



EQUITY RESEARCH

September 12, 2018

■ Tobacco

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INDUSTRY UPDATE

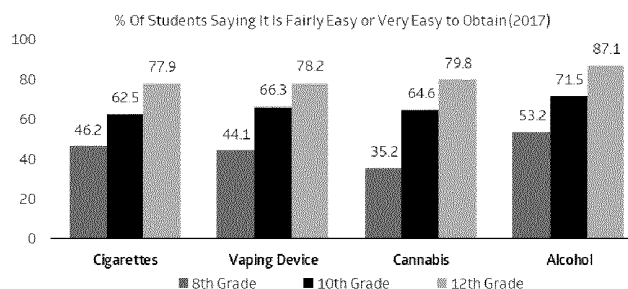
BIG TOBACCO FINDS A FRIEND IN THE FDA, TODAY

THE COWEN INSIGHT

This morning, the FDA announced that they will consider taking more aggressive action on e-cigs (including potentially banning flavors) to curb the rapidly growing use of the products among underage consumers. Given the competitive threat from JUUL, this is a notable positive for big tobacco.

The News

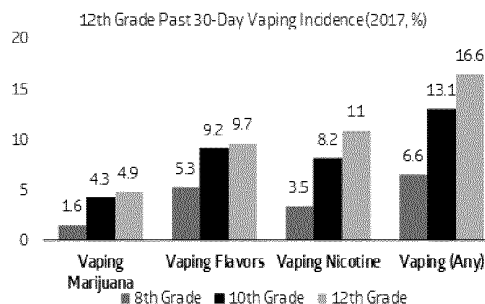
Today, the FDA announced that they have asked all the leading e-cigarette manufacturers to submit a plan in 60 days to explain to the agency how they plan on addressing the rising prevalence of e-cigarette use among youth. To the extent that the agency does not find the plans compelling, the agency indicated they are open to pulling flavored e-cigarettes off the market. We do wonder how satisfactory any plan will be given that teens report having easy access to a whole host of products that are viewed as dangerous, in particular when consumed by underage consumers.



Source: Monitoring the Future and Cowen and Company

The Youth Problem

E-cigarette incidence among underage consumers has been growing rapidly. According to the University of Michigan's Monitoring the Future survey, past 30 day use of any vaping among 12th graders (ages 17 and 18) was ~17%, meaningfully ahead of the 9.7% past 30 day Cigarette incidence seen for the same age cohort. Indeed, since the survey began asking about e-cigarettes in 2014, the form factor has consistently been reported as more popular among youth than cigarettes. See our deep dive on teen use here.



Source: Monitoring the Future and Cowen and Company

Please see pages 3 to 8 of this report for important disclosures.

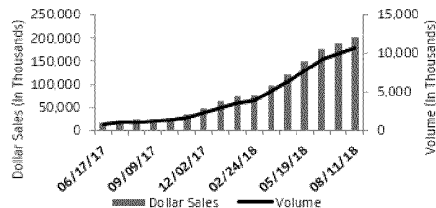
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Implications for e-cigarettes

The growing popularity of JUUL has reinvigorated growth in the overall e-cigarette category. In the most recent Nielsen data, JUUL achieved a 72% dollar share of the category, and accounted for ~100% of category growth. The growing popularity of JUUL seems to be driven by flavored offerings (in particular Cool Cucumber and Mango). For a deep dive on JUUL consumer survey work (18+), see our note here.



Source: The Nielsen Company and Cowen and Company

Implications for Big Tobacco

Among tobacco investors there has been growing concern that the widespread popularity of JUUL is having a negative impact on the cigarette industry, which headwind would seemingly only grow as JUUL continues to gain traction with consumers. Given that big tobacco has yet to find a productive way to meaningfully compete against JUUL, an FDA decision to pull flavors from the market would be a notable positive for MO, BATS, IMB, and JT as it would reset the competitive landscape in vapor. Maintain Outperform ratings on MO, BATS and IMB.

