Illicit tobacco in Australia

2014 Half Year Report
13 October 2014
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### Glossary

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<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>ABS</td>
<td>Australian Bureau of Statistics</td>
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<tr>
<td>ACBPS</td>
<td>Australian Customs and Border Protection Service</td>
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<td>ACT</td>
<td>Australia Capital Territory</td>
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<td>AIHW</td>
<td>Australian Institute of Health and Welfare</td>
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<td>AIT</td>
<td>Anti Illicit Trade</td>
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<td>ATO</td>
<td>Australian Taxation Office</td>
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<tr>
<td>AWOTE</td>
<td>Average Weekly Ordinary Time Earnings</td>
</tr>
<tr>
<td>BATA</td>
<td>British American Tobacco Australia</td>
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<tr>
<td>CAGR</td>
<td>Compound Annual Growth Rate</td>
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<tr>
<td>CATI</td>
<td>Computer Aided Telephone Interview</td>
</tr>
<tr>
<td>CAWI</td>
<td>Computer Aided Web Interview</td>
</tr>
<tr>
<td>Contraband</td>
<td>Genuine manufactured cigarettes that are sold without the payment of applicable excise taxes in the market of consumption. Contraband cigarettes tend to have been made in a low-tax country and brought into the country of consumption illegally, or acquired without taxes (for export purposes) and illegally re-sold in the market of consumption. This includes genuine products which are brought into a country in amounts exceeding the personal allowance; in Australia this limit is 50 sticks or 50 grams of RYO per person</td>
</tr>
<tr>
<td>Counterfeit</td>
<td>Manufactured cigarettes which are illegally manufactured and carry the trademark and/or branding of a legally sold brand without the consent of the trademark owner. Counterfeit cigarettes are also known as fake cigarettes. For the purposes of this analysis, data relating to counterfeit is not included within the definition of contraband</td>
</tr>
<tr>
<td>CPI</td>
<td>Consumer Price Index</td>
</tr>
<tr>
<td>EOS</td>
<td>Exchange Of Sales data. Shipment data provided by the industry</td>
</tr>
<tr>
<td>EPS</td>
<td>Empty Pack Survey</td>
</tr>
<tr>
<td>FCTC</td>
<td>Framework Convention on Tobacco Control</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>H1</td>
<td>First half of the year i.e. the period from January to June</td>
</tr>
<tr>
<td>H2</td>
<td>Second half of the year i.e. the period from July to December</td>
</tr>
<tr>
<td>Illicit whites</td>
<td>‘Illicit whites’ is a term for brands of manufactured cigarettes that are not legally available in the local market. Whilst possibly legal at the point of manufacture, these brands are typically not sold legally anywhere, and are often made exclusively for smuggling</td>
</tr>
<tr>
<td>Inflows</td>
<td>Total volume of cigarettes coming into Australia</td>
</tr>
<tr>
<td>ITA</td>
<td>Imperial Tobacco Australia</td>
</tr>
<tr>
<td>kg</td>
<td>Kilogram</td>
</tr>
<tr>
<td>KPI</td>
<td>Key Performance Indicator</td>
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<tr>
<td>LDC</td>
<td>Legal Domestic Consumption</td>
</tr>
<tr>
<td>LDS</td>
<td>Legal Domestic Sales</td>
</tr>
<tr>
<td>LTM</td>
<td>Last Twelve Months</td>
</tr>
<tr>
<td>LTM H1</td>
<td>Last Twelve Months to the end of June (e.g. 1 July 2013 to 30 June 2014)</td>
</tr>
<tr>
<td>MSI</td>
<td>MSIntelligence</td>
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<tr>
<td>Term</td>
<td>Definition</td>
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<td>--------------</td>
<td>----------------------------------------------------------------------------------------------------------------------</td>
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<tr>
<td>ND(L)</td>
<td>Non-Domestic Legal is the legitimate tobacco purchased in duty free or abroad within personal allowance limits</td>
</tr>
<tr>
<td>Non-domestic cigarettes</td>
<td>Cigarettes which are not Australian (i.e. health warnings missing or not in English, brands not sold in Australia, packs with identifying marks from other markets such as tax stamps)</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Cooperation &amp; Development</td>
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<tr>
<td>PDI</td>
<td>Personal Disposable Income</td>
</tr>
<tr>
<td>PML</td>
<td>Philip Morris Limited</td>
</tr>
<tr>
<td>pp</td>
<td>Percentage point</td>
</tr>
<tr>
<td>Project SUN</td>
<td>A study of the illicit cigarette market in the European Union by KPMG</td>
</tr>
<tr>
<td>Outflows</td>
<td>Legitimate tobacco purchased in Australia and taken abroad</td>
</tr>
<tr>
<td>RMR</td>
<td>Roy Morgan Research</td>
</tr>
<tr>
<td>RSP</td>
<td>Retail Selling Price</td>
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<tr>
<td>RYO</td>
<td>Roll Your Own</td>
</tr>
<tr>
<td>TISG</td>
<td>Tobacco Industry Stakeholder Group. Formerly known as the Tobacco Industry Forum (TIF)</td>
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<tr>
<td>Tonnes</td>
<td>Thousand kilograms</td>
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<tr>
<td>WHO</td>
<td>World Health Organisation</td>
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<tr>
<td>Unbranded tobacco</td>
<td>Illegal loose leaf tobacco upon which no duty has been paid and which carries no labelling or health warnings. It is sold and consumed either in RYO form (called Chop Chop) or inserted into empty cigarette tubes. Commonly sold in both bags or boxes</td>
</tr>
<tr>
<td>YoY</td>
<td>Year on Year</td>
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1. Executive summary and key findings

1.1 Key messages
1.2 The purpose of this report
1.3 KPMG LLP’s anti-illicit tobacco experience
Illicit tobacco consumption increased as a percentage of overall consumption in LTM H1 2014

1.1 Key messages

Figure 1.1 Consumption of illicit tobacco products by category and as a percentage of overall consumption, 2007 – LTM H1 2014(1)(2)(3)(4)(a)(b)

Introduction

This is the third report published by KPMG LLP examining the size of the illicit tobacco market in Australia. In this report we have used the same methodology as in the previous two reports. The size of the illicit market is estimated using a consumer survey and an empty pack survey.

We have updated our reported figures based on new smoking prevalence data released by the Australian Institute of Health and Welfare (AIHW). These figures are published roughly every three years, last in 2010. Figure 1.1 illustrates our measures of illicit tobacco consumption as a percentage of overall consumption, based on both the 2010 and 2013 AIHW survey results. The estimate of smoking prevalence is a key input in our measurement of the unbranded loose tobacco market.

The AIHW produced new statistics for smoking prevalence in 2014. KPMG have therefore re-stated the results from 2011 to incorporate the changes in the health surveys, as shown in figure 1.1. This is the first report when this new data has become available. Therefore, as with previous reports, KPMG have re-stated past results to reflect these changes.

The percentage of illicit tobacco consumption in Australia

Figure 1.1 shows that from July 2013 to June 2014 (LTM H1 2014), the level of illicit tobacco consumption is estimated to have grown from 13.5% to 14.3% of total consumption, based on the new 2013 AIHW survey results.

If this tobacco had been consumed in the legitimate market, we estimate it would have represented an excise amount payable to Government of AUD1.2bn at the average excise rate for LTM H1 2014.

Note: (a) KPMG re-stated the illicit trade results in 2013 as a percentage of overall consumption, rather than as a percentage of legal domestic sales. For details on the re-statements, please refer to the H1 LTM 2013 Report appendices. (b) Results shown using both 2010 and 2013 AIHW surveys

Sources: (1) Deloitte, Illicit Trade of Tobacco in Australia, 2010, 2011, 2012 (2) Industry data (3) KPMG analysis (4) Euromonitor, Tobacco Consumption in Australia, July 2012
1.2 The purpose of this report

British American Tobacco Australia, Imperial Tobacco Australia Limited and Philip Morris Limited have commissioned KPMG LLP to conduct an independent report to estimate the size of the consumption of illicit tobacco in Australia. The purpose of this report is:

1. To provide an overview of the nature and dynamics of the legal and illicit tobacco markets in Australia, and

2. To provide an independent estimate of the size of the illicit tobacco market in Australia.

This report covers the twelve months (July 2013 to June 2014) up to the end of the first half of 2014 (H1 2014).

This H1 2014 report measuring the consumption of illicit tobacco in Australia is the first of two reports that will be published for 2014. KPMG has been appointed to produce bi-annual reports on the illicit trade for the industry in Australia.

1.3 KPMG LLP’s anti-illicit tobacco measurement experience

KPMG LLP has significant experience in the measurement of illicit tobacco consumption across a number of markets. As well as Australia, our work has covered markets in Europe, Latin America, Asia and the Middle East.

Our work was pioneered in Europe where we have published an annual report on illicit cigarette consumption since 2006. The report, which is currently commissioned jointly by British American Tobacco plc, Imperial Tobacco Limited, JT International SA and Philip Morris International Management (“Project SUN”). The study included all 28 European Union member states. The project has also been endorsed by the OECD task force for charting illicit trade, who consider it to be the “most authoritative assessment of the level of counterfeit and contraband cigarettes across EU Member States”.(1)
2. Australian tobacco market

2.1 Tobacco consumption in Australia
2.2 Legal tobacco market
Legal tobacco products

There are two main types of tobacco products considered in this report (cigars and pipe tobacco have been excluded for the purposes of this study):

Manufactured cigarettes – made for the legal tobacco market and sold in packets.

Loose tobacco – Legal loose leaf tobacco sold in pouches and used in Roll-Your-Own (RYO) cigarettes, which are consumed using rolling papers or tubes.

As shown in section 5.1, additional legal consumption is possible in the form of non-domestic legal product, that is tobacco purchased by consumers in other countries and imported into Australia, in person, legally for personal consumption.

Illicit tobacco consumption

Illicit tobacco is mainly brought into the country illegally from overseas markets without the payment of excise duties. This tobacco is sold to consumers at lower prices than Australian cigarettes, avoiding Australian tax obligations or is brought into the country in amounts exceeding the allowable personal limit. According to the Australian Crime Commission, organised crime groups perceived tobacco smuggling to be low-risk and highly profitable. Penalties for smuggling illicit tobacco have been increased, with potential for a jail term of up to ten years.\(^1\)

Counterfeit

These are manufactured cigarettes, often specifically manufactured overseas on a large scale. Once manufactured, they are smuggled into Australia most commonly via ports on large container freight and other channels including airmail. These products carry branding without the consent of the trademark owner to imitate popular legitimate tobacco product brands.

According to the Tobacco Industry Stakeholder Group (TISG)\(^6\) they do not adhere to industry production standards, they may pose additional serious health risks and are also known as fake cigarettes.\(^2\)

Contraband

These are mainly genuine cigarettes that are manufactured legally outside of Australia compliant with local regulations and smuggled into the Australian market. This also includes cigarettes which are purchased legally outside Australia but exceed the personal import allowance and have no duty paid.

Contraband cigarettes are legitimately manufactured by the trademark owner but avoid Australian government regulations, quarantine inspections and local product controls.\(^2\)

Illicit whites, as discussed in section 6, are also a constituent part of contraband. 'Illicit whites' is a term for brands of manufactured cigarettes that are not legally available in the local market, though they could be legal at the point of manufacture. These brands are often made exclusively for smuggling.

Unbranded tobacco

Unbranded tobacco is sold as finely cut loose leaf tobacco in half kilogram or one kilogram amounts. TISG indicates that it may be grown illicitly without a licence in Australia but is most commonly smuggled from overseas countries.

This product carries no labelling or health warnings and is consumed in RYO form or inserted into empty cigarette tubes which are available from legitimate tobacco retailers, often sold in the original cigarette tube boxes. The product is then sold loose in bags or pre-rolled tubes (called Chop Chop).\(^2\)

The Australian Crime Commission believes that the majority of unbranded tobacco is imported rather than grown in Australia. It is distributed by retailers in the same way as counterfeit and contraband products.\(^1\)
2.2 Legal tobacco market
2.2.1 Historic legal domestic sales

Australian tobacco market
Legal domestic sales volumes stabilised in 2012 but has resumed its long term decline in LTM H1 2014

Legal domestic sales in Australia, 2007 – LTM H1 2014(1)(2)

<table>
<thead>
<tr>
<th>Year</th>
<th>Legal Domestic Sales Volumes (kg millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>17.6</td>
</tr>
<tr>
<td>2008</td>
<td>17.5</td>
</tr>
<tr>
<td>2009</td>
<td>17.6</td>
</tr>
<tr>
<td>2010</td>
<td>16.4</td>
</tr>
<tr>
<td>2011</td>
<td>15.7</td>
</tr>
<tr>
<td>2012</td>
<td>15.3</td>
</tr>
<tr>
<td>LTM H1 2013</td>
<td>15.1</td>
</tr>
<tr>
<td>Full Year</td>
<td>15.2</td>
</tr>
<tr>
<td>LTM H1 2014</td>
<td>15.0</td>
</tr>
</tbody>
</table>


- Manufactured cigarettes -3.1% -1.8% -4.3%
- Loose tobacco 2.9% 4.3% 3.5%
- Total market -2.4% -1.0% -3.3%

Overall sales of legal domestic tobacco declined by 1.0% between H1 2013 and H1 2014: a lower decrease compared to an annual fall of 2.4% between 2007 and H1 2014.

Between H1 2013 and H1 2014 legal domestic sales declined by 1.0% with sales declining more rapidly in the second half of this period, however sales of loose tobacco continued to grow. These results are supported by industry volume figures reflecting a small decrease in sales by manufacturers into the tobacco trade.(3)(4)

Between FY 2013 and H1 2014 (the last six months), legal domestic sales appear to have resumed their long-term decline.

Whilst manufactured cigarette volumes have declined at an annual rate of 3.1% since 2007, loose tobacco volumes have increased at an annual rate of 2.9% over the same period, representing a shift in the mix of tobacco products consumed.

Legal domestic sales numbers for 2013 were based on an analysis of exchange of sales data and Euromonitor data as discussed on page 59. For subsequent reports, KPMG has examined a range of data sources, including exchange of sales and offtake data from each manufacturer, supplied by independent research agencies.

Sources:
(1) Euromonitor, Legal domestic sales, accessed August 2014
(2) KPMG analysis of data from Nielsen Australia and Aztec databases
(3) Reuters, Australia tobacco sales edge up despite plain packaging, www.reuters.com/article/2014/03/24/tobacco-data-idUSL2N0MI1D720140324
(4) Industry shipment data explained on page 59
2.2.2 Australia legal tobacco competitive overview

Market share by manufacturer, 2014

- **Manufactured cigarettes**
  - Imperial Tobacco: 26%
  - British American Tobacco: 40%
  - Philip Morris International: 34%
  
- **Loose tobacco**
  - Imperial Tobacco: 61%
  - British American Tobacco: 34%
  - Others: 5%

**Total market:**
- **Manufactured cigarettes:** 13.2 million kilograms
- **Loose tobacco:** 1.9 million kilograms

Market share

The three major tobacco manufacturers have large shares across both the manufactured cigarette and loose tobacco market. British American Tobacco has a market share of 40% in manufactured cigarettes. Imperial Tobacco’s market share increased from 20% to 26% between 2013 and 2014.

Market share of manufactured cigarettes by price category, 2007 – LTM H1 2014

<table>
<thead>
<tr>
<th>Year</th>
<th>Low</th>
<th>Medium</th>
<th>High</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>24%</td>
<td>25%</td>
<td>58%</td>
</tr>
<tr>
<td>2008</td>
<td>26%</td>
<td>30%</td>
<td>55%</td>
</tr>
<tr>
<td>2009</td>
<td>28%</td>
<td>30%</td>
<td>56%</td>
</tr>
<tr>
<td>2010</td>
<td>30%</td>
<td>30%</td>
<td>55%</td>
</tr>
<tr>
<td>2011</td>
<td>33%</td>
<td>30%</td>
<td>53%</td>
</tr>
<tr>
<td>2012</td>
<td>38%</td>
<td>30%</td>
<td>51%</td>
</tr>
<tr>
<td>2013</td>
<td>42%</td>
<td>30%</td>
<td>47%</td>
</tr>
<tr>
<td>LTM H1 2014</td>
<td>43%</td>
<td>30%</td>
<td>47%</td>
</tr>
</tbody>
</table>

Price category

Cigarettes are subject to a specific excise duty which is levied per cigarette and does not change with the retail price. An increase in the specific excise duty would, all other things being equal, maintain the price differential between low and high priced cigarettes.

Since 2007 there has been an increase in the market share of low priced categories at the expense of medium and more marginally high priced cigarettes as people are switching to cheaper cigarettes. This trend appears to have developed further in 2013 as the low price segment increased by 5pp. between 2012 and 2013, the biggest increase since 2007.
2.2.3 Supply and distribution of legal manufactured tobacco in Australia

Supply chain for legal tobacco products in Australia

Tobacco supply chain and sales channels
All manufactured tobacco products are imported into Australia as tobacco leaf or finished products. No tobacco is legally grown in Australia for any purpose. However, the majority of PML and BATA products are currently manufactured in Australia, whilst all of ITA’s products are imported. Some of the products manufactured in Australia are exported to other countries in the region.

Non-domestic legal consumption channel
A small amount of tobacco is imported into Australia by consumers for their own personal consumption. Since 1 September 2012, consumers have a limit of 50 cigarettes or 50g of loose tobacco (down from 250 of each) which can be brought into Australia without paying excise duty. This volume can be brought in from the country of origin or through duty free sales channels. This category may also include purchases by some consumers who order tobacco products available in other countries through the internet and have it delivered in the mail. Given this low allowance, there is significant evidence to suggest that non-domestic legal is a small proportion of consumption. Non-domestic legal consumption is discussed further in the appendix A7.
3. Macroeconomic environment

3.1 Macroeconomic context
3.2 Gross domestic product growth
3.3 Unemployment
3.4 Personal Disposable Income
3.5 Consumer Price Index
Macroeconomic environment

The Australian economy achieved steady growth over the last five years, with low unemployment rates compared with other OECD countries.

3.1 Macroeconomic context

This section provides background on the Australian economy as a change in GDP growth, unemployment, personal disposable income or inflation could impact consumer behavior and subsequently tobacco consumption.

The decline in legal domestic sales since 2009 needs to be examined in the context of the affordability of tobacco products. Personal disposable income (PDI) and the consumer price index (CPI) are analysed in order to assess possible reasons for changes in consumer behavior.

3.2 Gross domestic product growth

Australia has been one of the few members of the OECD to have experienced continuous economic growth since the 1990s. The global financial crisis caused a slow-down in growth as opposed to a recession.

Between 2007 and 2013 the economy grew at a compound annual growth-rate (CAGR) of 2.5%. The growth-rate in June 2014 of 3.0% was higher than the OECD average for the fourth year in a row.

Year-on-year GDP Growth, 2007 – 2014\(^{(1)}\)\(^{(2)(a)}\)

3.3 Unemployment

Unemployment in Australia is one of the lowest of all OECD countries. Unemployment increased in 2009 but remained broadly stable until 2012, when it started to increase.

