

## Tobacco

### Latest US Scanner Data Show Improving Trends for Cigarettes, JUUL

#### CONCLUSION

Tobacco companies continue to enjoy strong pricing power, barriers to entry, and a favorable position with the retail trade. Recent IRI data show improving cigarette sales in the US. While it is early in 2Q18, cigarette volumes for the 4 weeks ended May 6th are running ahead of our expectations. JUUL continues to lead US vapor, and its momentum continued in the period as well. Imperial remains focused on vapor, and its recent myblu launch helped grow its vapor sales 16% since January; its myblu Intense launch is in July.

- **Altria's cigarette sales improve sequentially.** Altria's total company measured retail sales increased 2.9% sequentially in the most recent 4 week period (through May 6th, vs. the 4 weeks ended April 8th). Its cigarette dollar sales increased 3.3% sequentially, and cigarette volumes increased 2% vs. the period ended April 8th. Compared to January, Altria's cigarette dollar sales are up 8.2% and volumes are up 6.5%. Year-over-year cigarette volume declines (down -4.5% in latest 4 weeks) also moderated from the prior 4 weeks' pace (down -6.2%), suggesting Altria cigarette sales trends are improving and are currently running ahead of our 2Q18 estimate for a -6.5% decline.
- **Core Mark commentary suggest improving cigarette sales.** Core Mark Holdings (CORE, not covered) is a large distributor to US convenience stores, and can offer helpful color on the retail environment for cigarettes. In its 1Q18 earnings call, Core Mark said that 1Q18 had overstated cigarette volume declines, partly from lapping the California tax increase, and will likely not be indicative of the full year. Core Mark said January experienced the steepest decline in cigarette carton sales, with each following month improving slightly, and it specifically called out Marlboro as having improved dramatically over the course of the quarter (excerpt from its call included inside note).
- **JUUL continues to grow over 20% sequentially.** JUUL measured retail sales grew 23% sequentially in the latest 4-week period, and it remains the clear leader in US vapor (chart inside). Its device unit sales grew 12% sequentially and pod sales rose 26%, consistent with recent trends, though device sales tend to fluctuate more. It is difficult to measure JUUL's share of total tobacco with much precision, but we estimate its share could now be greater than 3% of cigarettes plus the stick equivalents of its refill pods.
- **BAT grew sales, also had sequential cigarette improvement.** Reynolds American (BAT's US segment) had positive sales growth of 0.8% year-over-year in the most recent 4 weeks, although this is a deceleration from average growth of 4.5% over the past 3 years. Cigarette dollar sales improved 3.5% sequentially, while volumes increased 2%. Compared to January levels, RAI grew cigarette dollar sales 9.1% and volumes 7%, suggesting broad improvement across the US cigarette category during 1Q18.
- **Imperial's hopes for myblu likely rest on myblu Intense.** Total blu brand vapor sales increased 5% in the latest 4 weeks, and are up 16% since the February launch of myblu. Despite early success of myblu, which has earned \$6.8M in retail sales since launching, we believe its upcoming July launch of myblu Intense is likely the product to watch. myblu Intense uses nicotine salts, like JUUL, though consumer reception to taste and branding of myblu Intense remain wildcards.

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Related Companies:	Share Price:
BATS LN	38.27
IMB LN	27.46
MO	54.52
PM	79.93

Prices as of the close May 15, 2018

#### INDUSTRY RISKS

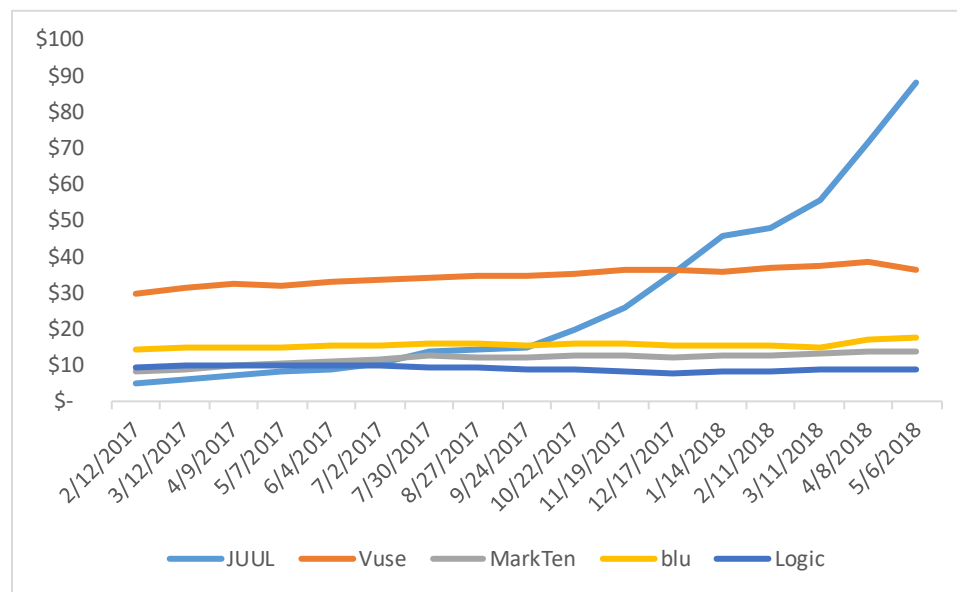
Unfavorable regulatory action, especially disruptive excise tax increases, growth in illicit trade, currency movements, and general macroeconomic erosion.