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Ticker	Rating	Price*	Price Target	Ticker	Rating	Price*	Price Target
MO	Outperform	\$59.47	\$70.00	BATS.LN	Outperform	3,554.50p	4,800.00p
IMB.LN	Outperform	2,608.50p	3,300.00p	PM	Market Perform	\$77.45	\$85.00
2914.JP	Market Perform	¥2,915.00	¥3,000.00				

*As of 09/11/2018

VALUATION METHODOLOGY AND RISKS

Valuation Methodology

Tobacco:

Our valuation methodology is primarily based on Price-to-Earnings (P/E), followed by Relative Price-to-Earnings (vs. the respective relative index) as well as Enterprise Value to EBITDA (EV/EBITDA). In cases where GAAP net income includes large, non-cash items (e.g., restructuring charges or the resolution of disputed MSA), we may use non-GAAP EPS.

Investment Risks

Tobacco: Global tobacco demand is subject to a number of potential headwinds. Most notably, increased awareness of the risks associated with traditional tobacco use, and resultant regulatory actions (e.g., indoor smoking bans, enlarged textual or graphic warnings, and / or plain packaging) can negatively impact smoking incidence and/or per capita consumption, and thus industry volumes. What is more, the industry is also subject to risk from disruptive tax increases, which result in higher prices, and can also depress consumption. Further, while diminished, litigation risk also exists.

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ADDENDUM**Stocks Mentioned In Important Disclosures**

Ticker	Company Name
MO	Altria Group
BATS.LN	British American Tobacco p.l.c.
IMB.LN	Imperial Brands
2914.JP	Japan Tobacco
PM	Philip Morris International

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Outperform (1): The stock is expected to achieve a total positive return of at least 15% over the next 12 months

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Underperform (3): Stock is expected to achieve a total negative return of at least 10% over the next 12 months

Assumption: The expected total return calculation includes anticipated dividend yield

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Distribution of Ratings/Investment Banking Services (IB) as of 07/02/18

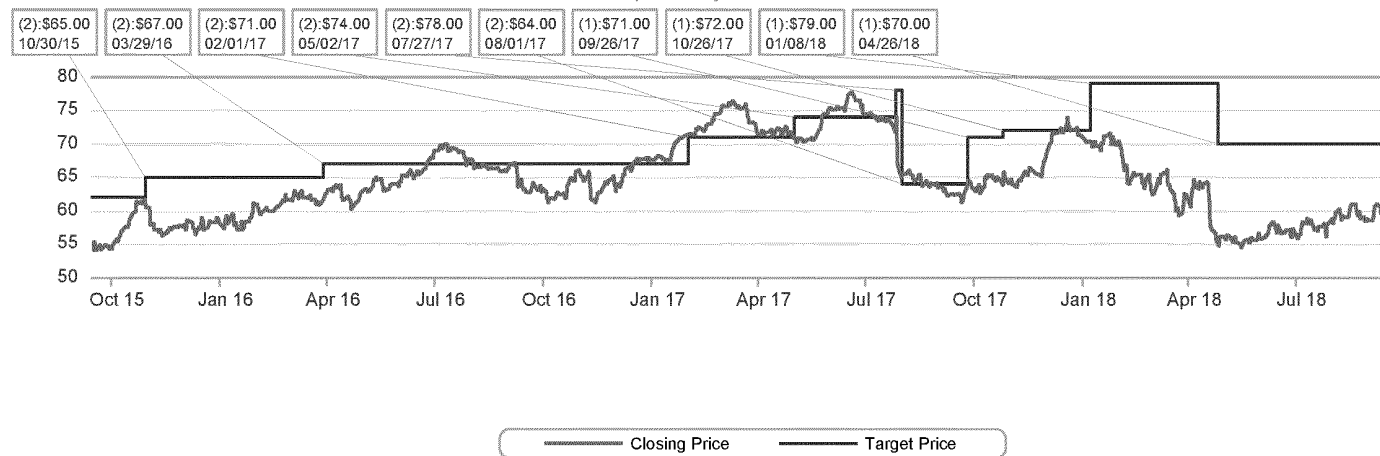
Rating	Count	Ratings Distribution	Count	IB Services/Past 12 Months
Buy (a)	476	63.55%	113	23.79%
Hold (b)	266	35.51%	18	6.74%
Sell (c)	7	0.93%	0	0.00%