Unemployment in June 2014 was 6.0%, a slight increase from the 5.7% recorded in June 2013.\(^{(5)}\)

Recorded unemployment, 2007 – 2014\(^{(3)}\)\(^{(4)}\)

Note: \(\text{a} \) Historical numbers for GDP have been updated and have been based on data from the Economist Intelligence Unit

Sources:  
(1) The Economist Intelligence Unit, GDP at constant prices, accessed July 2014  
(2) OECD, GDP (expenditure approach), accessed July 2014  
(3) The Economist Intelligence Unit, recorded unemployment as a percentage of total labour force, accessed July 2014  
(4) OECD, harmonized unemployment rates, accessed July 2014  
(5) Australia Bureau of Statistics
3.4 Personal disposable income

Australia has been through a period of consistently increasing Personal Disposable Income (PDI) during the past decade. PDI per capita increased by 4.7% p.a. between 2007 and 2014.

Despite the global financial crisis, income levels in Australia do not appear to be considerably impacted with growth in PDI being supported by an increase in hours worked (by part-time workers) and increased hourly wages. (2)

3.5 Consumer price index

Australia’s Consumer Price Index has developed at the same pace as the OECD average, growing consistently since 2007. However, forecasts suggest that inflation will be higher than the OECD average in 2014.

The Economist Intelligence Unit forecast that annual inflation will average 2.8% in 2013-17 is subject to both upside and downside risk. (5)(6) Interest-rate rises may relieve some inflationary pressure, but a revival in the housing market could cause inflation to accelerate.

Sources: (1) Euromonitor, Annual disposable income per capita, accessed July 2014
(2) Productivity Commission media release, Trends in the distribution of income in Australia, March 2013
(3) Euromonitor, Index of consumer prices; accessed March 2014
(4) OECD Economics, Consumer prices, accessed February 2014, rebased to 2007
(5) Economist Intelligence Unit, Consumer prices, accessed July 2014
4. Regulation and taxation

4.1 Tobacco regulation in Australia
4.2 Future proposed legislation
4.3 Recent development of excise duty and tobacco affordability in Australia
4.4 Regional tobacco prices
4.1 Tobacco regulation in Australia

In this section we discuss key government legislation and activities undertaken to control tobacco consumption. The advertisement of tobacco products by broadcast and publication is regulated by the Tobacco Advertising Prohibition Act 1992 (Cth). State and Territory legislation complements and supplements the Federal legislation by prescribing and proscribing activity dealing directly with the retail sale and display of tobacco products. The combined effect of the Federal, State and Territory legislation is that all manner of tobacco product advertisement and promotion to the public is strictly and rigidly controlled. The Department of Health and Ageing’s National Tobacco Strategy aims to reduce smoking prevalence nationally from over 15% in 2012 to 10% in 2018. To reduce smoking prevalence, numerous tobacco control regulations have been developed over time as demonstrated in Figure 4.1. A more detailed overview of recent legislative changes both at the Australian Commonwealth level and the state level are detailed in the appendix.

National Tobacco Strategy

The National Tobacco Strategy 2012-18 was released in January 2013. The strategy highlights nine priority areas including;

1. Protect public health policy, including tobacco control policies, from tobacco industry interference

Figure 4.1: Tobacco regulation timeline in Australia, 1992 – 2014

Key:
- National: Tobacco Advertising Prohibition Act (ban on broadcasting and printing of tobacco adverts)
- Northern Territory: Ban on smoking in public places indoors
- National: Government obtains Voluntary Agreement with manufacturers to disclose ingredients in cigarettes
- National: Australia signs WHO Framework Convention on Tobacco Control (FCTC)
- State laws: Ban on display of tobacco products in stores in South Australia and Tasmania
- Laws in ACT, TAS, VIC and WA: Ban on smoking in public places indoors
- National: 12.5% excise increases on tobacco every year for 4 years – first increase of 12.5% implemented December 2013
- VIC: Ban on smoking in public places extended to train stations, platforms and shelters; smoking banned where children play
- QLD: Ban on smoking in public places: Smoke Free Environment Act
- NSW: Ban on smoking in public places: Smoke Free Environment Act
- National: WHO FCTC comes into force as an international treaty
- National: Limit of 50 cigarettes or 50g of tobacco to be brought into country
- State laws: Ban on display of tobacco products in stores in ACT. Others came later.
- National: Plain Packaging came into force for retailers on 1 December 2012
- National: 25% increase in excise in public places: Smoke Free Environment Act
- National: Tradex Practices Regulations 2006 introduced 14 graphics, health warnings and messages that covered 30% of the front and 90% of the back face of cigarette packets
- National: Trade Practices Regulations 2008 mandate reduced fire risk (RFR) standards for cigarettes
- National: Regulation 1.5 of the Competition and Consumer (Tobacco) Information Standard 2011 introduced new packaging regulations
- National: Indexation of excise and excise equivalent customs duties changed to AWOTE from CPI from 1 March 2014
- National: Second 12.5% increase due in September 2014
- Queensland: Ban on smoking in public places: Smoke Free Environment Act
- Northern Territory: Ban on smoking in public places
- ACT, TAS, VIC: Ban on smoking in public places indoors
- National: Change in taxation laws from excise charged on weight to excise charged on the number of cigarettes
- National: 12.5% excise increases on tobacco every year for 4 years – first increase of 12.5% implemented December 2013
- VIC: Ban on smoking in public places extended to train stations, platforms and shelters; smoking banned where children play
- QLD: Ban on smoking in public places: Smoke Free Environment Act
- NSW: Ban on smoking in public places: Smoke Free Environment Act
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- National: Indexation of excise and excise equivalent customs duties changed to AWOTE from CPI from 1 March 2014
- National: Second 12.5% increase due in September 2014
4.1 Tobacco regulation in Australia (continued)

**Tobacco products regulation**

Tobacco products are regulated through, amongst other things, bans on advertising and packaging restrictions. The Tobacco Advertising Prohibition Act in 1992 banned the publication or broadcast of tobacco advertisements.

Subsequent amendments to the Act have resulted in online tobacco retailers having to display health warnings and comply with restrictions on advertisement wording. Brand and variant information is permitted to be displayed.

The Tobacco Plain Packaging Act, passed in 2011, made Australia the first country in the world to implement plain packaging of tobacco products. This means that all tobacco products are required to be displayed in the same standard colour packaging with all trademarks banned and the only differentiator being the name of the brand and variant, printed in Lucida Sans font.

**Smoke-free environment legislation**

The majority of smoke-free environmental laws in Australia are determined by State parliaments and further fragmented by local council by-laws. The Australian Federal Government passed legislation to create smoke-free environments in areas within its own jurisdiction, such as airports, whilst State parliaments historically created their own laws banning smoking in some public places.

State parliaments followed the Australian Commonwealth by passing legislation which banned smoking in restaurants in the early 2000s. (1)

The establishment of the WHO Framework Convention on Tobacco Control (FCTC) resulted in the creation of guidelines surrounding smoke-free environments which some State Parliaments adopted. In 2005 and 2006 the States passed laws which created smoke-free environments in public places including licensed premises, partially covered outdoor spaces and al fresco dining areas. States have continued to establish further smoke-free environments, including the banning of smoking on beaches, playgrounds and at stadia or other sporting events and concerts. (2)

Individual States in Australia have also passed laws which restrict smoking in cars with children under the age of 17. (3)

In November 2013, the Tobacco Amendment Act was assented by both houses of Victorian Parliament and will come into effect when proclaimed on 1 October 2014 at latest. This bill aims to extend smoking bans to a range of areas especially where children are present. (3) From 1 March 2014, train stations, tram shelters and platforms and bus shelters in Victoria have been made smoke-free. (4) From 1 April 2014, smoking was banned where children play; including within 10 meters of playgrounds and skate parks, sporting venues during under 18s events and within public swimming pool grounds in Victoria. (4) In September 2014, the Premier of Victoria also announced plans to ban smoking outside hospitals and other Government buildings. (5)

**Retailer regulations**

Australian States and Territories ban the sale of tobacco products to anyone under the age of 18. During the 1990s, States introduced laws which imposed harsher penalties on vendors that sold cigarettes to individuals under 18 years. Some States have also undertaken surveillance programmes to ensure compliance. In order to further regulate retailers, some States have required vendors to hold licenses to sell tobacco. With the exception of Victoria and Queensland, all other States and Territories require tobacco retailers to hold a licence. In the States and Territories that do require a tobacco licence, fees range from AU$200-AU$302.22 per annum. In New South Wales, retailers must inform the Department of Health that they will sell tobacco products. This enables the State to have additional control over tobacco retailers, as it can threaten to withhold licenses in the event of sales to minors. (2)

States and Territories have also banned retailers from point of sale advertising and the display of tobacco products within stores. New South Wales, Australia Capital Territory (ACT), the Northern Territory, Queensland and Tasmania all have legislation in place banning point of sale displays. South Australia, Victoria and Western Australia have similar legislation; however, there are exemptions in place for specialist outlets. South Australia has an exemption until December 2014. Victorian specialist outlets who were granted exemption prior to 1 April 2014 will be able to continue displaying products, however following this date no new specialist licenses will be issued. (4)

Some States and Territories have also applied restrictions on the number and operation of vending machines in licensed premises and gambling establishments. (2) In the ACT, cigarette vending machines have been banned entirely.

The Victorian government recently announced its intent to quadruple fines for retailers caught with illicit tobacco. (5)

Sources:
1. Tobacco Control Laws, Campaign for tobacco free kids, August 2013
6. Premier of Victoria, New Victorian smoking bans another step closer, September 2014

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4.1 Tobacco regulation in Australia (continued)

Duty free and customs allowances

The Treasurer announced as part of the 2012-13 Commonwealth Budget that the inbound traveller allowance from international travel would be reduced from 250g/250 sticks of tobacco per person to 50g/50 sticks.\(^{(4)}\)

In 2012 the Federal Government passed the Customs Amendment Act which conveyed new offences for smuggling or possessing illicit tobacco. It was the first time that custodial sentences were recommended for smuggling tobacco.\(^{(4)}\) Victoria has legislation which criminalises the possession of illicit tobacco or tobacco on which the appropriate excise duties have not been paid.\(^{(1)}\)

Excise duty increases

Australian excise duty has risen with inflation with the exception of a one-off 25% increase in 2010. The 2013-14 federal budget included a change to indexation of excise duty for tobacco and tobacco products from the Consumer Price Index (CPI) to Average Weekly Ordinary Time Earnings (AWOTE). AWOTE has historically grown 1.5 percentage points faster than CPI, therefore the indexation is likely to increase excise duty faster than the old indexation legislation.

In August 2013, the Federal Government announced excise duty increases in tobacco products of an additional 12.5% annually for the next four years in addition to the switch to AWOTE.\(^{(3)}\) The first of these increases was implemented on 1 December 2013, with further 12.5% increases to be applied on 1 September 2014, 1 September 2015 and 1 September 2016.\(^{(4)}\) As a result of these tax increases the excise on a pack of cigarettes in Australia will increase by 60% (compounded over four years) above the increase of AWOTE.

Framework Convention on Tobacco Control (FCTC)\(^{(4)}\)

Australia became a Signatory to the World Health Organization’s (WHO) Framework Convention on Tobacco Control (FCTC) on 5 December 2003. The Conference of Parties (COP) has adopted detailed guidelines for effective implementation of many of the broad range of legislative, executive, administrative and other measures required under the Convention. Together, the FCTC and its guidelines have the potential to help set the priorities of Australian governments, including Commonwealth, State and Territory, in relation to tobacco control policies and programmes.

4.2 Future proposed legislation

The FCTC also provides a framework for international cooperation in a number of areas of tobacco control in which Australia and other Parties cannot effectively act alone. These include the regulation of cross-border tobacco advertising, promotion and sponsorship and the implementation of measures to address illicit trade in tobacco products.

Australia has the responsibility to cooperate with other FCTC Parties to address trans-boundary tobacco control problems and to assist other Parties in meeting common challenges to effective tobacco control.

The Australian tobacco industry participated in a consultation around the Anti-Illicit Trade Protocol (AITP). The AITP was adopted on 12 November 2012 and opened for signature from 10 January 2013 to 9 January 2014. When the AITP was closed for signature, it had been signed by 53 countries and the European Union. However, Australia is not among the countries that have signed the AITP.\(^{(6)}\) AITP will only be legally binding once it has been formally ratified by 40 countries.

Continuous pursuit of smoke-free environments

State governments have continued to focus on the banning of smoking in public outdoor areas. Where states have not banned smoking in outdoor public areas, many local councils have issued the relevant bans and often play a key role in expanding public smoking restrictions. States continue to ban smoking or implement buffer zones at public events and any areas where children may be present such as open air concerts, playgrounds, sporting events and skate parks.\(^{(4)}\) Additionally, a number of states are also considering to impose smoking bans in prisons, with Northern Territory being the first to implement a smoking ban in prisons from 1 July 2013.\(^{(7)}\) Queensland also banned smoking in prisons in May 2014\(^{(8)}\), while Victoria announced a similar ban starting in July 2015.\(^{(9)}\)

Note:

(a) Customs duty is at the excise equivalent rate

Sources:

3. Department of Health, Victoria
5. Australian Customs and Border Protection Service

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Regulation and taxation

Excise rates have increased steadily in addition to two large excise increases in April 2010 and December 2013, with three more to be implemented annually through to September 2016.

4.3 Recent development of excise duty and tobacco affordability in Australia

Values of tobacco excise and customs duty, Australia, January 2007 – May 2014

The largest excise increase was a 25% increase introduced on April 30, 2010. In November 2013, the Government confirmed four increases in excise of 12.5% to be levied in December 2013, then September 2014, 2015 and 2016.

This increase is over and above the annual indexation linked to Average Weekly Ordinary Time Earnings (AWOTE). This has resulted in the excise on tobacco products increasing by 14.6% between July 2013 and June 2014.

Index of tobacco prices and per capita PDI, Australia, 2007 – 2013

Although PDI per capita has continued to grow, the excise rate increase in 2010, combined with subsequent increases, saw tobacco prices increase at a higher rate than PDI per capita.

This has resulted in a decline in relative affordability. This decline in relative affordability is likely to continue with the future planned excise rate increases.

Notes:
(a) Indexed with 2007 values taken as 100
(b) The historical numbers have been updated as Euromonitor has changed the Index of tobacco prices and personal disposable income
(c) Australian Government – Australian Taxation Office, New legislation: Excise and excise-equivalent customs duty - index tobacco excise to average weekly ordinary time earnings, 25 June 2013
(d) Euromonitor, Index of tobacco prices, accessed August 2014
(e) Euromonitor, Annual disposable income, accessed July 2014

Sources:
(3) Euromonitor, Annual disposable income, accessed July 2014
Regulation and taxation

The AWOTE has grown on average 1.5 percentage points faster than the CPI

Comparison between AWOTE and CPI, 2007-LTM H1 2014(1)(2)(a)(b)

The 2013-14 Federal Budget included a change to indexation of excise duty for tobacco and tobacco products from the Consumer Price Index (CPI) to Average Weekly Ordinary Time Earnings (AWOTE) commencing from 1 March 2014.

Although CPI has continued to grow, AWOTE has increased at a higher rate since 2009. If the AWOTE continues to grow at the same rate, the change in indexation is likely to lead to higher price increases.

Notes:
(a) Indexed with 2007 values taken as 100
(b) The historical numbers have been updated as Euromonitor has changed the Index of tobacco prices

Sources:
(1) Euromonitor, Index of tobacco prices, May 2014
(2) Australian Bureau of Statistics
Regulation and taxation

Australia has the highest cigarette prices within the Asia Pacific region

4.4 Regional tobacco prices

Price of a pack of 20 Marlboro cigarettes – Australia and selected markets, 2014(1)(2)(a)

Key:
- AUD12.00 or more
- AUD8.00 to AUD11.99
- AUD3.00 to AUD7.99
- Less than AUD2.99

Australia and New Zealand have significantly higher cigarette prices than surrounding markets in South East Asia, with Australian prices more than 50% higher than those of the nearest non-Australasian market.

This large price differential between Australia and other relatively nearby markets creates smuggling opportunities for those involved in the illicit market.

Notes:
(a) Prices for a 20 cigarette pack of Marlboro (taxes included); where Marlboro is not available, a comparable premium brand has been used
(b) As Marlboro is not legally sold in Myanmar, the price of a comparable premium local brand, Red Ruby, has been used in this report
(c) Prices for Fiji, Vanuatu, Papua New Guinea, Samoa, Tonga, Bangladesh and Myanmar are as of December 2013, while all others are as of July 2014

Sources:
(1) Industry data
(2) www.oanda.com

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Regulation and taxation
The price differential between legal products and illicit products widened further in 2014

4.5 Relative price of illicit tobacco

Price differential of illicit products to a packet of Winfield 25s, 2010 – H1 2014\(^{(1)(a)}\)

<table>
<thead>
<tr>
<th>Product Type</th>
<th>Jan-10</th>
<th>Jun-13</th>
<th>Jun-14</th>
</tr>
</thead>
<tbody>
<tr>
<td>Counterfeit</td>
<td>8.00</td>
<td>8.90</td>
<td>9.34</td>
</tr>
<tr>
<td>Contraband</td>
<td>3.83</td>
<td>7.94</td>
<td>12.00</td>
</tr>
<tr>
<td>Chop Chop Tubes</td>
<td>6.20</td>
<td>13.40</td>
<td>14.43</td>
</tr>
<tr>
<td>Chop Chop Loose</td>
<td>8.23</td>
<td>8.90</td>
<td>13.40</td>
</tr>
</tbody>
</table>

Data provided by BATA based upon covert purchases made across Australia highlights the price difference of illicit products compared to legitimate products. While this data will be impacted by the split of random versus intelligence led purchases, the data will provide some insights into the size and change in the market.

Between 2010 and 2014, the largest relative increases developed in counterfeit and contraband products where the price differential appears to have widened. For example, prices of counterfeit Winfield rose from AUD 10.92 to AUD 12.50, whilst prices of genuine Winfield rose from AUD 12.45 to AUD 21.40. This resulted in the price differential between counterfeit and genuine Winston rising from AUD 1.53 to AUD 8.90.

The industry has also highlighted that whilst prices of genuine Winfield increased by 72%, prices of contraband in particular have increased by 45% since January 2010, which has likely fuelled bigger margins for smugglers and illegal retailers.

Note: (a) Contraband and counterfeit prices are an average of price for products found in Sydney and Melbourne. Unbranded prices have been converted to a pack of 25 cigarette equivalents.

Source: (1) BATA intelligence data
5. Size of the illicit tobacco market

5.1 Estimating the illicit tobacco market

5.2 Illicit tobacco consumption in Australia
5.1 Estimating the illicit tobacco market

Methodology and validation

As discussed in section 2.1 KPMG divides the illicit tobacco market into unbranded tobacco and illicit manufactured cigarettes in the form of counterfeit and contraband. These categories taken together form total illicit consumption. It is therefore important to take account of all consumption flows when assessing the amount of illicit tobacco consumed.

The chart below illustrates how KPMG breaks consumption into a number of categories (defined in section 2.1) and how each category requires different data sources to estimate the size of the market and to validate the findings.

