

## Tobacco

### Early Look at Category Volumes Without Vapor in Mass.; First Look at IQOS Sales

#### CONCLUSION

As recent vapor-related illness may be causing consumer confusion about the products, it remains unclear how vapor users may respond and how cigarette sales may be impacted. It may be too early to know how indicative it could be of future trends, but recent IRI data show a -7% sequential decline in 4-week e-cigarette sales (following an -11% sequential decline in the prior 4 weeks), while combustible cigarette volume declines remained unchanged at -7.5%. In Massachusetts, where a ban on all vapor (including tobacco flavored) took effect for the latest 4-week period, vapor sales fell -84% sequentially while cigarette declines moderated, but stayed negative, improving from -9.8% to -4.1%.

- **Still too early to know how much combustible sales may benefit from vapor shifting.** In the most recent four weeks (ending October 20), national e-cig category sales declined -7% sequentially (following a -11% sequential decline in the prior 4 weeks). JUUL had 65% market share, and its sales declined -9% sequentially (and down -15% sequentially in the prior 4 weeks). Sequential declines were presumably driven by some degree of consumer uncertainty around recent vapor related illnesses, as well as the vapor product ban in Massachusetts (detailed below). Even though black market and THC products appear to be the cause, all vapor products may have some clouds of uncertainty for consumers (and regulators) until definitive reasons are precisely clear. A potentially more significant vapor headwind could come if the FDA removes all flavored vapor products from the market (including menthol and mint) as it plans to do.
- **Despite sequential vapor declines, cigarette category volumes still fell -7.5%.** The -7.5% 4-week category volume decline was a modest sequential deceleration from its -7.8% fall in the prior 4 week period (through September 22). It is too early to know how any sustained shift in e-cigarette growth may impact combustible cigarettes, but we were surprised that cigarette volume trends did not yet show a more obvious benefit from sequential vapor declines. We will continue to monitor these trends as flavored e-cigs are cleared from the market. Regarding cigarette volume trends by company in the latest four weeks, Altria's declined -8.1%, BAT's declined -8.5% and Imperial's fell -7.7%.
- **In Massachusetts, vapor ban has clear early impact on cigarette volumes.** Massachusetts banned the sale of e-cigs on September 24th, 2 days after our latest 4 week period of IRI data began. In the most recent 4 weeks, JUUL's Massachusetts retail sales volumes fell -84% sequentially while cigarette category volumes there fell -4.1% y-o-y, an improvement vs. the -9.8% decline in the prior 4-weeks but still shy of positive growth. The vapor ban has only begun, but cigarette category volumes appear to be getting a lift from vapers switching to cigarettes, though not in enough numbers to send cigarette volumes positive. This improvement appears consistent with our analysis on the potential national impact of a flavor ban (see note [here](#)), where we estimate category volume declines could moderate by 2-3pp in the event of a flavored vapor ban. Massachusetts banned all vapor, including tobacco flavored, driving a bigger lift to cigarette volumes there than we modeled from a ban on just non-tobacco flavors.
- **Way-too-early look at US IQOS momentum: It's selling!** Marlboro HeatSticks for IQOS have just begun selling outside of the two mall-based IQOS stores in a handful of local stores. It has predictably small but rapidly growing sales, and we expect growth to continue to accelerate. We still believe the bulk of HeatStick sales are at the IQOS stores (a sleeve of 10 packs are promotionally priced with the device). Sales chart inside note.

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Related Companies:	Share Price:
BATS LN	27.16
IMB LN	17.59
MO	46.38

Prices as of the close October 29, 2019

#### INDUSTRY RISKS

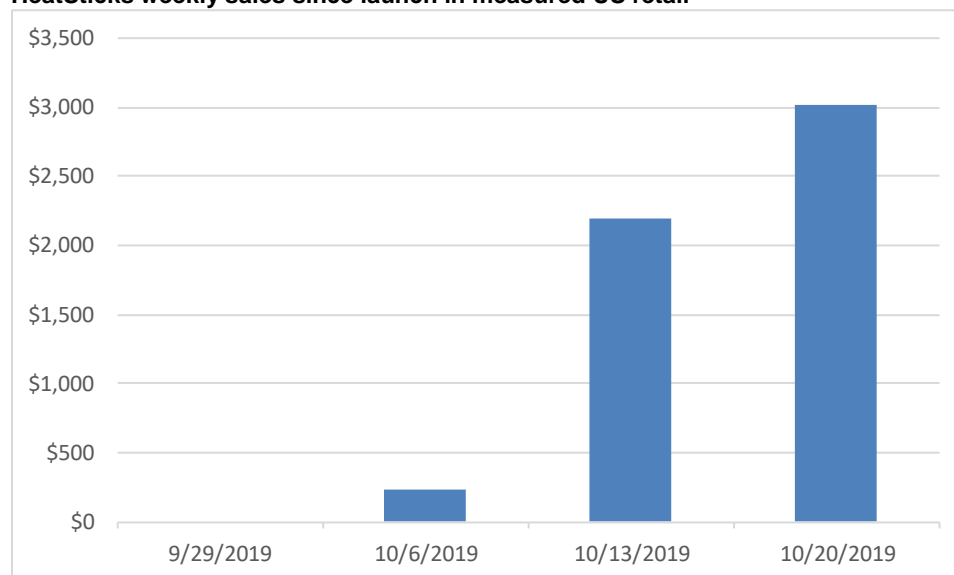
Unfavorable regulation, disruptive excise tax hikes, gains in illicit trade, and currency moves are risks to profits.