(a) Corresponds to "Outperform" rated stocks as defined in Cowen and Company, LLC's equity research rating definitions. (b) Corresponds to "Market Perform" as defined in Cowen and Company, LLC's equity research ratings definitions. (c) Corresponds to "Underperform" as defined in Cowen and Company, LLC's equity research ratings definitions. Cowen and Company Equity Research Rating Distribution Table does not include any company for which the equity research rating is currently suspended or any debt security followed by Cowen Credit Research and Trading.

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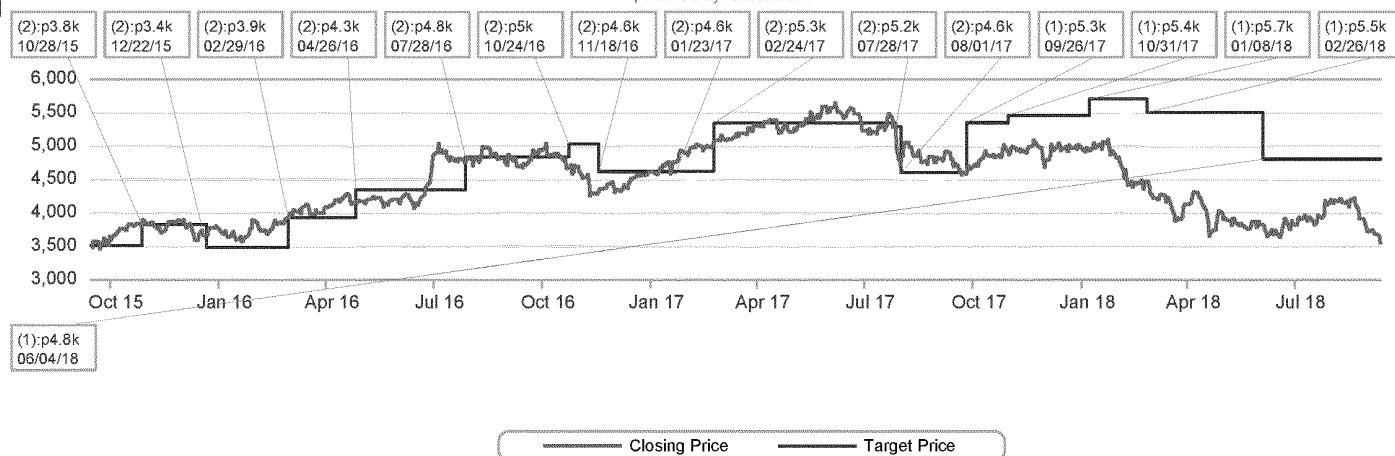
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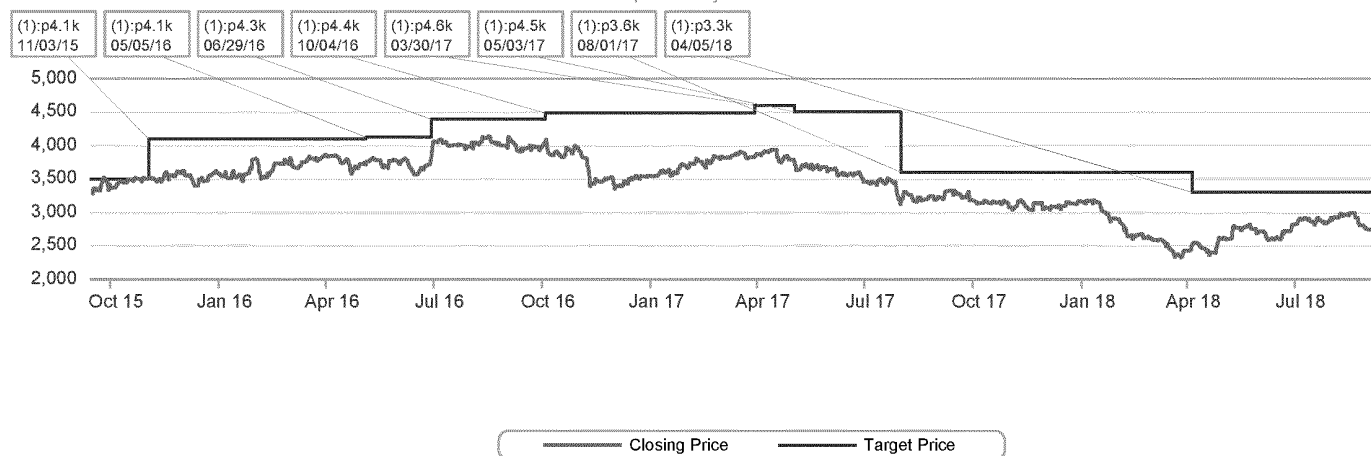
British American Tobacco p.l.c. Rating History as of 09/11/2018