For each of these categories a separate primary approach is used in order to estimate the volume of illicit tobacco. For unbranded tobacco a consumption model approach is used, based on results from a consumer survey. This includes Chop Chop (unbranded loose tobacco sold in bags) and unbranded tobacco sold in pre-filled tubes. For illicit manufactured cigarettes an empty pack survey analysis is used, based on the collection of discarded cigarette packs across Australia.

We believe this approach provides a robust estimate of the size of the illicit market in Australia. However, to further increase the level of confidence in this estimate, some alternative approaches are used to validate the illicit tobacco volumes generated by the consumption model and the empty pack survey analysis.

The validations can be used as alternative estimations, or to support trends and changes noted in the market. In this section each of the approaches are described before the process of estimation and validation is explained. A detailed overview of these approaches can be found in appendix A1.

<table>
<thead>
<tr>
<th>Data sources</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Tobacco Industry database (Nielsen, Aztec)</td>
<td>RMR consumer survey</td>
</tr>
<tr>
<td>Euromonitor</td>
<td>Tourism statistics</td>
</tr>
<tr>
<td>Datamonitor</td>
<td></td>
</tr>
<tr>
<td>Exchange of Sales</td>
<td>RMR consumer survey</td>
</tr>
<tr>
<td></td>
<td>Empty pack survey</td>
</tr>
<tr>
<td></td>
<td>Rolling papers sales data</td>
</tr>
<tr>
<td></td>
<td>Internal company intelligence data</td>
</tr>
<tr>
<td></td>
<td>Customs’ seizure data</td>
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<tr>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Note: (a) Definitions for the above sales categories can be found in the glossary on page 2</td>
</tr>
<tr>
<td></td>
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<tr>
<td></td>
<td></td>
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<td></td>
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</tr>
</tbody>
</table>
5.1 Estimating the illicit tobacco market (continued)

Primary approaches

Consumption model

This approach is based on the responses of consumers to the survey conducted by Roy Morgan Research in H2 2013 and H1 2014. The survey is commissioned by BATA, ITA and PML. The survey asks consumers about their consumption of both legal and illicit tobacco. These survey responses are then combined with other data sources to arrive at an estimate for total illicit tobacco consumption. Consumers are asked about both unbranded tobacco and illicit manufactured cigarettes.

For the purpose of this report, the consumption model number for unbranded volumes in LTM H1 2014 is based on the average of the H2 2013 and the H1 2014 consumer survey results. Since consumers are likely to give a more accurate estimate of their purchase behaviour over a shorter time period rather than the last twelve months, using an average of both surveys provides a more robust number for 2013. Detailed results of the consumer survey are discussed in section 6.

Empty pack survey (EPS)

An empty pack survey is a study undertaken independently by MSIntelligence which collect 12,000 discarded cigarette packs per wave across 16 different towns and cities in Australia. The brand and country of origin of each collected pack is assessed to determine whether it is a domestic or non-domestic product, and genuine or a counterfeit product. Products from different countries of origin are labelled as non-domestic. KPMG used the empty pack results to extrapolate overall consumption in the market. The percentages of non-domestic and counterfeit packs are applied to the volume of legal domestic sales in order to establish the total consumption of manufactured cigarettes in Australia.

The empty pack survey approach provides a robust and statistically significant estimate of the size of the illicit manufactured cigarette market. The results are not subject to respondent behaviour and are therefore less prone to sampling errors, whilst the 16 cities covered by the sample plan covers the equivalent of over 75% of Australia’s population.

A small proportion of non-domestic cigarettes are likely to have been brought into Australia legally by Australians travelling overseas or by tourists arriving in Australia. Travel statistics from the Australian Bureau of Statistics are reviewed in order to determine the likely volume.

An analysis of the amount of non-domestic legal brought into Australia by these two groups can be found in Appendix A7.

These non-domestic legal cigarettes are removed from the total non-domestic volume, which leaves the total illicit manufactured cigarette market, split into contraband and counterfeit cigarettes as described in section 2. The empty pack survey is conducted every six months.

Since 2012, empty pack surveys have been jointly commissioned by BATA, ITA and PML in 2012. Before H1 2013, the study was carried out by ACNielsen. Prior surveys were also run in 2009 and 2010 by ACNielsen on behalf of PML, and these have been made available to KPMG for use in this report.

For the purpose of this update report a new empty pack survey has been conducted in Q2 2014. The results from this survey have been used in conjunction with the empty pack survey results from Q4 2013 to arrive at an estimate for the illicit manufactured cigarette consumption for the year 2013. This method is consistent with the approach used by KPMG in Project SUN to assess the level of counterfeit and contraband cigarettes across the EU Member States. It is a widely accepted method for measuring the illicit market.
5.1 Estimating the illicit tobacco market (continued)

Means of validation

Rolling papers analysis

This analysis has been developed by KPMG and has been used with other clients to infer the volume of loose tobacco smoked from the quantum of papers sold. It compares sales of rolling papers provided by ITA with the legal sales of loose tobacco to estimate a consumption gap between legal and illicit.

In order to use this approach several assumptions are made:

1. Grams per rolled cigarette
2. Wastage rate of rolling papers
3. Rolling papers used for consumption of illegal drugs

Data obtained in consumer surveys carried out by the industry and sales figures from rolling papers manufacturers are used in order to verify these assumptions, along with data from the National Drug and Alcohol Centre.

We have found from previous analyses that given the number of assumptions in this approach it is useful for providing a range of estimates for the market size to help validate other estimates.

Seizures data

Seizures data obtained from the ACBPS shows the volume and type of tobacco intercepted at ports and airports.\(^1\) Using seizure data to size the illicit market is often unreliable since it is difficult to ascertain the proportion of total illicit product that is seized. In addition, seizure data used to intercept tobacco products coming into Australia will not pick up loose tobacco which may have been illegally grown in Australia.

Whilst seizure data is unlikely to generate an accurate estimate for the illicit tobacco market, it can be used to indicate trends and validate any considerable changes to the illicit market. For example, an increase in manufactured cigarette flows from a country picked up in the empty pack survey could be validated with a corresponding increase in seizures from that country or in manufactured cigarettes representing a growing percentage of seizures. We also use internal tobacco company intelligence data as a validation of trends. However, since this data is commercially sensitive we are unable to publish it.

Source: (1) Australian Customs and Border Protection Service, Annual Report 2013, October 2013
The empty pack survey and consumption model approaches are thought to be the most robust for estimating the illicit tobacco market. Figure 5.1 shows the process by which the consumption model and empty pack survey analysis is validated through alternative analysis.

1. Primary approaches

A Unbranded tobacco: The consumption model uses data from the Roy Morgan Research consumer survey, external data sources such as the Australian Institute of Health and Welfare and the Australian Bureau of Statistics to determine the results. We consider it to be the best way of sizing the unbranded tobacco market.

B Manufactured cigarettes: The empty pack survey is the most reliable measure of contraband and counterfeit. It also forms the foundation for Project SUN.

Total illicit tobacco (A+B): The total illicit tobacco market size estimate is calculated by adding the results of the validated empty pack survey analysis for manufactured cigarettes (i.e. contraband and counterfeit) with the output of the validated consumption model for unbranded tobacco. The results are presented in kilograms to show total consumption of both loose tobacco and manufactured cigarettes.

2. Validation

Rolling papers analysis is used in order to validate the unbranded tobacco market. Whilst assumptions relating to grams per tobacco, rolling paper leaf wastage and cannabis usage are hard to verify, rolling papers analysis is helpful to determine the likely ratio between consumption of loose tobacco and illicit loose (unbranded) tobacco.

The consumption model has historically been used in order to estimate the illicit volume of manufactured cigarettes. As such it provides a good approach by which to validate the empty pack survey results.

3. Additional validation

Total illicit tobacco consumption (i.e. unbranded tobacco and manufactured cigarettes together) can be validated further by seizures data.

Seizures data can be used in order to validate the likely mix of illicit tobacco consumption. If the consumption model and empty pack survey show a large change in the mix of illicit products, seizures data should support this change.

Using this validation process enables us to understand and corroborate any significant changes to illicit tobacco consumption.

Ongoing data source monitoring

We take a forward looking approach to ensuring the most appropriate data is used in the modelling process. For example, many surveys of smoking prevalence are conducted at irregular intervals whereas the actual decline is smooth over time between these periods. To avoid major future restatements that distort trends we continuously monitor the relevance of data sources and may rebase some data based on historic and forecast trends.

To ensure comparability with our ongoing methodology we have applied these changes retrospectively. See appendix A1 for details.
Illicit tobacco consumption in Australia

5.2 Illicit tobacco consumption in Australia

Consumption of tobacco products by category, 2007 – LTM H1 2014\(^{(1)(2)(a)(b)(c)}\)

<table>
<thead>
<tr>
<th>Tobacco product</th>
<th>CAGR (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>All illicit product</td>
<td>10.1%</td>
</tr>
<tr>
<td>Counterfeit</td>
<td>N/A +24.9%</td>
</tr>
<tr>
<td>Contraband</td>
<td>N/A -1.8%</td>
</tr>
<tr>
<td>Unbranded</td>
<td>-6.0% +27.7%</td>
</tr>
<tr>
<td>Non-domestic (legal)</td>
<td>-4.3% +115.1%</td>
</tr>
<tr>
<td>Legal domestic sales</td>
<td>-2.4% -1.0%</td>
</tr>
<tr>
<td>Total consumption</td>
<td>-1.4% +0.5%</td>
</tr>
</tbody>
</table>

The overall level of tobacco consumption in Australia was estimated at 17.5 million kilograms in H1 2014, of which 2.5 million kilograms were estimated to be illicit. The estimate of total consumption was marginally higher than H1 2013 but represents a decrease from FY 2013 of 1.6%.

The H1 2014 consumption volumes continued to show the high volumes of illicit manufactured cigarettes, first identified in H1 2013. However, since H1 2013 there was an increase in unbranded consumption.

Counterfeit consumption declined in H1 2014 compared with FY 2013, however, its share in total illicit consumption continued to be relatively small and contraband consumption remained the largest component of illicit manufactured cigarette consumption.

Illicit tobacco consumption as a proportion of total consumption, 2007 – LTM H1 2014\(^{(1)(2)(3)(4)}\)

The estimated level of illicit manufactured cigarette consumption in H1 2014 was 8.3% of total consumption, which is once again the highest level recorded. These results are presented based on the adjustments made to incorporate the 2013 AIHW survey results, discussed in Appendix A1.

Notes:
(a) H1 2014 represented consumption for the twelve months to end June 2014
(b) Counterfeit and contraband estimations are unavailable for 2007
(c) Non-domestic legal volumes are smaller than 0.1 million kg and volume labels have not been included for this category

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Size of the illicit tobacco market
The shift in mix towards manufactured cigarettes is supported by the consumption model. The validation process provides a high degree of confidence around the results

5.2 Illicit tobacco consumption in Australia (continued)

Table 5.2 Results of primary methodologies, H1 2013 – H1 2014

<table>
<thead>
<tr>
<th>H1 2013 and H1 2014 results (tonnes)</th>
<th>H1 2013</th>
<th>H1 2014</th>
<th>% change (H1 2013 - H1 2014)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Illicit manufactured cigarettes</td>
<td>Contraband</td>
<td>1,348</td>
<td>1,323</td>
</tr>
<tr>
<td></td>
<td>Counterfeit</td>
<td>85</td>
<td>106</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>1,433</td>
<td>1,429</td>
</tr>
<tr>
<td>2. Unbranded tobacco</td>
<td>834</td>
<td>1,066</td>
<td>27.7%</td>
</tr>
<tr>
<td>3. Total illicit tobacco</td>
<td>2,267</td>
<td>2,495</td>
<td>10.1%</td>
</tr>
</tbody>
</table>

1. Illicit manufactured cigarettes

Based on the empty pack survey analysis undertaken by KPMG, our LTM H1 2014 estimation of the illicit manufactured cigarettes market is 1,323 tonnes for contraband and 106 tonnes for counterfeit. This represents a decline of 1.8% for contraband and increase of 24.9% for counterfeit; a total decrease of 0.2%.

2. Unbranded tobacco

The consumption model indicates that the volume of unbranded tobacco consumed increased by 27.7% between H1 2013 and H1 2014, from 0.83 million kilograms to 1.07 million kilograms. This illicit volume is supported by the rolling papers analysis.

Our rolling papers analysis estimates that the unbranded tobacco market is likely to be between 0.8 million kilograms and 1.5 million kilograms. The 1.07 million kilograms sits comfortably within the mid point of this range. The small growth of rolling paper sales also supports an increase in unbranded between LTM H1 2012 and LTM H1 2013. See appendix A3 for more detail.

Volume of illicit unbranded tobacco generated by the rolling papers analysis, 2012- H1 2014

Sources: (1) Euromonitor, Legal domestic sales, July 2014
(2) KPMG analysis
3. Overall illicit tobacco consumption

The estimated movement in the unbranded tobacco and manufactured cigarette consumption between H1 2013 and H1 2014 is an overall increase of 10.1% with illicit tobacco consumption rising to 2,495 tonnes. This increase was characterised by a change in the mix of illicit tobacco consumed towards manufactured cigarettes, as stated in previous reports. In 2013 manufactured cigarettes accounted for nearly 60% of total illicit consumption. The results are further validated by seizures data.

Seizures data demonstrates a rise in the proportion of manufactured cigarettes as a percentage of illicit tobacco intercepted between 2010 and 2013. In 2010 18% of the volume of seizures came from manufactured cigarettes, whilst in 2013, 52% of tobacco seizures were manufactured cigarettes. The ACBPS publishes its results in October, therefore the recent increase in unbranded consumption may not be reflected in seizures results at the time of publication.

The volume increase of manufactured cigarettes seized between 2009 and 2013 also supports a significant increase in the size of the illicit manufactured cigarette market. Whilst it is hard to make direct correlations between seizures and the volume of illicit tobacco, it acts as collateral in support of the EPS which has shown significant increases in non-domestic incidence over the same time period.

There are many variables which may impact the overall volume of tobacco seized. These include the amount of activity taking place at ports, the number of customs officials on duty and changes to tobacco smuggling activities which may alter the amount detected. As a result, the overall volume of seizures is not used in order to corroborate likely volumes of illicit tobacco, however the larger seizures described in 2013 and 2014 may indicate increased criminal activity. Therefore, seizures data does provide useful evidence to promote some of the trends identified in illicit tobacco within this report.

Seizures activity in Victoria

Over the past 12 months the Government of Victoria had some successes in uncovering and preventing the distribution of large volumes of illicit tobacco. In 2012 Taskforce Trident was set-up as a joint agency taskforce to better police port activity in Melbourne. The agencies involved include Victoria Police, Australian Federal Police, Australian Customs and Border Protection Service and Australian Crime Commission.(2)

In October 2013, the Trident Taskforce (a joint agency made up of a number of agencies including the Victoria Police, Australian Federal Police, Australian Customs and Border Protection Service and Australian Crime Commission) seized 80 million cigarettes and 70 tonnes of loose tobacco. The tobacco was found in containers hidden amongst food. The shipments were thought to have come from the United Arab Emirates and Indonesia. In conjunction with this seizure, four arrests were made. The excise value of this seizure was estimated at AUD67 million.(2)

In March 2014, the Victoria Police seized 35,000 tobacco plants being grown illegally in Moorabool, approximately 40km from Melbourne. The seizure also uncovered other illegal substances and resulted in 27 arrests.(3)

In May 2014 the Australian Taxation Office, assisted by Australian Federal Police uncovered the largest ever seizure of illegal locally grown tobacco. The haul included approximately 350,000 mature tobacco plants worth an estimated excise value of AUD15 million.(4)
6. Drivers of results

6.1 Consumer survey results
6.2 Empty pack results
6.1 Consumer survey overview

6.1.1 Roy Morgan Research survey overview

- The consumer survey is primary research carried out to establish the size of the illicit tobacco market in Australia. The survey, commissioned by BATA, ITA and PML, was again carried out by Roy Morgan Research to ensure comparability with previous years.

- The survey made use of Computer Assisted Web-based Interviewing (CAWI). This enabled a sample of 2,104 adult respondents to be collected from 6,372 who responded to the email link sent out to Roy Morgan Research’s panel of respondents between 23rd May and 7th June 2014.

Figure 5.1.1 Roy Morgan Research survey attrition chart

- 231,493 received an e-mail invitation to complete the survey
- 6,372 clicked the e-mailed survey link
- 5,271 qualified to take part
- 3,217 were qualified smokers
- 2,104 completed the survey

- If a respondent was a regular smoker and fell into the appropriate demographic to be surveyed, they were considered eligible for the survey.\(^{(a)}\)
- Of those who proved to be eligible for the survey, 65% completed the survey.

Founded in 1941, Roy Morgan Research (RMR) is an established Australian market research company. RMR have significant experience working with consumer surveys monitoring legal and illicit tobacco consumption and have provided the consumer research for all of the previous versions of this report.

Note: (a) For the purposes of this report, a regular smoker is a person who smokes tobacco products on at least five days in a given week.
Drivers of results

Whilst the proportion of smokers who purchased unbranded tobacco remained stable, the overall volume purchased increased driven by frequency of purchases

6.1.2 Purchasers of illicit tobacco

The H1 2014 Roy Morgan Research consumer survey saw a similar proportion of respondents purchasing unbranded tobacco compared to H1 2013. However, average frequency of purchase increased from 10 to 14. Despite a decline of the average amount purchased, the average annual volume per consumer grew from 1.96kg to 2.5kg, an increase of 28%.

The combination of these movements, along with a small decline in the proportion of respondents who purchased illicit tobacco, explains why the unbranded volume grew from 0.96m kilograms to 1.07m kilograms.

Note: (a) 2012, 2013 and 2014 analysis is based on CAWI consumer survey results
Sources: (1) Deloitte, Illicit Trade of Tobacco in Australia, 2012
(2) Roy Morgan Research, Consumer survey, H1 2013, H2 2013 and H1 2014
6.2 Empty pack survey results

6.2.1 Australian empty pack survey sampling plan

Empty pack surveys analyse discarded cigarette packets which have been collected from a set area. The aim is to collect a representative sample of discarded cigarette packets which can then be analysed to provide information about the nature of consumption of manufactured tobacco products.

Empty packs are collected on a proportionate basis from several neighbourhoods. Packs are collected from streets and easy access public bins in areas on the sampling plan.

For the purpose of this report, an empty pack survey was carried out by an independent market research agency; MSIntelligence (MSI) across May – June 2014. This Q2 2014 EPS collection was based on a sampling plan consistent with the Q2 2013 and Q4 2013 EPS sampling plan: 12,000 packs were collected, the same neighborhoods were sampled and the same 16 cities were covered. This covered approximately 75% of the total population as shown in Figure 6.2.1.

Packs are collected from pre-determined neighbourhoods, selected to be representative of the city being sampled. Similarly, the neighbourhoods selected are also consistent with the previous surveys. Packs are collected irrespective of their brand and country of origin. Residences, offices and other locations such as stadiums have been excluded from the sampling plan.

After the collection is completed, to ensure the representativeness of the sample, packs are weighted based on the proportion of each city’s population.