# **JUUL continues US vapor leadership**

JUUL is the leader in US vapor by a wide margin, with sequential monthly sales growth regularly over 20%. Imperial got a small lift from its myblu launch in February, but we expect it to have more optimism for its upcoming myblu Intense launch in July.

Exhibit 1

## **4-week retail sales in the US vapor market, Feb 2017 – May 2018**



Source: IRI, Piper Jaffray & Co

In the Core Mark 1Q18 earnings call, CEO Thomas Perkins gave the following commentary on cigarette volumes in the Q&A section:

“So just to kind of restate where we were year-to-date, we were at 4.9% decline and we saw same-store declines around 9%. But if you backed out the California impact, it was more like 7%. If you look at where we were at in April, our same-store declines were more like 3% so we see a pretty positive trend in same-store sales. And also if you look to things that are going on with Marlboro and other promotions, we’ve seen Marlboro I think, at one time, it was down 9% and has improved pretty dramatically from that as well. So I don’t know where it’s going to end up, but we think that the first quarter, especially since we’re lapping the California tax was probably overstated from where we look for the balance of the year to be.”

**Philip Morris  
International (PMI)**

We rate PM Overweight. Our target price of \$105 applies a ~18x multiple to our 2019E EPS of \$5.75. We expect PMI to deliver 9-10% three-year average organic sales growth and 11-12% average EPS growth. Risks: Unfavorable regulatory action, especially disruptive excise tax increases, a stronger US dollar and the growth of counterfeit products could pose a risk to upside to the shares.

**Altria Group, Inc.  
(MO)**

We rate MO Overweight. Our target price of \$75 is ~17x our 2019E EPS of \$4.39, above its current multiple on our 2018E EPS. We expect Altria to deliver 1-2% three-year average sales growth and 12-13% average EPS growth. Risks: Unfavorable regulatory action, disruptive excise tax increases, growth in counterfeit products, or unexpected competitor price cuts could negatively impact share price.

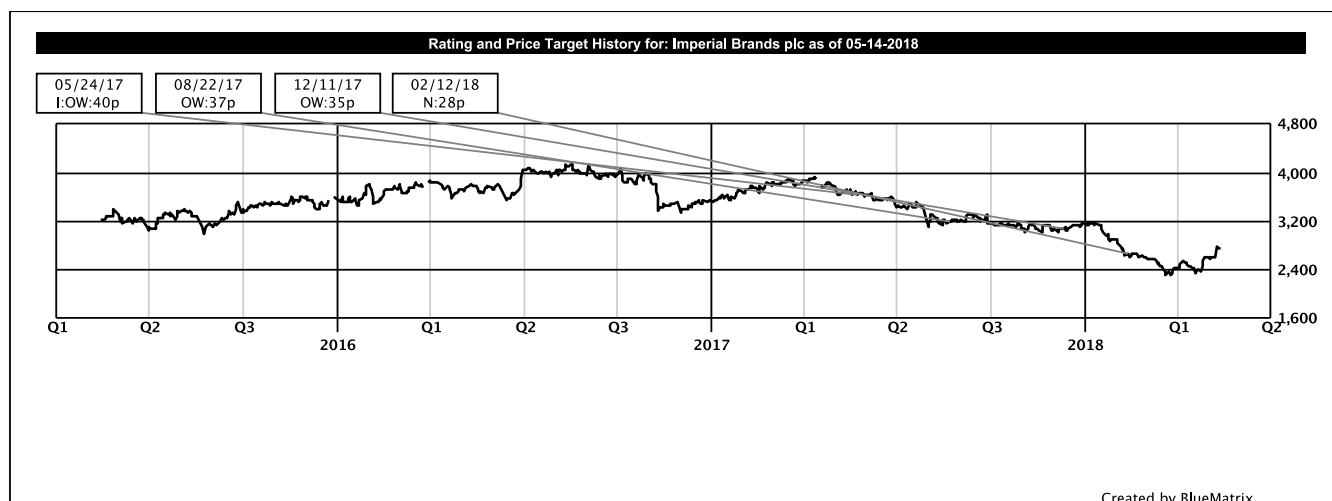
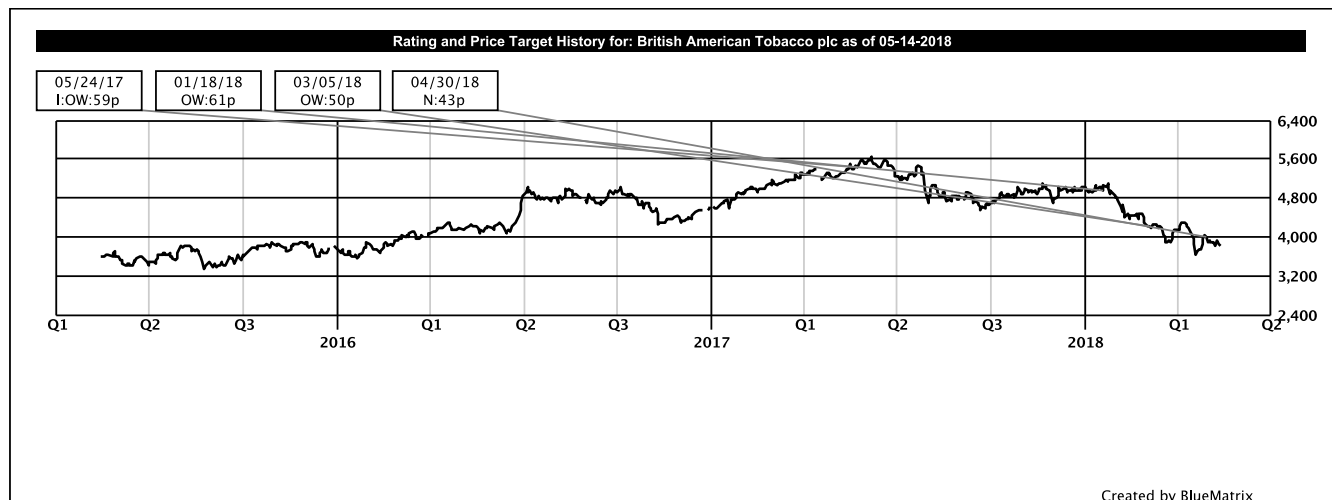
**Imperial Brands plc  
(IMB-LON)**