**HeatSticks now  
visible in retail data**

Marlboro HeatSticks are already appearing in measured US retail channels, though we believe devices are still only being sold in IQOS stores. In its first appearance in measured retail outlets, HeatSticks generated just over \$5,400 in measured retail sales in the first four weeks of its US launch (Exhibit 1). We will continue to monitor trends carefully as IQOS expands both within Atlanta and eventually beyond.

Exhibit 1

**HeatSticks weekly sales since launch in measured US retail**



Source: IRI, Piper Jaffray & Co

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

We rate MO Neutral. Our target price of \$49 is ~11.0x our 2020E EPS of \$4.49. Risks: Unfavorable regulatory action, disruptive excise tax increases, growth in counterfeit products, or unexpected competitor price cuts could negatively impact share price.

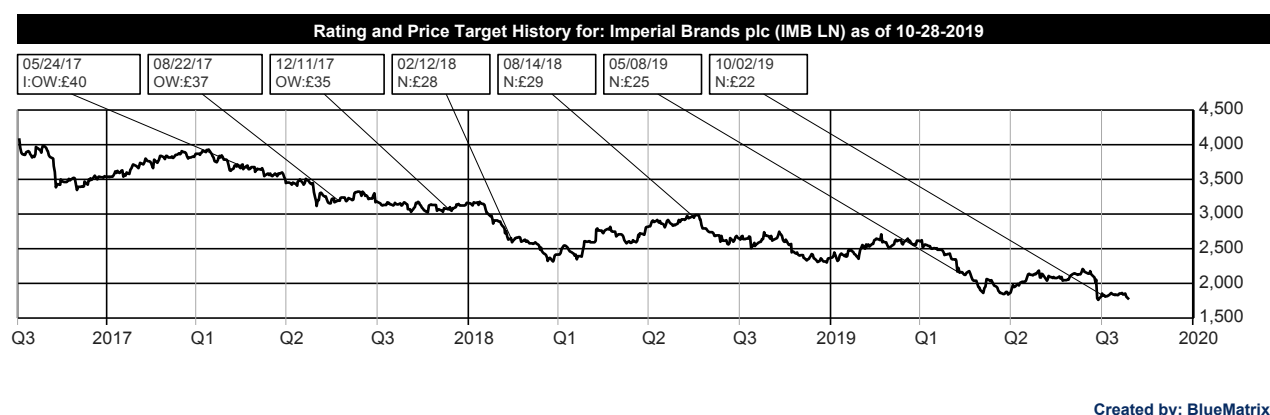
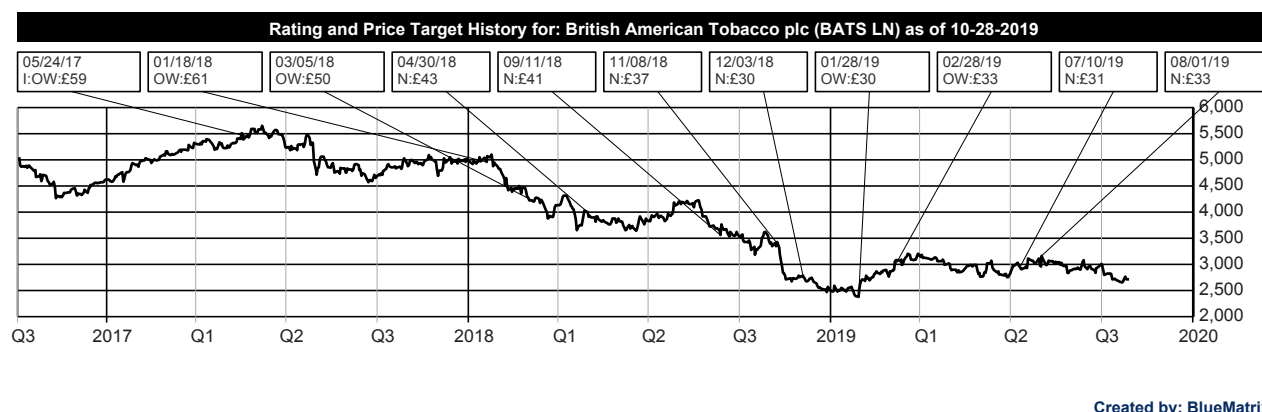
**Imperial Brands plc  
(IMB-LON)**

We rate IMB LN Neutral. Our target price of £22 is ~7.5x our CY2019E EPS of £2.93. 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 £33 applies a 9.0-9.5x multiple to our 2020E EPS of £3.50. Risks: Disruptive excise taxes, macro pressure, and currency moves may pose risks to profits.

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SELL [UW]	8	1.33	1	12.50

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

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