Figure 6.2.1 Q4 2013 empty pack survey sampling plan

<table>
<thead>
<tr>
<th>City</th>
<th>Population (million)</th>
<th>Sample packs</th>
<th>Weighted packs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sydney</td>
<td>4.7</td>
<td>3,000</td>
<td>3,253</td>
</tr>
<tr>
<td>Melbourne</td>
<td>4.2</td>
<td>2,500</td>
<td>2,959</td>
</tr>
<tr>
<td>Brisbane</td>
<td>2.2</td>
<td>1,200</td>
<td>1,526</td>
</tr>
<tr>
<td>Perth</td>
<td>1.9</td>
<td>1,000</td>
<td>1,322</td>
</tr>
<tr>
<td>Adelaide</td>
<td>1.3</td>
<td>800</td>
<td>890</td>
</tr>
<tr>
<td>Goldcoast – Tweed Heads</td>
<td>0.6</td>
<td>400</td>
<td>412</td>
</tr>
<tr>
<td>Newcastle</td>
<td>0.4</td>
<td>400</td>
<td>292</td>
</tr>
<tr>
<td>Canberra - Queanbeyan</td>
<td>0.4</td>
<td>300</td>
<td>287</td>
</tr>
<tr>
<td>Wollongong</td>
<td>0.3</td>
<td>300</td>
<td>197</td>
</tr>
<tr>
<td>Sunshine coast</td>
<td>0.3</td>
<td>300</td>
<td>199</td>
</tr>
<tr>
<td>Hobart</td>
<td>0.2</td>
<td>300</td>
<td>151</td>
</tr>
<tr>
<td>Geelong</td>
<td>0.2</td>
<td>300</td>
<td>125</td>
</tr>
<tr>
<td>Townsville</td>
<td>0.2</td>
<td>300</td>
<td>120</td>
</tr>
<tr>
<td>Cairns</td>
<td>0.1</td>
<td>300</td>
<td>98</td>
</tr>
<tr>
<td>Darwin</td>
<td>0.1</td>
<td>300</td>
<td>92</td>
</tr>
<tr>
<td>Toowoomba</td>
<td>0.1</td>
<td>300</td>
<td>77</td>
</tr>
<tr>
<td><strong>Total sample</strong></td>
<td><strong>17.2</strong></td>
<td><strong>12,000</strong></td>
<td><strong>12,000</strong></td>
</tr>
<tr>
<td><strong>Total population of Australia</strong></td>
<td><strong>22.9</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note:
(a) Population numbers are based on the Australian Census, 2011
Sources:
(1) MSIntelligence Research, Empty pack survey, Q2 2013, Q4 2013 and Q2 2014
(2) Australian Bureau of Statistics

Founded in 2001, MSI is a private company with headquarters in Geneva, Switzerland specialising in market research. MSI have particular experience in the tobacco industry and have conducted over 850 empty pack surveys in more than 70 countries.
Drivers of results
The growth of non-domestic cigarette consumption was driven by significant increases in Melbourne and Perth.

6.2.2 Australian empty pack survey results – non-domestic incidence by city

The Q2 2014 survey found non-domestic packs in 15 out of 16 cities, with packs present in all cities in the Q2 2013 survey. Townsville was the only city to have no non-domestic packs identified in Q2 2014. Whilst the overall non-domestic percentage increased, Darwin, Cairns, Hobart and Townsville experienced significant declines of over seven percentage points.

The highest increases in the percentage of non-domestic packs identified came in Melbourne and Perth. Sydney had the highest level of non-domestic incidence and accounted for 38% of the total non-domestic sticks found in Australia.

Source: (1) MSIntelligence Research, Empty pack survey, Q2 2013, Q2 2014
Drivers of results
Non-domestic incidence of manufactured cigarettes remained stable, although volumes of illicit whites were replaced by legitimate brands

6.2.3 Australian empty pack survey results – non-domestic incidence by brand

Total non-domestic incidence by brand as a percentage of total manufactured cigarette consumption
Q4 2009 – Q2 2014

A blended empty pack survey approach, assigning equal weighting to the Q4 2013 and Q2 2014 empty pack surveys, has been used to size the illicit manufactured cigarette consumption volume for the year LTM Q2 2014. As highlighted earlier, using the blended method is consistent with the approach used by KPMG in Project SUN to assess the level of counterfeit and contraband cigarettes across the EU Member States. A blended approach gives a more accurate view on the full year findings as each quarterly empty pack survey is reflective of market trends at that point in time only.

The empty pack survey indicates that there was a growth in non-domestic incidence from 9.7% in Q4 2013 to 10.3% in Q2 2014. When both survey results are combined it gives a total non-domestic incidence of 10.0%, a small increase of 0.3 pp from the figures reported in LTM 2013 of 9.7%.

Whilst the overall non-domestic incidence remained stable, a higher volume of legitimate brands were identified compared with illicit whites.

‘Illicit whites’ is a term for brands of manufactured cigarettes that are not legally available in the local market, although they could be legal at the point of manufacture. While they may be exported legally from some countries, they are smuggled across borders during their transit to their final destination market where they have limited or no legal distribution and are sold without payment of tax. Illicit white brands are not counterfeit products as they do not infringe on intellectual property rights. Illicit white volumes form part of the contraband volumes in Australia. Please refer to section 6.2.7 for further details.

The share of illicit whites declined in Q2 2014 to 0.3% of manufactured cigarettes consumption, resulting in much lower volume in LTM 2014 compared to LTM 2013. As a result, the majority of contraband in H1 LTM 2014 comprised of Marlboro and Dunhill, along with a wide range of brands owned by China National, JT International and KT&G.

Note: (a) KPMG is using a new list of illicit white brands resulting in new reporting compared to previous reports
(b) The LTM 2014 figures are based on the blended result of the Q2 2014 and the Q4 2013 empty pack surveys using the weighted number of cigarettes

Sources:
(1) MSIntelligence Research, Empty pack survey, Q2 2013, Q4 2013 and Q2 2014
Drivers of Results
The volume of unspecified non-domestic packs collected declined in Q2 2014; however, packs from South Korea continued to grow.

6.2.4 Australian empty pack survey results – country of origin

Total non-domestic incidence by country of origin as a percentage of total manufactured cigarette consumption
Q4 2009 – LTM H1 2014(1)(2)(a)(b)

Duty free volumes represent all duty free variant packs collected. South Korean duty free continues to be the largest category, accounting for 43% of duty free volumes. This resulted in over a third of non-domestic cigarettes coming from South Korea.

Asian countries were the primary source for inflow of non-domestic manufactured products into Australia, with high levels of duty free products also present. South Korea (including South Korea duty free) remains the largest individual source country for non-domestic manufactured products, accounting for 34% of all product identified in Australia. The majority of Marlboro and Dunhill (the largest non-domestic brands) that enter Australia came from South Korea. Increases in growth of product from China are largely China National brands.

Inflows of non-domestic manufactured products with unspecified labelling declined significantly. Products with unspecified labelling were a large component of non-domestic inflows in the Q2 2013 empty pack survey with a share of over 21%. Many products with unspecified labelling were illicit whites, which also declined in Q2 2014. A small proportion of the brands with unspecified labelling were also counterfeit.

Despite the decline in illicit whites, the overall percentage of non-domestic manufactured cigarettes remained high. The empty pack survey highlighted that consumption of illicit manufactured cigarettes has shifted from illicit whites to legitimate brands from lower priced countries.

Note: (a) Vietnam has replaced Indonesia as the fifth largest constituent of non-domestic products in the Q4 2013 empty pack survey
(b) The LTM Q2 2014 figures are based on the blended result of the Q2 2014 and the Q4 2013 empty pack surveys using the weighted number of cigarettes
Sources: (1) MSIntelligence Research, Empty pack survey, Q2 2013, Q4 2013 and Q2 2014

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Drivers of results

After PMI and BAT products, China National had the third highest prevalence of non-domestic product found in Australia in Q2 2014.

6.2.5 Trademark owners/manufacturers of non-domestic products

<table>
<thead>
<tr>
<th>Year</th>
<th>PMI</th>
<th>BAT</th>
<th>JT International</th>
<th>JTS Tobacco</th>
<th>KT &amp; G</th>
<th>China National</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009 Q4</td>
<td>0.2%</td>
<td>0.4%</td>
<td>1.5%</td>
<td>0.4%</td>
<td>0.5%</td>
<td>1.1%</td>
</tr>
<tr>
<td>2010 Q4</td>
<td>0.2%</td>
<td>0.4%</td>
<td>1.5%</td>
<td>0.4%</td>
<td>0.5%</td>
<td>1.1%</td>
</tr>
<tr>
<td>2012 Q2</td>
<td>0.4%</td>
<td>0.6%</td>
<td>1.6%</td>
<td>1.6%</td>
<td>1.8%</td>
<td>1.8%</td>
</tr>
<tr>
<td>2013 Q2</td>
<td>0.4%</td>
<td>0.6%</td>
<td>1.6%</td>
<td>1.6%</td>
<td>1.8%</td>
<td>1.8%</td>
</tr>
<tr>
<td>2013 Q4</td>
<td>0.4%</td>
<td>0.6%</td>
<td>1.6%</td>
<td>1.6%</td>
<td>1.8%</td>
<td>1.8%</td>
</tr>
<tr>
<td>2014 Q2</td>
<td>0.4%</td>
<td>0.6%</td>
<td>1.6%</td>
<td>1.6%</td>
<td>1.8%</td>
<td>1.8%</td>
</tr>
<tr>
<td>LTM H1 2014</td>
<td>0.4%</td>
<td>0.6%</td>
<td>1.6%</td>
<td>1.6%</td>
<td>1.8%</td>
<td>1.8%</td>
</tr>
</tbody>
</table>

PMI and BAT products registered the largest volume of non-domestic products found in Australia. China National products had the third largest share accounting for 16% of the total non-domestic products found in the Q2 2014 survey. There appears to be a growth in non-domestic packs entering Australia from established manufacturers. For PMI, BAT and JTI brands over 80% of this product appears to have been intended for the South Korea market (domestic and Duty Free). Over 90% of China National’s non-domestic packs had Chinese labelling.

Note: (a) The LTM Q2 2014 figures are based on the blended result of the Q2 2014 and the Q4 2013 empty pack surveys using the weighted number of cigarettes.
Sources: (1) MSIntelligence Research, Empty pack survey, Q2 2013, Q4 2013 and Q2 2014

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Drivers of results

Counterfeit incidence decreased significantly in the Q2 2014 empty pack survey

6.2.6 Australian empty pack survey results – counterfeit

Counterfeit incidence as a percentage of total manufactured cigarette consumption
2012– LTM H1 2014(1)(2)(a)(b)(c)

The Q2 2014 empty pack survey indicated that 0.1% of manufactured cigarettes consumed in Australia were counterfeit. This represents a large decline from the Q4 2013 empty pack survey.

Although the share of counterfeit of total consumption remains relatively small, it is worth noting that this is the lowest level of counterfeit incidence recorded in an empty pack survey since 2012.

The empty pack survey indicated that 4.8% of counterfeit packs carried branding that was available in the Australian market prior to the introduction of Plain Packaging. To date there has been no evidence of counterfeit Plain Packaging cigarettes. This represents a change from 2012 where approximately 45% of counterfeit cigarettes consumed appeared to have been designed for the local market. This shows that since the introduction of plain packaging, Australian counterfeit cigarettes have declined.

Notes:
(a) Counterfeit incidence is not available for 2009, 2010 and 2011
(b) Counterfeit packs refer to counterfeit packs of the companies participating in the empty pack surveys only
(c) The LTM Q2 2014 figures are based on the blended result of the Q2 2014 and the Q4 2013 empty pack surveys

Sources:
(1) MSIntelligence Research, Empty pack survey, Q2 2013, Q4 2013 and Q2 2014
(2) AC Nielsen, Empty pack survey, 2012
Drivers of results
The number of cities where counterfeit packs were collected fell from 12 in H1 2013 to six in H1 2014

6.2.6 Australian empty pack survey results – counterfeit

Figure 6.2.6 shows the growth of counterfeit cigarettes in Australia between Q2 2013 and Q2 2014. The empty pack survey for Q2 2014 showed that total consumption of counterfeit cigarettes had declined from 0.58% to 0.10% of manufactured cigarettes. It was located in 6 out of 16 cities in Australia, compared to 12 cities in Q2 2013.

Hobart was the only new city where counterfeit cigarettes were found in the Q2 2014 empty pack survey.

The highest increase in counterfeit incidence in Q2 2014 was observed in Brisbane which contributed 47% of the total counterfeit packs. Melbourne constituted 26% of the counterfeit packs in Q2 2014 which is a 23 percentage point increase from Q2 2013.

Notes: (a) Analysis is based on weighted number of sticks
Source: (1) MSIntelligence Research, Empty pack survey, Q2 2013, Q4 2013 and Q2 2014
Drivers of results

The consumption of illicit whites reduced greatly in Q2 2014 with far lower volumes of Manchester identified.

6.2.7 Australian empty pack survey results – illicit whites

Consumption of selected illicit white brands as a percentage of total manufactured cigarette consumption
Q4 2009 – Q2 2014\(^{(1)(2)(a)(b)(c)(d)(e)}\)

<table>
<thead>
<tr>
<th>Year</th>
<th>2009 Q4</th>
<th>2010 Q4</th>
<th>2012 Q2</th>
<th>2013 Q2</th>
<th>2013 Q4</th>
<th>2014 Q2</th>
<th>LTM 2014 Q2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Others</td>
<td>0.19%</td>
<td>0.79%</td>
<td>0.99%</td>
<td>0.98%</td>
<td>0.17%</td>
<td>0.07%</td>
<td>0.12%</td>
</tr>
<tr>
<td>Bridgeway</td>
<td>0.79%</td>
<td>0.98%</td>
<td>0.08%</td>
<td>0.04%</td>
<td>0.06%</td>
<td>0.06%</td>
<td>0.02%</td>
</tr>
<tr>
<td>Golden Kings</td>
<td>1.20%</td>
<td>0.09%</td>
<td>0.04%</td>
<td>1.54%</td>
<td>0.04%</td>
<td>0.03%</td>
<td>0.04%</td>
</tr>
<tr>
<td>Mega</td>
<td>1.19%</td>
<td>0.04%</td>
<td>0.08%</td>
<td>1.80%</td>
<td>0.07%</td>
<td>0.12%</td>
<td>0.03%</td>
</tr>
<tr>
<td>Manchester</td>
<td>1.04%</td>
<td>0.82%</td>
<td>0.19%</td>
<td>0.21%</td>
<td>0.25%</td>
<td>1.19%</td>
<td>1.04%</td>
</tr>
</tbody>
</table>

Additional analysis was undertaken on illicit white brands and their trademark owners for this report. This report has re-classified illicit white brands in order to remove brands which are well established in other countries. This analysis was undertaken by KPMG in conjunction with the industry.

According to the Q2 2014 empty pack survey, 0.25% of all manufactured cigarettes consumed in Australia were illicit whites, a decline from the 1.19% consumption recorded in the Q2 2013 empty pack survey. Most of the decline was driven by Manchester, which was widely available throughout Australia until 2014.

Analysis of the total illicit white volumes in a market is difficult to perform as manufacturers of illicit whites often change brand names frequently in order to avoid detection. The Q2 2014 empty pack survey did not show any previously unknown brands of significant volume. This, along with the significant reduction of Manchester, explains the reduction of illicit whites identified.

The Q2 2014 empty pack survey showed that the total consumption of Manchester declined from 0.98% in Q2 2013 to 0.25% in Q2 2104. In Q2 2013 Manchester was present in 13 out of 16 cities, while in Q2 2014 it was present in 2 cities; Sydney and Melbourne. Manchester is not sold legally in any retail outlets in Australia but appeared to be available throughout the country. Sydney remained the largest source of Manchester, with 65% of packs collected.

Notes:

(a) Others include Oscar, Otto, Ashima, Business Royals, Sunlite, Jet, Ray, DJ Mix, Easy, Doomok, Amor, A, M1, Marcopolo and Top Mountain.
(b) The top brands reported in the Q2 2014 empty pack survey are different from the ones reported in the FY 2013 report.
(c) These brands are known illicit whites as provided by the industry
(d) The share of illicit whites is calculated based on the number of sticks, however, in the H1 report the share of illicit white brands was calculated based on weighted packs. The share of illicit whites when calculated based on weighted packs would have been: 0.3% in Q4 2009, 0.8% in Q4 2010, 1.4% in Q2 2012, 1.6% in Q2 2013, 2.3% in Q4 2013 and 0.5% in Q2 2014.
(e) The LTM 2014 Q2 figures are based on the blended result of the Q2 2014 and the Q4 2013 empty pack surveys.

Sources:

(1) MSIntelligence Research, Empty pack survey, Q2 2013, Q4 2013 and Q2 2014
7. Conclusion
Conclusion

Recent increases in illicit tobacco consumption are a result of an increase in unbranded tobacco. The volume of illicit manufactured cigarettes stabilised.

<table>
<thead>
<tr>
<th></th>
<th>LTM H1 2013</th>
<th>LTM H1 2014</th>
<th>% change (H1 2013 - H1 2014)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Illicit manufactured cigarettes</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contraband</td>
<td>1,348</td>
<td>1,323</td>
<td>-1.8%</td>
</tr>
<tr>
<td>Counterfeit</td>
<td>85</td>
<td>106</td>
<td>24.9%</td>
</tr>
<tr>
<td>Total</td>
<td>1,433</td>
<td>1,429</td>
<td>-0.2%</td>
</tr>
<tr>
<td><strong>Unbranded tobacco</strong></td>
<td>834</td>
<td>1,066</td>
<td>27.7%</td>
</tr>
<tr>
<td><strong>Total illicit tobacco</strong></td>
<td>2,267</td>
<td>2,495</td>
<td>10.1%</td>
</tr>
<tr>
<td><strong>Illicit tobacco consumption as % of total consumption</strong></td>
<td>13.0%</td>
<td>14.3%</td>
<td>n/a</td>
</tr>
<tr>
<td><strong>Equivalent excise value (AUDm)</strong></td>
<td>AUD995</td>
<td>AUD1,200</td>
<td>20.6%</td>
</tr>
</tbody>
</table>

The illicit market in Australia

Our study indicates there has been a growth in the consumption of illicit tobacco in Australia. As a proportion of total consumption this represents an increase from 13.0% in H1 2013 to 14.3% in LTM H1 2014. This trend is consistent with a range of secondary data sources.

The most pronounced change within the overall make-up of illicit tobacco consumption is the availability of genuine contraband brands from South Korea at the expense of illicit white brands with unspecified labelling.

If all of this tobacco had been consumed in the legitimate market, we estimate it would have represented an excise amount of AUD1.2 billion at current excise rates.\(^1\)

Whilst the high growth of illicit manufactured cigarettes reported in H1 2013 appears to have stabilised, growth in LTM H1 2014 has been driven by an increase in illicit unbranded tobacco.

The legal tobacco market in Australia

Whilst legal domestic sales of manufactured cigarette volumes have declined at an annual rate of 3.1% since 2007, loose tobacco volumes have increased at a CAGR of 2.9% over the same period, representing a shift in the mix of tobacco products consumed. Therefore, overall sales of legal domestic tobacco declined at an annual rate of 2.4% since 2007.

