activity; PMI's anti-illicit strategy; communications plans, including fact gaps and hypotheses; and any additional research requirements.

The 11 priority Member States are: Czech Republic; France; Germany; Greece; Ireland; Italy; Netherlands; Poland; Romania; Spain and the UK;

The three cluster meetings will consist of:

Czech Republic; Germany; Netherlands; Poland;

France; Ireland; Spain; UK;

Greece; Italy; Romania.

In other markets, KPMG will share provisional findings of our analysis based on information provided by the PMI ITS&P group with selected members of the local management team prior to finalising our results.

4. KPMG will conduct analysis and report findings to PMI on three topics of focus: Illicit Whites, Other Tobacco Products (OTP); and, flow categorisation.
5. In addition to the detailed EU reports and management meetings, KPMG will also undertake the following activities in support of Project STAR:

Manage and lead two key intervention sessions between the joint PMI and KPMG teams, these being:

Project Kick Off (to take place week commencing 5th November 2012) to agree priority markets based on available primary research and highlight potential communication considerations at a country level;

Review of detailed provisional EU and country level findings for each of the 27 markets and address key challenges and agree appropriate response. To take place mid February 2013.

Upon finalisation of the EU results, provide to PMI data tables containing the following information:

Summary of EU total counterfeit and contraband inflows by source and destination market;

Detailed analysis of total non-domestic outflows to the EU split by destination market and brand for the following source countries: Ukraine; Russia; Moldova; Belarus; Serbia; Poland; and the Czech Republic.

Scope of work (2 of 2)

6. Information from several independent sources will be used. These sources will include:
 - Tobacco industry research and statistics;
Sales data, consumer surveys provided by PMI and/or Tobacco Manufacturers' Associations;
Where available, regional sales data will be provided to corroborate cross border trends between neighbouring countries;
PMI consumer survey data will be provided to corroborate consumption trends arising from Project STAR results and identify any further areas of analysis (e.g. extent of smokers switching to RYO products).
 - Estimates of non-domestic consumption used by PMI management teams in each market (where available) will be provided to provide evidence based support for observed trends in each county.
Detailed breakdowns of any survey results will be made available to KPMG in a timely manner for modelling purposes;
Information regarding the methodology and sampling plan will be provided to KPMG for our review.
 - Empty Pack Surveys commissioned by the PMI ITS&P group will be conducted by third party research providers in a majority of Member States and the results provided to KPMG as soon as they are available to consider alongside information provided by the markets.
 - Independent non-domestic research;
Surveys to analyse the flows of non-domestic (legal) sales will be undertaken in a limited number of Member States with coverage to be agreed between PMI and KPMG;
Third party research will be contracted directly by PMI;
In those markets where research is not conducted, KPMG will provide estimates of the trend in non-domestic (legal) sales using both historical consumer research results and third party statistics regarding travel and tourism trend.
 - Expert opinions and expert panel data;
In areas where information provided may be inconclusive we will undertake structured interview programmes designed to capture and quantify the opinions of relevant expert groups including, among others, customs and law enforcement officials.
 - Existing public studies and statistics;
Research and data published by government agencies (including Ministries of Finance), health bodies, customs authorities, market researchers and academics will be provided by PMI management teams to corroborate findings.
7. Interviews and data from external sources will be obtained on a best efforts basis. We will work with PMI to identify and contact key customs and Manufacturer's Associations members. We will require access to identified PMI personnel throughout this project and our ability to deliver this scope depends on this access being made available.



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