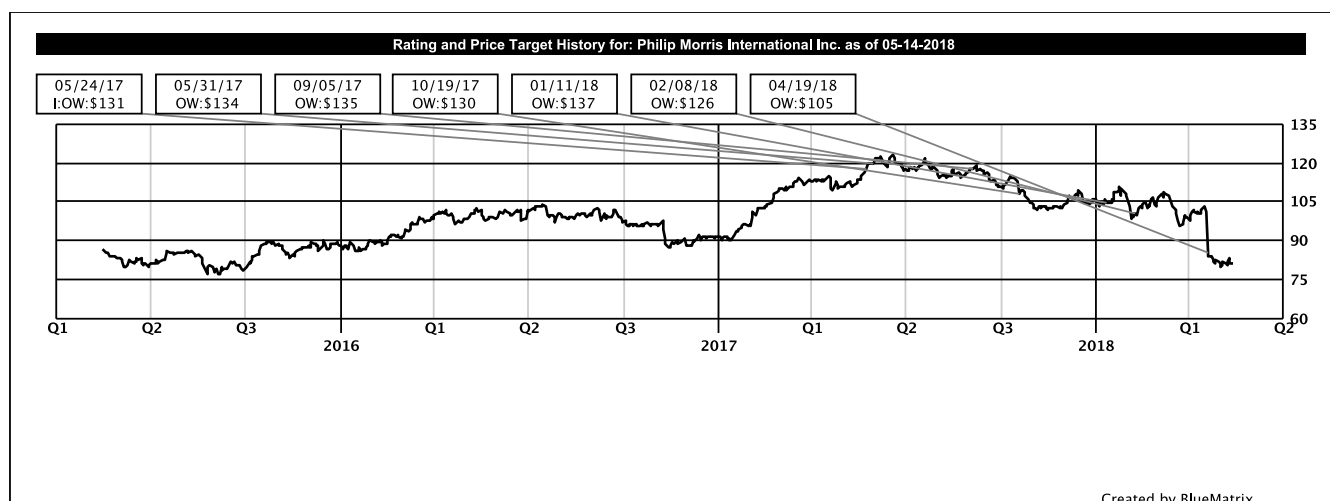
We rate IMB LN Neutral. Our target price of £28 is ~10.5x our CY2019E EPS of £2.68. We expect Imperial to average 0-1% organic sales growth (fiscal year) and 0-1% compound annual EPS growth (fiscal year) from 2018-20. Risks: Disruptive excise taxes, macro pressure, and currency moves may pose risk to profits.

**British American  
Tobacco (BATS-  
LON)**

We rate BATS LN Neutral. Our target price of £43 applies a ~14x multiple to our 2019E EPS of £3.09. We expect BATS to deliver 6-7% three-year average organic sales growth and 5-6% average EPS growth. Risks: Disruptive excise taxes, macro pressure, and currency moves may pose risks to profits.

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HOLD [N]	228	36.77	18	7.89
SELL [UW]	21	3.39	0	0.00

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**Analyst Certification — Michael S. Lavery, Sr. Research Analyst**

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