The Australian market is the most expensive market in the region. A packet of Marlboro 20s is 5% more expensive than in New Zealand; the second most expensive market. However, a packet is 55% more than the third most expensive market (Singapore) and 700% more expensive than in South Korea (AUD18.64 in Australia to AUD2.61 in South Korea) from where the empty pack survey indicates the majority of new contraband is originating.

The Australian Crime Commission believe that organised crime groups perceive tobacco smuggling to be low-risk and highly profitable.\(^2\) As a result, this price differential may explain some of this growth.

Sources:  
\(^1\) Based upon the average excise rate over the past 12 months for both loose and manufactured cigarettes.  
\(^2\) Australian Crime Commission, Organised Crime in Australia, July 2013
Appendices

A1 Consumption model
A2 Empty pack survey
A3 Rolling papers analysis
A4 Impact of changes in estimation of smoking population on prior results
A5 Source of legal domestic sales estimates
A6 Recent regulatory changes
A7 Non-domestic legal calculation
A8 Consumer surveys
A9 Scope of work
A10 Questionnaire
A11 Bibliography
KPMG has used a consumption based approach to size the unbranded tobacco market in Australia

A1 Consumption model

Introduction

The primary methodology we have used to size the unbranded tobacco market in Australia is the consumption model approach. The approach adopted by KPMG is similar to that used in previous reports on the illicit tobacco market in Australia.

The consumption model utilises the results of the Roy Morgan consumer survey to determine the core inputs to the model, combined with publicly available information on the legal tobacco market and smoking population.

For the purpose of this report, the consumption model number for unbranded volumes for LTM H1 2014 is based on the average of the H2 2013 and the H1 2014 consumer survey results. Since consumers are likely to give a more accurate estimate of their purchase behaviour over a shorter time period rather than the last twelve months, using an average of the H2 2013 and H1 2014 consumer survey results provide a more accurate number for LTM H1 2014.

The consumer survey

The consumer survey was based on the responses of 2,104 smokers in Australia to a CAWI web based questionnaire. Respondents come from Roy Morgan Research’s existing consumer panel, from both metropolitan and non-metropolitan areas. The respondents are weighted by Roy Morgan Research in order to ensure that the sample is representative of Australia’s demographics. The sampling plan is consistent with the survey carried out by Roy Morgan Research in 2013.

The survey was conducted in May and June 2014. Consumers were asked about their consumption and purchase of legal and illicit tobacco products; namely Chop Chop (unbranded loose tobacco sold in bags), pre-rolled unbranded tobacco as well as counterfeit and contraband manufactured cigarette products.

The consumer survey is used as one tool to form an estimate of the illicit market

The consumer survey responses are used to obtain several core inputs for the consumption model process. These core inputs are based on consumer responses and include;

- How many smokers purchase the different types of illicit tobacco,
- How often these illicit purchasers purchase illicit tobacco, and
- How much illicit tobacco these illicit purchasers purchase on each purchase occasion.

These responses generate the core assumptions which are used in the consumption model and are illustrated on figure A1.1 overleaf.

Additional assumptions

In addition to the results generated by the consumer survey there are some additional assumptions and data-points which are used:

- Total adult smoking population – we assumed that the total smoking population was 2.4 million. This is based on AIHW data updated for the decline in smoking population numbers since the last official estimate.
- Quantity of legal tobacco purchased – we have obtained this data from Euromonitor and estimate the total legal sales volume to be 15.1 million kilograms.
A1 Consumption model (continued)

The core inputs from the consumer survey and publicly available information are used in the consumption model, illustrated in table A1.1. These core inputs are factored together to produce an estimate of the amount of illicit tobacco product consumed by the representative population sampled in the Roy Morgan Research consumer survey covering the steps outlined:

- Steps 1 and 2 are used to calculate the total annual volume of illicit consumption per consumer in step 3.
- The number of illicit tobacco users is calculated using the percentage of illicit tobacco users noted in the consumer survey in step 5.
- This is multiplied by the total number of smokers in Australia in Step 6 which is multiplied by the average quantity purchased to give the total quantity of illicit tobacco consumption in Australia in step 7.

The consumption model approach measures illicit tobacco consumption by utilising consumers’ responses. It is not possible to accurately break down illicit consumption into its constituent parts of loose unbranded and branded tobacco as consumers may be unable to tell the difference in the way in which the tobacco is sold.

The H1 2014 consumption model process and relevant data sources are shown in detail overleaf.

Table A1 Consumption model data sources and process

<table>
<thead>
<tr>
<th>Consumption model inputs</th>
<th>Table A1 Consumption model data sources and process</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quantity of illicit tobacco purchased per occasion (g)</td>
<td>1 Roy Morgan consumer survey</td>
</tr>
<tr>
<td>Frequency of illicit tobacco purchased per annum</td>
<td>2 Roy Morgan consumer survey</td>
</tr>
<tr>
<td>Quantity of illicit tobacco purchased per annum (g)</td>
<td>3 ( 1 \times 2 )</td>
</tr>
<tr>
<td>Total adult smoking population ('000)</td>
<td>4 Extrapolated Australian Bureau of Statistics smoking prevalence data(^{(a)})</td>
</tr>
<tr>
<td>Illicit tobacco users as % of Australia tobacco users</td>
<td>5 Roy Morgan consumer survey</td>
</tr>
<tr>
<td>Number of illicit tobacco users, Australia ('000)</td>
<td>6 ( 4 \times 5 )</td>
</tr>
<tr>
<td>Quantity of illicit tobacco purchased in Australia (tonnes)</td>
<td>7 ( 3 \times 6 )</td>
</tr>
<tr>
<td>Quantity of illicit tobacco purchased in Australia in LTM H1 2014 (tonnes)</td>
<td>8 Average of H2 2013 and H1 2014 quantity of unbranded tobacco</td>
</tr>
</tbody>
</table>

Note: \(^{(a)}\) Please see appendix A4 for details of the estimation of the smoking population.

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The results of the H1 2014 consumption model indicate a small decline in unbranded consumption compared to H2 2013.

### Table: Consumption Model Results, H1 2014

<table>
<thead>
<tr>
<th></th>
<th>Unbranded</th>
<th>Counterfeit</th>
<th>Contraband</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Quantity of illicit tobacco purchased per occasion (g)</td>
<td>221</td>
<td>179</td>
<td>94  230</td>
</tr>
<tr>
<td>2 Frequency of illicit tobacco purchased per annum</td>
<td>12</td>
<td>14</td>
<td>7   11</td>
</tr>
<tr>
<td>3 Quantity of illicit Tobacco purchased per annum (g)</td>
<td>2,652</td>
<td>2,510</td>
<td>658  2,526</td>
</tr>
<tr>
<td>4 Total adult smoking population ('000)</td>
<td>2,437</td>
<td>2,392</td>
<td>2,437  2,392</td>
</tr>
<tr>
<td>5 Illicit tobacco users as % of Australian tobacco users</td>
<td>16.9%</td>
<td>17.3%</td>
<td>4.1%  3.9%</td>
</tr>
<tr>
<td>6 Number of illicit tobacco users, Australia ('000)</td>
<td>412</td>
<td>414</td>
<td>101  94</td>
</tr>
<tr>
<td>7 Quantity of illicit tobacco purchased in Australia (tonnes)</td>
<td>1,093</td>
<td>1,039</td>
<td>1,066  1,039</td>
</tr>
</tbody>
</table>

The consumption model is used in order to size the unbranded tobacco market.

For the purpose of this report, the H1 2014 estimate of unbranded consumption volume is based on the average of the H2 2013 and H1 2014 consumer surveys. The net result of this approach is 1,066 tonnes.

We believe that consumers are likely to give a more accurate estimate of their recent purchase behaviour rather than that of the last twelve months. Therefore, using an average of the H2 2013 and H1 2014 consumption model results would provide a more robust number for LTM H1 2014.

The consumption model also generates an estimate for both counterfeit and contraband manufactured cigarettes. This estimate can vary significantly; as a result the primary methodology used for estimating counterfeit and contraband is the empty pack survey analysis. However, the results are used in order to validate trends, such as increased or decreased awareness of the product.

Sources:  
(1) Roy Morgan Research, Consumer survey, H2 2013 and H1 2014  
(2) KPMG analysis
A1 Consumption model (continued)

Re-statement of illicit estimate, H1 2014

As discussed, the consumption model uses an estimate of the number of adult daily smokers in Australia. This number is used to extrapolate the consumption model results to arrive at an illicit estimate for the entire population. This method is used to calculate both the unbranded and non-domestic legal volumes.

There is no robust, pan-Australian, yearly estimate of smoking incidence available. The most widely accepted estimate of adult smoking incidence available is obtained from the AIHW National Drug Strategy Household Survey, published every three years.

The results of the 2013 AIHW survey became available in 2014. For the 2013 reports KPMG used the long-term trend from the 2007 and 2010 results to estimate the smoking population, assuming a 3.1% CAGR decline\(^5\). The 2013 results showed a greater decline. The data-points and methodology used to calculate the smoking population are discussed in Appendix A4.

The impact of this adjustment on illicit tobacco as a percentage of overall consumption is shown below.

Illicit tobacco consumption as a proportion of total consumption,
2011- LTM H1 2014\(^1\)(2)(3)(4)(5)

<table>
<thead>
<tr>
<th>Year</th>
<th>2011</th>
<th>2012</th>
<th>H1 2013</th>
<th>2013</th>
<th>H1 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Smoking Prevalence (Daily smokers aged 14 and over)</td>
<td>14.7%</td>
<td>14.2%</td>
<td>13.7%</td>
<td>13.7%</td>
<td>13.3%(^{(a)})</td>
</tr>
<tr>
<td>Unbranded loose</td>
<td>1,405</td>
<td>1,495</td>
<td>895</td>
<td>1,034</td>
<td>1,154</td>
</tr>
<tr>
<td>Non-domestic legal</td>
<td>47</td>
<td>36</td>
<td>11</td>
<td>22</td>
<td>22</td>
</tr>
</tbody>
</table>

KPMG results based on 2013 AIHW data

<table>
<thead>
<tr>
<th>Year</th>
<th>2011</th>
<th>2012</th>
<th>H1 2013</th>
<th>2013</th>
<th>H1 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Smoking Prevalence (Daily smokers aged 14 and over)</td>
<td>14.4%</td>
<td>13.6%</td>
<td>12.8%</td>
<td>12.8%</td>
<td>12.4%(^{(a)})</td>
</tr>
<tr>
<td>Unbranded loose</td>
<td>1,375</td>
<td>1,431</td>
<td>834</td>
<td>964</td>
<td>1,066</td>
</tr>
<tr>
<td>Non-domestic legal</td>
<td>46</td>
<td>34</td>
<td>10</td>
<td>21</td>
<td>22</td>
</tr>
</tbody>
</table>

Note: \(^{(a)}\) The smoking prevalence figures used for 2014 are forecasted by KPMG assuming the same downward trend seen between the 2010 and 2013 AIHW surveys.

Sources:  
(2) Industry data  
(3) KPMG analysis  
(4) Australian Bureau of Statistics  
Appendix

The Q2 2014 empty pack survey found that 10.3% of manufactured cigarettes consumed originated outside Australia.

A2 Empty pack survey analysis

Six empty pack surveys have been carried out in Australia in the last five years.

AC Nielsen carried out surveys commissioned by PML in Q4 2009 and Q4 2010. The 2009 survey consisted of 9,343 collected packs and the 2010 survey 6,000 packs. These surveys are believed to be broadly comparable to the 2012 and 2013 empty pack surveys.

AC Nielsen also carried out the 2012 Q2 survey which was commissioned by all three industry parties; BATA, PML and ITA. The 2012 survey was conducted in May, June and July and consisted of 12,000 packs collected across 16 cities.

In 2013, the empty pack survey provider changed from AC Nielsen to MSIntelligence (MSI). MSI were selected after a tender process. MSIntelligence were commissioned to replicate the survey using an identical methodology to AC Nielsen. MSIntelligence have been commissioned by BATA, PML and ITA to undertake surveys every six months. These surveys collect 12,000 packs across the same 16 cities in Australia.

The empty pack survey records the number of cigarettes in each pack collected. This enables us to report using the number of cigarettes rather than the number of packs. As there can be considerable variation in pack sizes, utilising a measurement based on the number of cigarettes provides a more accurate representation of consumption patterns.

KPMG used the empty pack survey analysis in order to take the proportion of cigarettes which are not Australian (health warnings missing or non-domestic health warning, brands not sold in Australia, packs with identifying marks from other markets such as tax stamps) and class these cigarettes as “non-domestic”. The proportion of non-domestic cigarettes recorded by the empty pack survey is called the non-domestic incidence. The non-domestic incidence of the EPS is shown above.

The total non-domestic incidence in Australia in the Q2 2014 survey was 10.3% (on the basis of number of cigarettes) and 12.2% (on the basis of number of packs). These results are slightly higher than the non-domestic incidence recorded in the Q4 2013 survey. Overall the Q2 2014 non-domestic incidence is the highest level of non-domestic incidence recorded in an empty pack survey and indicates an increase in illicit manufactured cigarettes.

Whilst a proportion of non-domestic cigarettes will be legally brought into Australia by both inbound (foreign nationals travelling to Australia) and outbound travellers (Australians returning from abroad), this legal proportion is relatively small, with the majority of non-domestic cigarettes being illicit. A calculation of the legal volume of non-domestic cigarettes is shown in appendix A7. Nonetheless, this increase occurred at a time after the inbound traveller allowance was reduced in September 2012.

The total non-domestic incidence in Australia for Q2 2009 was 11.7% (on the basis of number of cigarettes) and 12% (on the basis of number of packs) and for Q4 2010 was 11.8% (on the basis of number of cigarettes) and 12.2% (on the basis of number of packs). The Q2 2013 non-domestic incidence was 11.7% (on the basis of number of cigarettes) and 11.8% (on the basis of number of packs).

The non-domestic incidence of the EPS is shown above.

The total non-domestic incidence in Australia for Q2 2014 was 10.3% (on the basis of number of cigarettes) and 12.2% (on the basis of number of packs).

Notes:
(a) No survey was conducted in 2011, trend line is for information only
(b) Non-domestic incidence based on the number of packs is higher than the non-domestic incidence based on the number of sticks due to the average Australian pack of cigarettes being larger than an international pack, i.e. the most commonly sold pack size in Australia is 25 cigarettes compared to the standard 20 cigarettes packs available internationally

Sources:
(1) MSIntelligence Research, Empty pack survey, Q2 2013, Q4 2013 and Q2 2014
Appendix
The increase in the non-domestic incidence of manufactured cigarettes was driven by contraband products

A2 Empty pack survey analysis (continued)

Break down of non-domestic incidence,
Q2 2012 – LTM Q2 2014

As discussed on the previous page, not all non-domestic tobacco is illicit tobacco. Non-domestic incidence can be broken down into three separate categories:

1. Non-domestic legal – These are cigarettes legally brought into Australia as part of travelers’ non-domestic allowance. (a)

2. Counterfeit – The packs collected in the empty pack survey are examined by the participating companies. They are able to identify packs which are counterfeit versions of their products.

3. Contraband – The remainder, and majority, of non-domestic manufactured cigarettes are legitimate products (i.e. non-counterfeit) that have entered Australia illegally.

Of the total non-domestic incidence reported in the Q2 2014 survey, 0.1% can be attributed to non-domestic legal volumes. The decline from 2012 is in part explained by the reduction in Australia’s duty free allowance from 250g to 50g/50 sticks per person per trip in September 2012. (a)

The majority of non-domestic cigarettes are therefore illicit, with the illicit proportion of manufactured cigarettes consumed in Australia showing a marked increase.

The empty pack survey findings showed that 0.1% of all packs collected in Q2 2014 were counterfeit products, with contraband cigarettes representing the remaining 10.1% indicating that contraband product is the predominant driver of the increase in illicit manufactured cigarette volumes between Q4 2013 and Q2 2014.

(a) Please refer to appendix A7 for detailed for detail on the calculation of non-domestic legal volumes
Sources:
(1) MSIntelligence Research, Empty pack survey, Q2 2013, Q4 2013 and Q2 2014
(2) AC Nielsen, Empty pack survey, 2012
(3) KPMG analysis
A2 Empty pack survey analysis (continued)

The empty pack survey is conducted in a consistent way in each time period. It follows a four step process:

1. City selection

16 cities are chosen based on parameters such as population, size and geographical location. The cities chosen represent the 16 largest population centres in Australia and cover 75% of Australia’s population. MSI inform us that this provides a margin of error of 0.89% with a confidence interval of 95%.

Each city is divided into five sectors (north, south, east, west and centre). Each sector is subdivided into neighborhoods of the same size (250 meter radius).

2. Pack collection

Each neighbourhood is assigned a number of discarded packs for collection. For example, the centre of Sydney includes eight neighbourhoods representative of the population of Sydney and includes residential, commercial and industrial areas. In total, 281 neighborhoods are sampled across Australia. As a result, the EPS does not focus on tourist areas but is representative of the Australian population.

A minimum of 30 empty packs are collected from each neighbourhood. Each neighbourhood has a specific starting point and a fixed route. The collectors accumulate as many empty packs as possible within each neighbourhood regardless of the quota requested in the sampling plan. Packs are collected from any manufacturer regardless of whether they participate in the survey. Collectors revisit the neighbourhood as many times necessary in order to achieve the requested quotas.

All MSI collectors are recruited, selected and trained including an explanation of the methodology and running of pilots prior to the collection. Each team of collectors is supervised by a supervisor.

3. Pack processing

The empty packs are placed into bags and stored at a safe collection point. Packs are discarded if they do not meet the survey quality requirements (e.g. torn, unreadable, rotten). The survey qualified packs (+5% extra) are cleaned and placed in a transparent nylon bag with a zipper that carries a unique barcode label indicating the serial number of the pack (corresponding to the datasheet). The details are then entered into the survey “Data Sheet” provided by MSI. The packs are delivered to the client(s) in a way that enables easy processing and identification.

4. Pack analysis

The client(s) check their packs to identify counterfeit and inform the agency who collates and updates the datasheets. The brands are analysed and any new brands are checked for legitimacy. The unknown brands are then sent back to the client(s) to assess whether they are illicit whites. These data-sheets are finally provided to KPMG and analysed to calculate the non-domestic incidence and contraband and counterfeit volumes.
A2 Empty pack survey analysis (continued)

Validation of empty pack survey analysis

A common criticism of the empty pack survey is that it samples discarded cigarette packs rather than household waste and therefore significantly overstated non-domestic incidence. Sampling for household waste is impractical in most countries. The only market we have come across where household waste has been sampled in conjunction with an empty pack survey is Germany. The household waste survey, known as a Yellow Bag Survey (YBS), is possible in Germany because household waste is sorted, mainly for the purposes of recycling, which makes it possible to separate cigarette packs from other waste.

The Yellow Bag Survey collected 500 packs a month from 24 waste disposal centers throughout Germany. This resulted in over 120,000 weighted packs collected throughout the year, typically a larger sample than an empty pack survey. A comparison was undertaken by KPMG between different methodologies in 2008 and 2009.

In addition to the benefits of the higher sample size, collections from waste disposal centers resulted in packs coming from both household waste and public bins. The 24 waste disposal centers are selected from around the country which removes any urban / rural bias the Empty Pack Survey may have. As such, the Yellow Bag Survey is likely to give a more representative result compared to the EPS.