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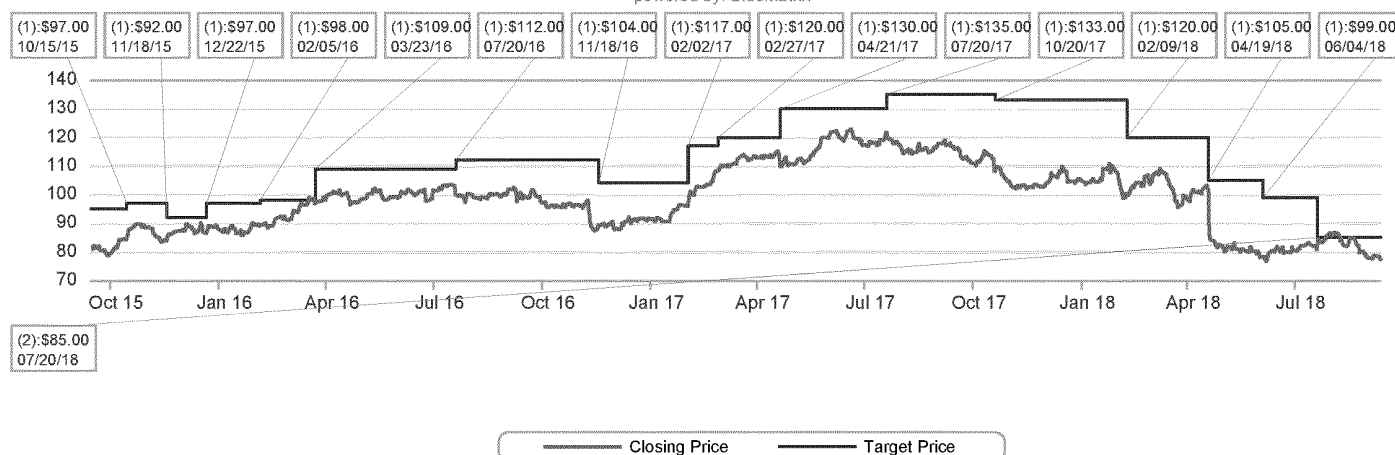
Imperial Brands Rating History as of 09/11/2018

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Philip Morris International Rating History as of 09/11/2018

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Legend for Price Chart:

I = Initiation | 1 = Outperform | 2 = Market Perform | 3 = Underperform | UR = Price Target Under Review | T = Terminated Coverage | \$xx = Price Target | NA = Not Available | S=Suspended

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