This enables us to compare the results of the Yellow Bag Survey with the EPS to understand differences in the amount of non-domestic product that is captured.

<table>
<thead>
<tr>
<th>Year</th>
<th>EPS</th>
<th>Yellow Bag Survey</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>19.9%</td>
<td>19.7%</td>
</tr>
<tr>
<td>2009</td>
<td>19.3%</td>
<td>19.7%</td>
</tr>
</tbody>
</table>

In 2008 and 2009, empty pack surveys were also undertaken in Germany. Four quarterly waves were undertaken in 2008 with waves undertaken in Q1 and Q3 in 2009. Each wave collected 10,000 packs. Each survey was conducted across 52 cities in Germany, representing 27% of the total German population.

The non domestic incidence measured by the EPS was 1.2 percentage points higher in 2008 and 0.4 points higher in 2009. Whilst the EPS results are slightly higher, the overall non-domestic incidence is very close. These differences may be due to the following reasons:

1. **Timings of EPS** – the EPS takes place at one point in time during the quarter whereas the yellow bag survey takes place monthly.
2. **Urban / Rural differences** – the EPS covers a lower sample of the total population which excludes smaller population centers.
3. **Number of packs** – given the number of packs collected by the yellow bag survey, it is likely to generate slightly more accurate results.

We recognize this is a single point of comparison in one market but it provides us with confidence that the results of EPS are a reliable measure of non domestic incidence.

Sources: (1) MSIntelligence Research, Germany Empty pack survey report, Q2 2009  
(2) Ipsos, Yellow Bag Survey, 2008-2009
The results of the empty pack survey analysis indicate an illicit volume of 1.4 million kilograms for manufactured cigarettes

A2 Empty pack survey analysis (continued)

We have used the non-domestic incidence obtained from the empty pack surveys as the basis of estimates for the volumes of counterfeit and contraband consumption in Australia.

The 10.3% non-domestic incidence is combined with estimates for legal domestic sales volumes from Euromonitor to create a volume estimate for illicit manufactured cigarettes. This can then be broken down into volume estimates for non-domestic legal, counterfeit and contraband.

**Figure A1.2.3**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal sales of manufactured cigarettes (kg'000s)</td>
<td>1</td>
<td>10</td>
<td>15,881</td>
<td>14,598</td>
<td>13,908</td>
<td>13,468</td>
<td>13,321</td>
</tr>
<tr>
<td>Empty pack survey non-domestic incidence</td>
<td>2</td>
<td>37</td>
<td>1.2%</td>
<td>1.7%</td>
<td>-</td>
<td>4.3%</td>
<td>9.8%</td>
</tr>
<tr>
<td>Total consumption of manufactured cigarettes (kg'000s)</td>
<td>3</td>
<td>= 1 / (100% − 2)</td>
<td>16,071</td>
<td>14,857</td>
<td>-</td>
<td>14,068</td>
<td>14,762</td>
</tr>
<tr>
<td>Non-domestic consumption (kg'000s)</td>
<td>4</td>
<td>= 3 − 1</td>
<td>191</td>
<td>258</td>
<td>-</td>
<td>600</td>
<td>1,441</td>
</tr>
<tr>
<td>Non-domestic (legal) volume estimate (kg'000s)</td>
<td>5</td>
<td>70</td>
<td>34.6</td>
<td>33.7</td>
<td>-</td>
<td>35.6</td>
<td>21.3</td>
</tr>
<tr>
<td>Illicit consumption (kg'000s)</td>
<td>6</td>
<td>= 4 − 5</td>
<td>156.4</td>
<td>224.3</td>
<td>-</td>
<td>564</td>
<td>1,419</td>
</tr>
<tr>
<td>Empty pack survey counterfeit incidence</td>
<td>7</td>
<td>40</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>0.4%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Counterfeit consumption (kg'000s)</td>
<td>8</td>
<td>= 4 * (7 / 2)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>50</td>
<td>143</td>
</tr>
<tr>
<td>Contraband consumption (kg'000s)</td>
<td>9</td>
<td>= 6 − 8</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>515</td>
<td>1,276</td>
</tr>
</tbody>
</table>

Figure A1.2.3 shows the calculation used to estimate the total volume of illicit manufactured cigarettes consumed in Australia. The percentage of non-domestic cigarettes is added to legal domestic consumption in order to calculate total consumption in step 3. Total illicit consumption is calculated by removing the non-domestic legal volume estimate in step 6.

The EPS also records the counterfeit incidence as a percentage in step 7. This counterfeit incidence is taken as a percentage of total non-domestic consumption and multiplied by the illicit consumption estimate in step 8, with the remainder contraband in step 9.

The results of the empty pack survey analysis show non-domestic volumes increased significantly in 2013. As non-domestic legal volumes declined sharply, this translated into much higher volumes of illicit counterfeit and contraband manufactured cigarettes.

Whilst volumes attributable to counterfeit manufactured cigarettes rose, the true volume increase was driven by contraband product, which accounts for 93% of the total illicit consumption indicated by the empty pack survey analysis.

Notes: (a) We have uplifted the Euromonitor manufactured cigarettes volumes by 2% in each year, as we believe that the overall quantum of estimate is too low. (b) 2013 legal sales of manufactured cigarettes are for the latest 12 months. (c) Counterfeited incidence is not available for 2009, 2010 and 2011.

Sources: (1) MSIntelligence Research, Empty pack survey, Q2 2013, Q4 2013, Q2 2014 (2) AC Nielsen, Empty pack survey, 2009, 2010, 2012 (3) Euromonitor, Legal domestic sales, August 2013 (4) KPMG analysis
Appendix

The illicit tobacco volumes generated by the consumption model fall within the range provided by the rolling papers analysis

A3 Rolling papers analysis

Figure A1.3.1 Rolling papers calculation for unbranded tobacco

Figure A1.3.1 highlights our approach to the rolling papers analysis used to calculate the total volume of unbranded tobacco. Each step of the calculation involves the following assumptions and data-points:

1. **Total volume of rolling papers and tubes** – the volume used comes from retail sales data provided by Aztec and cannot be published due to contractual obligations with the data provider.

2. **Wastage rate** – The wastage rate is the percentage of rolling papers used and excludes any discarded or spoilt papers. This data has been sourced through consumer research undertaken by the industry and is commercially sensitive and cannot be published.

3. **Conversion rate** – The amount of grams of tobacco used in a rolled cigarette. Consumer surveys and estimations by the industry have produced a range of values. As a sensitivity, we use an upper and lower limit of 0.75 and 0.6 respectively. We believe that a lower limit of 0.6g is reflective of the Australian market – this limit may be lower or higher than other markets.

4. **Cannabis consumption** – Rolling papers are also used in the consumption of cannabis. The conversion rate for use of papers and tubes is assumed to be the same as the conversion rate for cigarettes. Total cannabis consumption is estimated on the basis of the Australian Department of Health and Aging survey at a total volume of 22,500kg.(2) We note from the recent AIHW data that the incidence of use of cannabis has decreased slightly (i.e. from 10.3% to 10.2%).(3) However, since it is not possible to calculate consumption based on these figures we have not adjusted the results.

The chart above illustrates a sensitized range for the rolling papers analysis. The sensitivity is based around the value for the conversion rate which is the most uncertain variable in the analysis. By flexing this value between a high value of 0.75g per rolled cigarette and a low value of 0.6g per rolled cigarette, we can determine a range of potential market sizes. We believe that this approach is appropriate to validate the unbranded tobacco market and we intend to keep tracking it similarly in subsequent reports.

The volume of illicit unbranded tobacco generated by the consumption model output is within the range of the rolling papers analysis in both the 2013 and H1 2014. As highlighted earlier, KPMG has used a prudent estimate of unbranded consumption in 2013. We have utilised the same methodology and taken an average of the H2 2013 and H1 2014 results to derive a more accurate estimate for LTM H1 2014. The increase in volumes indicated by the rolling papers analysis supports the increase of unbranded reported in the consumption model.

Sources:  
(1) Size of rolling papers market obtained from the industry  
(2) National Drug and Alcohol Centre NSW, Cannabis in Australia, June 2007  
(3) AIHW, National Drug Strategy Household Survey, Use of Illicit Drugs in Australia, June 2014
Several estimations of Australian smoking prevalence are publicly available, but yearly data is not available from Australian government estimates.

A4 Use of smoking prevalence data and updated results

**Smokers as a percentage of population, 2007- H1 2014**

<table>
<thead>
<tr>
<th>Year</th>
<th>Euromonitor</th>
<th>Australian Institute of Health and Welfare</th>
<th>Australian Bureau of Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>19.6%</td>
<td>18.4%</td>
<td>N/A</td>
</tr>
<tr>
<td>2008</td>
<td>18.8%</td>
<td>15.1%</td>
<td>N/A</td>
</tr>
<tr>
<td>2009</td>
<td>16.6%</td>
<td>12.8%</td>
<td>N/A</td>
</tr>
<tr>
<td>2010</td>
<td>18.3%</td>
<td>15.6%</td>
<td>N/A</td>
</tr>
<tr>
<td>2011</td>
<td>18.8%</td>
<td>17.9%</td>
<td>N/A</td>
</tr>
<tr>
<td>2012</td>
<td>18.1%</td>
<td>17.4%</td>
<td>N/A</td>
</tr>
<tr>
<td>2013</td>
<td>18.3%</td>
<td>17.4%</td>
<td>N/A</td>
</tr>
<tr>
<td>2014</td>
<td>18.4%</td>
<td>17.4%</td>
<td>N/A</td>
</tr>
</tbody>
</table>

**CAGR (%) 2007-13**

- **Euromonitor** -1.5%
- **Australian Institute of Health and Welfare** -4.2%
- **Australian Bureau of Statistics** N/A

Official Australian Government estimates of smoking incidence are available from both the AIHW and the Australian Bureau of Statistics (ABS). Euromonitor also provide estimates of smoking incidence.

Each of the surveys reflects specific age groups. The AIHW and ABS estimates reflect prevalence for 14 year olds and above, whilst Euromonitor figures estimate prevalence among those aged over 18. This in part explains the higher Euromonitor estimate.

Timing of estimates also varies. The National Drug Strategy Household Survey is conducted by the AIHW every three years and includes questions on smoking prevalence. AIHW has produced smoking prevalence estimates since 1991. The last three surveys were conducted in 2007, 2010 and 2013, with the 2013 data becoming available for this report. The 2013 results led to the re-statement of results, as discussed in appendix A4.

ABS figures are taken from Australian Health Surveys carried out in 2008 and 2012, whilst Euromonitor compiles its estimates annually.

All smoking prevalence surveys encounter issues with respondents under reporting. The AIHW survey highlights the possibility of under-reporting as some respondents did not answer smoking related questions. Potential under-reporting was identified in the ABS report, primarily due to social pressures, especially where other household members / parents were present at the interviews for respondents. We show the possible extent of under-reporting on page 58.

Where KPMG require prevalence data for our modelling process, we have used the AIHW results to ensure that our estimate for the number of Australian smokers is not overstated. Overstating the number of smokers would lead to an incorrectly inflated estimate of the size of the illicit trade.

Notes:  
(a) Euromonitor, percentage of population that are smokers refers to daily smokers > 18 years  
(b) Australian Institute of Health and Welfare and ABS percentage of population that are smokers refers to daily smokers >14 years  
(c) Euromonitor figures for 2013 are based on full year estimates  
Sources:  
(1) Euromonitor, smoking prevalence, accessed July 2013  
(3) Australian Bureau of Statistics
As with prevalence, KPMG believes it is prudent to use the lowest estimates of smoking population to calculate illicit consumption.

The number of adult daily smokers in Australia is used to extrapolate the consumer survey results up to an illicit estimate for the entire population.

For H1 2013 and FY 2013 reports, KPMG extrapolated the numbers based on the AIHW 2010 data (as shown above). However, as the 2013 data for smokers from AIHW became available, we have restated the smoker population numbers for 2013. We used the decline in smokers recorded between 2010 and 2013 to estimate the number of smokers in 2014.

### Estimates of smoking population (daily smokers aged 14 and over), 2007-2014 (a)(b)(c)

### Appendix

A4 Use of smoking prevalence data and updated results (cont)

Total number of smokers, 2007-2014 (1)(2)(a)(b)(c)

Sources:

<table>
<thead>
<tr>
<th>Year</th>
<th>KPMG estimate based on AIHW 2010 number</th>
<th>KPMG estimate based on AIHW 2013 number</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>2.86</td>
<td>2.86</td>
</tr>
<tr>
<td>2008</td>
<td>2.82</td>
<td>2.82</td>
</tr>
<tr>
<td>2009</td>
<td>2.78</td>
<td>2.78</td>
</tr>
<tr>
<td>2010</td>
<td>2.74</td>
<td>2.74</td>
</tr>
<tr>
<td>2011</td>
<td>2.68</td>
<td>2.68</td>
</tr>
<tr>
<td>2012</td>
<td>2.64</td>
<td>2.64</td>
</tr>
<tr>
<td>2013</td>
<td>2.59</td>
<td>2.59</td>
</tr>
<tr>
<td>2014</td>
<td>2.49</td>
<td>2.49</td>
</tr>
</tbody>
</table>

Notes:

(a) The Australian Institute of Health and Welfare considers population aged 14 years or older.
(c) Figures for 2013 are based on full year estimates.

Sources:


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Our estimate of total tobacco consumption is historically higher than using consumer survey data

Comparison total consumption of tobacco in Australia using different data sources, 2007 – 2013\(^{(1)(2)(a)(b)}\)

<table>
<thead>
<tr>
<th>Consumer prevalence data compared to KPMG consumption volumes</th>
<th>CAGR 2007-2010</th>
<th>CAGR 2010-2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Smoking prevalence(^{(3)})</td>
<td>16.6%</td>
<td>n/a</td>
</tr>
<tr>
<td>Smoking population (m)</td>
<td>2.86</td>
<td>2.74</td>
</tr>
<tr>
<td>cigarettes smoked per week(^{(3)})</td>
<td>98</td>
<td>112</td>
</tr>
<tr>
<td>Average daily consumption (Cigarettes)</td>
<td>14</td>
<td>16</td>
</tr>
<tr>
<td>Total implied tobacco consumption (million KG)</td>
<td>10.21</td>
<td>11.17</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Smoking consumption from AIHW</th>
<th>2007</th>
<th>2010</th>
<th>2013</th>
<th>2010-2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Smoking prevalence(^{(3)})</td>
<td>15.1%</td>
<td>n/a</td>
<td>12.8%</td>
<td>n/a</td>
</tr>
<tr>
<td>Smoking population (m)</td>
<td>2.74</td>
<td>2.44</td>
<td>-1.4%</td>
<td>2.44</td>
</tr>
<tr>
<td>Cigarettes smoked per week(^{(3)})</td>
<td>112</td>
<td>96</td>
<td>4.5%</td>
<td>-3.9%</td>
</tr>
<tr>
<td>Average daily consumption (Cigarettes)</td>
<td>16</td>
<td>14</td>
<td>4.5%</td>
<td>-4.8%</td>
</tr>
<tr>
<td>Total implied tobacco consumption (million KG)</td>
<td>11.17</td>
<td>8.55</td>
<td>3.0%</td>
<td>-8.5%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Using cigarette volumes</th>
<th>2007</th>
<th>2010</th>
<th>2013</th>
<th>2010-2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal domestic sales (million KG)(^{(4)})</td>
<td>17.56</td>
<td>16.37</td>
<td>-2.3%</td>
<td>15.21</td>
</tr>
<tr>
<td>Illicit tobacco consumption (million KG)(^{(1)(2)(5)(6)(7)})</td>
<td>1.59</td>
<td>2.40</td>
<td>14.7%</td>
<td>2.38</td>
</tr>
<tr>
<td>Total consumption (million KG)</td>
<td>19.19</td>
<td>18.80</td>
<td>-0.7%</td>
<td>17.62</td>
</tr>
</tbody>
</table>

We have undertaken a comparison of total tobacco consumption between KPMG’s estimates based on actual sales data and the consumption statistics from the AIHW survey. By using the smoking prevalence data and data on average daily consumption, it is possible to calculate overall tobacco consumption from the AIHW survey. The result for total consumption is lower than the actual legal domestic sales.

This analysis shows that smoking prevalence surveys may encounter issues with respondents under-reporting. As previously stated, the AIHW survey highlights the possibility of under-reporting as some respondents did not answer smoking related questions.

Notes:
(a) Counterfeit and contraband estimations unavailable for 2007
(b) Legal consumption includes both legal domestic sales volumes and non-domestic legal volumes
Sources:
(1) KPMG analysis of previous reports on illicit trade in Australia, run by Deloitte between 2009 and 2012
(4) Euromonitor, Legal domestic sales, accessed July 2014 and industry sales data
(5) Roy Morgan Research, Consumer survey, H1 2013, H2 2013, H1 2014
(6) MSIntelligence Research, Empty pack survey, Q2 2013, Q4 2013, Q2 2014
Appendix

Over the past few years Euromonitor has tracked the market most accurately in Australia. As a result, we have adopted this as our measure for legal domestic sales.

A5 Source of legal domestic sales estimates


![Graph showing volume of legal domestic sales over time]

<table>
<thead>
<tr>
<th>CAGR (%)</th>
<th>2007-09</th>
<th>2009-LTM H1 2014</th>
<th>2007-LTM H1 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Datamonitor</td>
<td>-2.9%</td>
<td>-1.5%</td>
<td>-2.0%</td>
</tr>
<tr>
<td>Euromonitor</td>
<td>-0.0%</td>
<td>-5.3%</td>
<td>-3.7%</td>
</tr>
</tbody>
</table>

In order to accurately reflect the size and trend of the illicit tobacco volumes, it is necessary to obtain a robust estimate of legal domestic sales. Under-stating legal domestic sales has the effect of incorrectly inflating the estimate of the illicit proportion of the market.

We have examined several publicly available estimates of Australian legal domestic sales and have compared it to sales data supplied by the industry. Whilst we cannot publish sales data from industry players due to the commercial sensitivity of this information, we show an indicative range on the chart above. We have analysed this industry sales data and how it relates to publicly available estimates of the illicit market in Australia.

As indicated in the H1 2013 and FY 2013 reports, compared with industry sales data, Euromonitor data most accurately captures both the nominal volumes and the trend in the market across the 2007-LTM H1 2014 period as a whole. As a result, we have adjusted the historic illicit volumes estimations based on using Euromonitor volume estimates.

In order to estimate total tobacco consumption for the LTM period ending in June 2014 we have used industry offtake sales data detailing the percentage change in sales volumes.

The data we use to estimate the sales volume for LTM Q1 2014 covers the last six months of 2013 and the first six months of 2014.

Note: (a) To preserve confidentiality of commercially sensitive data, Exchange of Sales data has been grossed up to factor in the market coverage of the data and then rounded to the nearest thousand.

Sources: (1) Datamonitor
(2) Euromonitor, Legal domestic sales, accessed July 2014
(3) Industry sales data
The Commonwealth government implemented the Plain Packaging Act and other tobacco control measures in 2012.

### A6 Recent regulatory changes

#### Table A1.7.1: Recent regulatory changes 2012/13/14

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Legislation title</th>
<th>Regulation type</th>
<th>Effective date</th>
<th>Brief description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Tobacco Advertising Prohibition Amendment Act 2012</td>
<td>Internet advertising</td>
<td>6 September 2012</td>
<td>It is made a criminal offence to publish tobacco advertising on the internet or other electronic media (including mobile phones).</td>
</tr>
<tr>
<td></td>
<td>Amendment of the Principal Act (Tobacco Advertising Prohibition Act 1992) and the Regulation (Tobacco Advertising Prohibition Regulation 1993)</td>
<td></td>
<td></td>
<td>The Tobacco Advertising Prohibition Regulation 1993 made it mandatory for internet point-of-sale tobacco advertisements to be presented in plain text-only format with graphic health warnings and warnings about age restriction on tobacco sales.</td>
</tr>
<tr>
<td></td>
<td>Tobacco Plain Packaging Act 2011; Trade Marks Amendment (Tobacco Plain Packaging) Act 2011; Tobacco Plain Packaging Regulations 2011</td>
<td>Plain packaging of tobacco</td>
<td>1 December 2012</td>
<td>Law on plain packaging for all tobacco products sold enacted and fully implemented.</td>
</tr>
<tr>
<td></td>
<td>Customs Amendment (Smuggled Tobacco) Act 2012</td>
<td>Illicit tobacco</td>
<td>7 November 2012</td>
<td>Smuggling tobacco or possessing illicit tobacco will attract tougher penalties including potential imprisonment.</td>
</tr>
<tr>
<td></td>
<td>Amendment of Customs Act 1901</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Competition and Consumer (Tobacco) Information Standard 2011</td>
<td>Health warnings</td>
<td>1 January 2012</td>
<td>Tobacco products required to display the updated and expanded graphic health warnings covering 75% of the front of face.</td>
</tr>
<tr>
<td></td>
<td>Customs Act 1901, Customs Tariff Act 1995</td>
<td>Duty free tobacco restrictions</td>
<td>1 September 2012</td>
<td>Inbound traveller allowance for tobacco products is reduced from 250g per person to 50g/50 sticks per person.</td>
</tr>
</tbody>
</table>

The Commonwealth government implemented the Plain Packaging Act and other tobacco control measures in 2012

A6 Recent regulatory changes (continued)

Table A1.7.1: Recent regulatory changes 2012/13/14(1)(2)

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Legislation title</th>
<th>Regulation type</th>
<th>Effective date</th>
<th>Brief description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Excise Tariff Amendment (Tobacco) Act 2014 and Customs Tariff Amendment (Tobacco) Act 2014 Amendment of the Customs Tariff Act 1995 and Excise Tariff Act 1921</td>
<td>Excise</td>
<td>Assent on 18 March 2013 1 December 2013 for excise increases 1 March 2014 AWOTE change effective</td>
<td>In August 2013 the Australian government announced excise duty increases in tobacco products of an additional 12.5% annually for the next four years in addition to the switch to AWOTE. The first of these increases was implemented on 1 December 2013.</td>
</tr>
</tbody>
</table>

Sources: (1) Australian Government Department of Health  
Appendix
States introduced additional regulations to further restrict consumption and meet tobacco control objectives

A6 Recent regulatory changes (continued)

Table A1.7.2 Recent regulatory changes 2012/13/14 – state specific\(^{(1)(2)(3)(4)}\)

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Legislation title</th>
<th>Regulation type</th>
<th>Effective date</th>
<th>Brief description</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>Public Health (Tobacco) Act 2008; Public Health (Tobacco) Regulation 2009</td>
<td>Retail Display Ban</td>
<td>1 July 2013</td>
<td>Exemption for specialist tobacconists under the ban on the display of tobacco products at point-of-sale ends.</td>
</tr>
<tr>
<td></td>
<td>Tobacco Legislation Amendment Act 2012</td>
<td>Smoke free Local Areas</td>
<td>7 January 2013</td>
<td>Ban on smoking in enclosed public places extended to within 10 metres of children’s play equipment, swimming pool complexes, spectator areas at sports grounds and venues, within 4 metres of pedestrian access to a building (with effect from 6 July 2015 for licensed pedestrian access to a building).</td>
</tr>
<tr>
<td></td>
<td>Amendment of the Smoke Free Environment Act 2000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Victoria Tobacco Act 1987 Amended by the Tobacco Amendment (Smoking at Patrolled Beaches) Act 2012, Tobacco Amendment (Shopper Loyalty Schemes) Act 2012, Tobacco Amendment Act 2013 (66/2013) and the Mental Health Act 2014</td>
<td>Smoke free Local Areas</td>
<td>1 December 2012</td>
<td>A ban on smoking at all of Victoria’s patrolled beaches in the area between the red-and-yellow lifesaving flags and within a 50 metre radius of a red-and-yellow flag.</td>
</tr>
<tr>
<td></td>
<td>Tobacco Amendment (Shopper Loyalty Schemes) Bill 2012</td>
<td>Removal of tobacco from shopper loyalty programs</td>
<td>1 March 2013</td>
<td>Prohibits using tobacco products for earning points under shopper loyalty initiatives.</td>
</tr>
<tr>
<td></td>
<td>Tobacco Amendment Bill 2014</td>
<td>Additional fines for retailers and individuals selling tobacco and expansion of smoke free outdoor areas</td>
<td>Royal assent on 9 September 2014</td>
<td>Smoking to be banned outside public buildings within the vicinity of certain pedestrian access points, including hospitals, schools and other Government buildings. Fines of as much as AUD35,000 for individuals and AUD177,000 for businesses caught selling illicit tobacco.</td>
</tr>
</tbody>
</table>
Appendix

States introduced additional regulations to further restrict consumption and meet tobacco control objectives

Table A1.7.2 Recent regulatory changes 2012/13/14 – state specific

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Legislation title</th>
<th>Regulation type</th>
<th>Effective date</th>
<th>Brief description</th>
</tr>
</thead>
</table>
| Victoria (continued) | Tobacco Amendment Act 2013 | Smoke free Local Areas, Cessation of new certification for specialist tobacconists | 1 April 2014 | Introduction of smoke-free children’s playgrounds and related recreational areas. Smoking is banned outdoors within 10 meters of playgrounds and skate parks, sporting venues during under 18s events and within public swimming pool grounds from 1 April 2014.
Applications for specialist tobacconist certification received on or after 1 April 2014 will not be considered. This also prevents persons from being able to make an application for certification of tobacco retailing premises.
The Bill received Royal assent on 6 November 2013. |
| South Australia | Tobacco Products Regulation (Further Restrictions) Amendment Act 2012 and Work Health and Safety Act 2012 Amendment to the Principal Act – Tobacco Products Regulation Act 1997 | Retail Display Ban | 1 January 2012 for restrictions on retail displays 1 July 2013 for restrictions on capsule cigarettes | Ban on smoking in certain public transport areas, near certain playground equipment, empowers ministers to enforce short term and long term bans in public areas.
From 1 January 2012, restrictions on retail displays for fruit or confectionary flavoured cigarettes, and ban on advertising such cigarettes in vending machines.
From 1 July 2013, capsule cigarettes may not be displayed for sale, included in prescribed price board, price ticket or vending machines. This restriction also extends to price tickets. |
| | Tobacco Products Variation Regulations 2011 | | 1 January 2012 | Prohibition of all tobacco products at points of sale from 1 January 2012. |
| | Tobacco Products (Smoking Bans in Public Areas – Longer Term) Regulations 2012 | Smoke free Local Areas | September 2012 | Ban on smoking in Moseley Square Glenelg and Royal Adelaide Show. |

Note: (a) There has been no new legislation specifically for the Australian Capital Territory
Appendix

States introduced additional regulations to further restrict consumption and meet tobacco control objectives

A6 Recent regulatory changes (continued)

Table A1.7.2 Recent regulatory changes 2012/13/14 – state specific(1)(2)(3)(4)(a)

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Legislation title</th>
<th>Regulation type</th>
<th>Effective date</th>
<th>Brief description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tasmania</td>
<td>Public Health Amendment Act 2011</td>
<td>Retail Display Ban</td>
<td>1 March 2012</td>
<td>Specialist tobacconists included in retail display ban, removing earlier exemption.</td>
</tr>
<tr>
<td></td>
<td>Public Health Act 1997</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Removal of tobacco from</td>
<td>1 March 2012</td>
<td>Tobacco products are prohibited from earning points under shopper loyalty initiatives.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>shopper loyalty programs</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Licensing of tobacco retailers</td>
<td>1 March 2012</td>
<td>Licences must be obtained prior to selling products from additional venues.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Licenses are not transferable to new business owners.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Licences will not be displayed in premises.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Vending machine restrictions</td>
<td>1 March 2012</td>
<td>Tobacco vending machines now restricted to one machine per site within specified locations.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Smoke free Local Areas</td>
<td></td>
<td>Extension of smoke free areas to include public swimming pools, between flags at beaches, pedestrian malls, within 3 metres of bus shelters, within 10 meters of children’s playgrounds, outdoor dining areas and within 3 metres of outdoor dining areas not surrounded by a screen.</td>
</tr>
<tr>
<td>Queensland</td>
<td>Health Legislation Amendment Act 2011</td>
<td>Tobacco type restriction</td>
<td>25 November 2012</td>
<td>Ban on the sale of fruit &amp; confectionery flavoured cigarettes. From 25 November 2013 there is an additional ban on the sale of ‘novelty items’ (such as toys) that resemble smoking products.</td>
</tr>
<tr>
<td></td>
<td>Amendment of the Tobacco and Other Smoking Products Act 1998</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Corrective Services Regulations 2006</td>
<td>Ban on smoking in prisons</td>
<td>5 May 2014</td>
<td>Total ban on tobacco in prisons followed by amendment to Tobacco and Other Smoking Products Act 1998 to remove exemption from smoking in secure correctional facilities.</td>
</tr>
<tr>
<td></td>
<td>Amendment to Tobacco and Other Smoking Products Act 1998</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: (a) There has been no new legislation specifically for the Australian Capital Territory

Sources:
(1) Australian Government Department of Health
(3) AIHW Media Release, 22 October 2013
### States introduced additional regulations to further restrict consumption and meet tobacco control objectives

#### A6 Recent regulatory changes (continued)

**Table A1.7.2 Recent regulatory changes 2012/13/14 – state specific**(1)(2)(3)(4)(a)

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Legislation title</th>
<th>Regulation type</th>
<th>Effective date</th>
<th>Brief description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Queensland (Continued)</td>
<td>Health Legislation Amendment Bill 2014</td>
<td>Smoking and vapourised devices ban</td>
<td>Proposed – Introduced before Parliament on 9 September 2014</td>
<td>Intends to prohibit smoking around public facilities including health facilities, schools and prisons. The law also applies existing to tobacco laws to personal vaporising devices.</td>
</tr>
<tr>
<td>The Northern Territory</td>
<td>Correctional Services Act 2014 and Correctional Services Regulations Act 2014</td>
<td>Ban on smoking in prisons</td>
<td>1 July 2013</td>
<td>Total ban on tobacco in prisons.</td>
</tr>
<tr>
<td></td>
<td>Tobacco Control Amendment Regulations 2014</td>
<td></td>
<td></td>
<td>Patrons allowed to consume meals in designated smoking areas, staff service is not available from staff to patrons in, the outdoor smoking areas. Ban on smoking in cars where children under 16 are present.</td>
</tr>
<tr>
<td></td>
<td>Tobacco Control Legislation Amendment Act 2014</td>
<td></td>
<td>11 June 2014</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** (a) There has been no new legislation specifically for the Australian Capital Territory

**Sources:**
1. Australian Government Department of Health
3. AIHW Media Release, 22 October 2013
Visitors to non-domestic source countries appear to have grown

A7 Non-domestic legal calculation (continued)

Travel trend data is used by KPMG to estimate non-domestic legal volumes, i.e. tobacco products that are brought into the country legally by consumers, such as during an overseas trip.

Trips made to key non-domestic source countries of manufactured cigarettes increased at a faster rate than overall visits, 6.6% compared to 4.5% between 2013 to LTM H1 2014.

Later in the report this data is used to estimate legal non-domestic sales which, it will be shown, is immaterial in size.

Visits to key non-domestic source countries reached a total of 2.52 million in LTM H1 2014 accounting for approximately 30% of all trips made overseas by Australian residents.

However, reductions in inbound traveller allowances will likely have tempered the growth of legal non-domestic consumption. We examine this in more detail overleaf.

Note:  (a)  Key non-domestic source countries have been selected from the empty pack survey carried out in 2013, the countries highlighted in the graph above accounted for over 75% of the non-domestic cigarette packs found in Australia and excludes packs that come from unspecified countries

Appendix
Visitors from source countries also serve as contributors to non-domestic packs found in Australia

A7 Non-domestic legal calculation (continued)

Example non-domestic legal calculation (outbound)

<table>
<thead>
<tr>
<th>Year</th>
<th>Overseas visits</th>
<th>ND uplift</th>
<th>% population smokers</th>
<th>Propensity to purchase</th>
<th>Amount per trip</th>
<th>Total (tonnes)</th>
</tr>
</thead>
<tbody>
<tr>
<td>LTM H1 2014</td>
<td>2.5m</td>
<td>×</td>
<td>10%</td>
<td>×</td>
<td>12.4%</td>
<td>×</td>
</tr>
</tbody>
</table>

KPMG non-domestic legal calculation\(^{(1)(2)(3)(a)(b)(c)}\)

<table>
<thead>
<tr>
<th>Source</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>LTM H1 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overseas trips to non-domestic source countries in the year (m)</td>
<td>Australian Bureau of statistics</td>
<td>1.53</td>
<td>1.53</td>
<td>2.20</td>
<td>2.35</td>
<td>2.44</td>
</tr>
<tr>
<td>Non-domestic source uplift</td>
<td>Empty pack survey</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>% of population that are smokers</td>
<td>AIHW (and extrapolated)</td>
<td>15.5%</td>
<td>15.1%</td>
<td>14.4%</td>
<td>13.6%</td>
<td>12.8%</td>
</tr>
<tr>
<td>% of smokers that buy tobacco</td>
<td>RMR consumer survey</td>
<td>53%</td>
<td>53%</td>
<td>53%</td>
<td>53%</td>
<td>59%</td>
</tr>
<tr>
<td>Number of smokers purchasing overseas (m)</td>
<td>Inbound traveller allowance</td>
<td>0.14</td>
<td>0.14</td>
<td>0.18</td>
<td>0.19</td>
<td>0.20</td>
</tr>
<tr>
<td>Amount purchased</td>
<td></td>
<td>250</td>
<td>250</td>
<td>250</td>
<td>183</td>
<td>50</td>
</tr>
<tr>
<td>Total (kg)</td>
<td></td>
<td>34,565</td>
<td>33,673</td>
<td>46,046</td>
<td>34,054</td>
<td>10,124</td>
</tr>
<tr>
<td>Non-domestic legal as % of total consumption</td>
<td></td>
<td>0.2%</td>
<td>0.2%</td>
<td>0.3%</td>
<td>0.2%</td>
<td>0.1%</td>
</tr>
</tbody>
</table>

Estimates of non-domestic legal show that total volumes account for a small proportion of total consumption.

The change to inbound traveller allowances made in September 2012 has a considerable impact on the amount of tobacco consumers can bring back into the country legally, reducing the estimate of legal non-domestic volumes further in 2013.

A consumer survey undertaken in February 2013 was the first time respondents were asked about overseas travel and tobacco purchase. The H1 2014 survey suggested that 59% of smokers bought cigarettes overseas.

Notes:
(a) Respondents were asked “Q51. Have you travelled outside of Australia in the last 6 months?”
(b) Respondents were then asked “Q52. Did you buy any manufactured cigarettes or any other tobacco products to bring back to Australia on any of your trips to other countries in the past 6 months?”
(c) The inbound traveller allowance for 2012 has been calculated using the 250g limit for 8 months and the 50g limit for 4 months to reflect the change in inbound traveller allowances made in September 2012.

Sources:
(1) Roy Morgan Research, Consumer survey, H1 2013, H2 2013 and H1 2014

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Appendix

Visitors from countries indicated by the empty pack survey also serve as contributors to non-domestic packs found in Australia

A7 Non-domestic legal calculation (continued)

Overseas visitors arrivals from key non-domestic countries include both short term arrivals and permanent settlers. Visitors from the key non-domestic source countries identified by the EPS have increased since 2007. Visitors from China have increased at 12% CAGR between 2007 and LTM H1 2014.

Later in the report this data together with the overseas travel of Australian residents data are used to estimate legal non-domestic sales which, it will be shown, the impact of the change in domestic legal inflows calculation is immaterial in size. In the absence of data, KPMG has made a prudent assumption that all visitors who are calculated to be smokers bring their 50 cigarette duty free limit.

Overseas visitors (short term visitors and settlers) arrivals to Australia, 2007 – LTM H1 2014\(^{(1)(2)(a)}\)

<table>
<thead>
<tr>
<th>Year</th>
<th>Key countries</th>
<th>Other countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>6.7</td>
<td>5.8</td>
</tr>
<tr>
<td>2008</td>
<td>6.6</td>
<td>5.7</td>
</tr>
<tr>
<td>2009</td>
<td>6.6</td>
<td>5.7</td>
</tr>
<tr>
<td>2010</td>
<td>7.0</td>
<td>6.0</td>
</tr>
<tr>
<td>2011</td>
<td>7.1</td>
<td>6.0</td>
</tr>
<tr>
<td>2012</td>
<td>7.5</td>
<td>6.3</td>
</tr>
<tr>
<td>2013</td>
<td>7.9</td>
<td>6.6</td>
</tr>
<tr>
<td>LTM H1 2014</td>
<td>8.1</td>
<td>6.8</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Key ND source countries</td>
<td>-2.3%</td>
<td>13.4%</td>
<td>8.7%</td>
<td>6.6%</td>
</tr>
<tr>
<td>Total overseas trips</td>
<td>-0.4%</td>
<td>2.5%</td>
<td>4.9%</td>
<td>2.5%</td>
</tr>
</tbody>
</table>

Overseas visitors arrivals from key non-domestic source countries, 2007 – LTM H1 2014\(^{(1)(2)(a)}\)

<table>
<thead>
<tr>
<th>Year</th>
<th>Vietnam</th>
<th>Philippines</th>
<th>Thailand</th>
<th>Indonesia</th>
<th>Korea</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>0.9</td>
<td>0.9</td>
<td>0.8</td>
<td>0.4</td>
<td>4.3</td>
<td>9.9</td>
</tr>
<tr>
<td>2008</td>
<td>0.9</td>
<td>0.9</td>
<td>0.8</td>
<td>0.4</td>
<td>4.4</td>
<td>9.9</td>
</tr>
<tr>
<td>2009</td>
<td>0.8</td>
<td>0.8</td>
<td>0.4</td>
<td>0.4</td>
<td>4.5</td>
<td>9.9</td>
</tr>
<tr>
<td>2010</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.1</td>
<td>5.0</td>
<td>10.6</td>
</tr>
<tr>
<td>2011</td>
<td>1.1</td>
<td>1.1</td>
<td>1.1</td>
<td>1.2</td>
<td>5.2</td>
<td>12.2</td>
</tr>
<tr>
<td>2012</td>
<td>1.2</td>
<td>1.2</td>
<td>1.2</td>
<td>1.3</td>
<td>5.5</td>
<td>13.3</td>
</tr>
<tr>
<td>2013</td>
<td>1.3</td>
<td>1.3</td>
<td>1.3</td>
<td>1.3</td>
<td>5.8</td>
<td>13.3</td>
</tr>
<tr>
<td>LTM H1 2014</td>
<td>1.3</td>
<td>1.3</td>
<td>1.3</td>
<td>1.3</td>
<td>5.9</td>
<td>13.3</td>
</tr>
</tbody>
</table>

Note: (a) Key non-domestic source countries have been selected from the empty pack survey carried out in 2013, the countries highlighted in the graph above accounted for over 75% of the non-domestic cigarette packs found in Australia. Packs that come from unspecified countries are excluded.


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Appendix

Non-domestic legal estimates calculated on the basis of inbound visitor arrivals indicate that non-domestic legal remains a small proportion of total consumption

A7 Non-domestic legal calculation (continued)

![Image of calculation diagram]

**Example non-domestic legal calculation (inbound)**

<table>
<thead>
<tr>
<th>Inbound visitor arrivals&lt;sup&gt;(a)&lt;/sup&gt;</th>
<th>% population above 18</th>
<th>% population smokers</th>
<th>Amount per trip (max. allowance of 50g)</th>
<th>Total (Kg)</th>
</tr>
</thead>
<tbody>
<tr>
<td>x</td>
<td>x</td>
<td>x</td>
<td>=</td>
<td></td>
</tr>
</tbody>
</table>

**Estimated number of visitors who bring in tobacco to Australia**

**Example of KPMG non-domestic legal calculation based on overseas visitor arrivals to Australia<sup>(1)(2)(3)(4)</sup>**

<table>
<thead>
<tr>
<th>LTM H1 2014</th>
<th>Inbound visitor arrivals&lt;sup&gt;(a)&lt;/sup&gt;</th>
<th>% population above 18&lt;sup&gt;(b)&lt;/sup&gt;</th>
<th>% population smokers</th>
<th>Number of visitors bringing tobacco&lt;sup&gt;(c)&lt;/sup&gt;</th>
<th>Amount purchased (kg)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source</td>
<td>Australian Bureau of statistics</td>
<td>Euromonitor</td>
<td>Euromonitor</td>
<td></td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>0.79</td>
<td>69%</td>
<td>25%</td>
<td>0.138</td>
<td>6,903</td>
</tr>
<tr>
<td>Korea</td>
<td>0.20</td>
<td>69%</td>
<td>19%</td>
<td>0.027</td>
<td>1,352</td>
</tr>
<tr>
<td>Indonesia</td>
<td>0.15</td>
<td>63%</td>
<td>36%</td>
<td>0.033</td>
<td>1,644</td>
</tr>
<tr>
<td>Thailand</td>
<td>0.08</td>
<td>67%</td>
<td>23%</td>
<td>0.012</td>
<td>587</td>
</tr>
<tr>
<td>Philippines</td>
<td>0.08</td>
<td>56%</td>
<td>28%</td>
<td>0.012</td>
<td>593</td>
</tr>
<tr>
<td>Vietnam</td>
<td>0.05</td>
<td>67%</td>
<td>22%</td>
<td>0.007</td>
<td>340</td>
</tr>
<tr>
<td>Total (kg)</td>
<td>1.33</td>
<td>0.224</td>
<td>11,419</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Notes:**
- Inbound visitor arrivals to include arrivals of short term overseas visitors and permanent settlers
- Population within the age group 18-64 years
- KPMG has used a prudent approach and assumed that 100% of visitors arriving in Australia purchase the maximum inbound traveller allowance

**Sources:**

Estimation of non-domestic legal volumes shows that total volumes account for a small proportion of total consumption. This proportion remains insignificant even if arrivals data is included in the non-domestic legal calculation. This has been shown in detail on the next page.
Appendix

The summation of non-domestic legal from both inbound and outbound tourism is shown below to show the total non-domestic legal volume

A7 Non-domestic legal calculation (continued)

<table>
<thead>
<tr>
<th>KPMG total non-domestic legal calculation</th>
<th>2007</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>LTM H1 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outbound trips ('000 kg)</td>
<td>28.6</td>
<td>34.6</td>
<td>33.7</td>
<td>46.0</td>
<td>34.1</td>
<td>10.1</td>
<td>10.1</td>
</tr>
<tr>
<td>Inbound trips ('000 kg)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>11.2</td>
<td>11.4</td>
</tr>
<tr>
<td>Total ND(L) ('000 kg)</td>
<td>28.6</td>
<td>34.6</td>
<td>33.7</td>
<td>46.0</td>
<td>34.1</td>
<td>21.3</td>
<td>21.5</td>
</tr>
<tr>
<td>Non-domestic legal as % of total consumption</td>
<td>0.1%</td>
<td>0.2%</td>
<td>0.2%</td>
<td>0.3%</td>
<td>0.2%</td>
<td>0.1%</td>
<td>0.1%</td>
</tr>
</tbody>
</table>

One limitation of this methodology is that it does not include cigarettes purchased through mail order and imported legally into Australia. Given the limited financial gain associated with paying Australian excise duty on cigarettes purchased abroad, compared to those purchased in Australia, we feel that the volume consumed is unlikely to be significant.

Anecdotally, we understand that there are large volumes of tobacco which has arrived in Australia but has not been claimed. We await official publications from the Australian Customs and Border Protection Service (ACBPS) for any data related to excise paid on mail order purchases.
The outputs of the Roy Morgan Research survey are broadly consistent with the AIHW survey on major indicators.

### A8 Alternative illicit tobacco estimates

#### Comparison of unbranded illicit tobacco awareness levels in consumer surveys

<table>
<thead>
<tr>
<th>Year</th>
<th>AIHW</th>
<th>RMR</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>48.0%</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>46.3%</td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>33.9%</td>
<td></td>
</tr>
<tr>
<td>LTM H1 2014</td>
<td>52.3%</td>
<td></td>
</tr>
</tbody>
</table>

#### Comparison of unbranded illicit tobacco prevalence in consumer surveys

<table>
<thead>
<tr>
<th>Year</th>
<th>AIHW</th>
<th>RMR</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>16.5%</td>
<td>20.0%</td>
</tr>
<tr>
<td>LTM H1 2014</td>
<td>17.1%</td>
<td>20.0%</td>
</tr>
</tbody>
</table>

### Comparison of RMR and AIHW consumer surveys

<table>
<thead>
<tr>
<th>Survey focus</th>
<th>RMR</th>
<th>AIHW (conducted by RMR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Survey focus</td>
<td>Size of the illicit tobacco market</td>
<td>Knowledge of and attitudes towards drugs, drug consumption histories and related behaviours</td>
</tr>
<tr>
<td>Frequency</td>
<td>At least annually from 2009 and biannually from 2013</td>
<td>Every three years</td>
</tr>
<tr>
<td>Sample size</td>
<td>2010: 949</td>
<td>&gt;26,000 people aged 12 years or older participated in the 2010 survey</td>
</tr>
<tr>
<td></td>
<td>2011: 931</td>
<td>~24,000 people aged 14 years or older participated in the 2013 survey</td>
</tr>
<tr>
<td></td>
<td>2012: 1,405</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2013: 4,223 (H1: 2,107 + H2: 2,116)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>H1 2014: 2,104</td>
<td></td>
</tr>
<tr>
<td>Age groups</td>
<td>Smokers aged 18+</td>
<td>Smokers aged 14+</td>
</tr>
<tr>
<td>Methodology</td>
<td>Web based surveys</td>
<td>Self-completion drop and collect methodology</td>
</tr>
<tr>
<td>Types of tobacco addressed</td>
<td>Unbranded, counterfeit cigarettes, contraband cigarettes</td>
<td>Unbranded, counterfeit cigarettes</td>
</tr>
</tbody>
</table>

The Australian Institute of Health and Welfare’s (AIHW) National Drug Strategy Household Survey is the only other major consumer survey in Australia that provides an overview on the prevalence of the use of illicit tobacco. There are a number of differences between the Roy Morgan Research and AIHW survey including the frequency of surveys carried out, size of the sample and the key purpose of each. The RMR survey is used to estimate the size of the illicit market whereas the AIHW survey is focused more on attitudes and behaviours. Both the AIHW and the RMR surveys record awareness and prevalence indicators of unbranded illicit tobacco. Awareness of unbranded tobacco was 33.9% in the AIHW survey while it was 52.3% in the RMR survey. Both surveys highlight the difference in responses when asking consumers about having ‘ever smoked’ compared to ‘currently smoking’. Respondents in both cases more willing to admit to illicit behaviour when it’s not considered a ‘current’ activity. As the AIHW survey excluded questions about unbranded cigarettes the results are not directly comparable with previous years.

Notes:
(a) Roy Morgan Research results for 2013 and 2014 are based on CAWI responses only
(b) Results from the 2013 AIHW survey asked questions only about unbranded loose tobacco, whereas the 2010 and 2007 surveys also asked about unbranded cigarettes

Sources:
(1) Roy Morgan Research, Consumer survey, H1 2013, H2 2013, H1 2014
In 2010 the Cancer Council Victoria (CCV) undertook their own study into the volume of illicit tobacco. Compared with KPMG’s methodology, it generated a lower level of illicit use, reporting 2.0%-3.2% against KPMG’s reported 13.0% in H1 2013. The table below explains CCV’s alternative methodology and compares with KPMG’s.

### Comparison of KPMG and Cancer Council Victoria illicit tobacco consumption methodology

<table>
<thead>
<tr>
<th></th>
<th>Cancer Council Victoria approach</th>
<th>Comparison with KPMG</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Volume of unbranded tobacco</strong></td>
<td>Cancer Council Victoria (CCV) uses data from the National Drug Strategy Household Survey (NHDSHS), which covers questions on unbranded tobacco consumption. This consumer survey data is dated 2010 -- and therefore needs updating if it is to be used in comparison with current data. The incidence, in NHDSHS, of unbranded consumers is significantly lower than in the RMR surveys which we cannot explain.</td>
<td>The RMR survey used in the KPMG report asks consumers about both the volume and frequency of purchase of unbranded tobacco.</td>
</tr>
<tr>
<td></td>
<td>A key assumption is the amount of tobacco consumed and the frequency of consumption. CCV assumed that illicit consumers smoke the same amount of product as legal users, which RMR research evidence contradicts.</td>
<td>The RMR survey asks consumers how many grams of tobacco they purchase to remove any assumptions made about the conversion rates.</td>
</tr>
<tr>
<td></td>
<td>CCV does not use primary research on the quantum of illicit manufactured cigarettes consumed, and so infers this from the split of seizures data between manufactured cigarettes and unbranded tobacco.</td>
<td>KPMG use empty pack surveys to calculate the volume of non-domestic manufactured cigarettes by scaling up the results from legal domestic consumption to determine non domestic consumption. This research method has been favourably reviewed by the OECD and other stakeholders.</td>
</tr>
<tr>
<td></td>
<td>Given the potential volatility of seizures as a measure of illicit consumption, KPMG does not use the volume of seizures to corroborate consumption results.</td>
<td>Travel trends and duty free allowances are used to subtract non domestic legal volumes in order to isolate illicit volumes.</td>
</tr>
<tr>
<td><strong>Volume of illicit manufactured cigarettes</strong></td>
<td><strong>Seizures data:</strong> Cancer Council Victoria’s estimate of unbranded tobacco equates to approximately 240 tonnes. This compares to the 311 tonnes seized in Australia through Sea Ports in 2009-10. The Cancer Council Victoria illicit market estimate equates to a seizure rate of approximately 80% (of illicit consumption). World Customs Organization estimates, as a rule of thumb, seizures rates representing 10% of illegal volumes.</td>
<td><strong>Seizures data:</strong> KPMG uses seizures data in order to understand trends within the overall illicit tobacco consumption only.</td>
</tr>
<tr>
<td></td>
<td><strong>Rolling papers analysis:</strong> KPMG examines the quantum of papers sold to determine the overall volume of loose tobacco consumed.</td>
<td><strong>Seizures data:</strong> KPMG uses seizures data in order to understand trends within the overall illicit tobacco consumption only.</td>
</tr>
</tbody>
</table>

Appendix

The description of the services set out below comprises the agreed scope of our work

A9 Scope of work

Scope

We will analyse and report on:

■ The total level of legal domestic sales of tobacco products and consumption in the market.
■ The estimated proportion of the Australian tobacco market accounted for by the illicit trade, across both manufactured products and the unbranded, encompassing contraband, counterfeit and unbranded products (including ‘chop chop’).
■ An overview of the nature of the illicit trade in the country, including the sources of illicit product.
■ Findings on the characteristics and consumption patterns of illicit tobacco users, and how these have changed from the results of surveys previously undertaken, based on the consumer research outputs.
■ Data on how taxation has evolved over time and report on tobacco regulation in the Australian market.

Methodology

In order to size the illicit tobacco market, we will use two principal approaches:

Consumer research approach: utilising the 2014 half yearly and full year 2013 Roy Morgan Research reports, commissioned and provided to us by BATA, PML and ITAL; namely:
■ Analyse consumer responses to seek to establish the proportion of illicit tobacco consumed.
■ Extrapolate the proportion of illicit tobacco consumed on a national level.
■ Express the findings as a proportion of total tobacco consumption.

Empty pack survey approach: utilising empty pack survey data commissioned and provided to us by BATA, PML and ITAL; namely
■ Analyse the data output from MSI to seek to establish the proportion of market accounted for by non-domestic manufactured cigarettes.
■ Extrapolate the non-domestic and counterfeit incidence estimates identified in the EPS against the level of legal domestic sales in Australia.
■ Express findings on the estimates of both non-domestic consumption of manufactured cigarettes and consumption of counterfeit product as a proportion of consumption.

The overall results from the two approaches will then be compared and combined in order to build up our overall estimate of the size and composition of the illicit market as a proportion of total tobacco consumption.

These results will be compared to our analysis of rolling papers data, seizures data and historical consumption trends to help to validate findings.
Appendix
Questions asked by the consumer survey

A10 Roy Morgan Research questionnaire

Do you, or does any member of your immediate family work in any of the following companies/industry sectors?

What is your post code?

What is your gender?

Are you currently employed?

Which of the following occupational categories best suits you? (Options provided)

What is your approximate annual personal income?

What is your current age?

Which products do you currently consume? (Options provided)

What type of tobacco product do you smoke or use, even if only occasionally?

How often do you normally smoke manufactured cigarettes?

How often do you normally smoke roll your own cigarettes?

How many manufactured cigarettes do you normally smoke each day (on average)?

How many roll your own cigarettes do you normally smoke each day (on average)?

What is your regular brand of manufactured cigarettes, that is, the one you smoke more than any other brand now-a-days?

What other brands of manufactured cigarettes do you currently smoke?

What is your regular brand of roll your own cigarettes, that is, the one you smoke more than any other brand now-a-days?

What other brands of roll your own cigarettes do you currently smoke?

Are you aware that unbranded tobacco can be purchased? Unbranded tobacco is also known as ‘chop chop.’ It is loose tobacco or cigarettes in cartons or packs that are sold without a brand name. This does not include branded tobacco products that are now sold in plain packaging that are green/brown in colour with graphic health warnings and information messages.

Since you turned 18 have you ever purchased unbranded tobacco?

Throughout the survey, we’re just focusing on products you buy for your own use. Do you purchase unbranded tobacco for your own use currently?

Have you purchased unbranded tobacco in the last 12 months? (we are talking about purchases for your use)

In the past 12 months, how often did you purchase unbranded tobacco?

Well, can you give me an estimate of how often you purchased unbranded tobacco in the past 12 months?

Since you turned 18, how long had you been buying unbranded tobacco?

Well, can you give an estimate of how long you had been buying unbranded tobacco since you turned 18?

When you last purchased unbranded tobacco, from which outlet or outlets did you buy it?

When you last purchased unbranded tobacco, how many grams of unbranded tobacco did you purchase?

When you last purchased unbranded tobacco, what format or formats was the unbranded tobacco in?

When you last purchased loose unbranded tobacco, how many grams did you buy? (In grams)

When you last purchased loose unbranded tobacco, how much did it cost in total?

How long ago was your most recent purchase of loose unbranded tobacco?

Well, can you give me an estimate of when your most recent purchase of loose unbranded tobacco was?

When you last purchased cartons of unbranded tobacco, how many did you buy?

When you last purchased cartons of unbranded tobacco, how much did it cost in total?

How long ago was your most recent purchase of unbranded tobacco in cartons?

Well, can you give me an estimate of when your most recent purchase of unbranded tobacco in cartons was?

When you last purchased packs of unbranded tobacco, how many did you buy?

When you last purchased packs of unbranded tobacco, how much did it cost in total?

How long ago was your most recent purchase of unbranded tobacco in packs?

Well, can you provide an estimate of when your most recent purchase of unbranded tobacco in packs was?

When you were smoking unbranded tobacco, how much of it would you say that you smoked per day?

Well, can you provide an estimate of how much unbranded tobacco you were smoking per day?

How did you usually consume unbranded tobacco?
Appendix
Questions asked by the consumer survey

A10 Roy Morgan Research questionnaire

How many suppliers did you ever purchase unbranded tobacco from, since you turned 18?
When you stopped buying unbranded tobacco did you not smoke or did you purchase duty paid tobacco products?
Why did you smoke unbranded tobacco?
Do you know the country of origin of the unbranded tobacco that you purchased?
Where does it usually come from?
Please select the reasons why you stopped purchasing unbranded tobacco? (Options provided)
How often do you purchase unbranded tobacco?
Well, can you provide an estimate of how often you purchase unbranded tobacco?
Since you turned 18, how long have you been buying unbranded tobacco?
Well, can you provide an estimate of how long you have been buying unbranded tobacco?
From which outlets do you usually buy your unbranded tobacco?
How many grams of unbranded tobacco do you purchase for the average purchase?
What format or formats do you usually purchase unbranded tobacco in?
What is the minimum price that you have paid for loose unbranded tobacco in bags?
What is the average price that you have paid for loose unbranded tobacco in bags?
What is the maximum price that you have paid for loose unbranded tobacco in bags?
What is the minimum price that you have paid for unbranded cigarettes in cartons?
What is the average price that you have paid for unbranded cigarettes in cartons?
What is the maximum price that you have paid for unbranded cigarettes in cartons?
What is the minimum price that you have paid for unbranded cigarettes in packs?
What is the average price that you have paid for unbranded cigarettes in packs?
What is the maximum price that you have paid for unbranded cigarettes in packs?
How much would you say that you smoke per day of unbranded tobacco?
The most recent time you purchased unbranded tobacco what format or formats was it?
How much loose unbranded tobacco did you buy? (In grams)
How much did it cost in total?
How long ago was your most recent purchase of loose unbranded tobacco?
Well, can you provide an estimate of when your most recent purchase of loose unbranded tobacco was?
How many cartons of unbranded cigarettes did you buy?
How much did it cost in total?
How long ago was your most recent purchase of unbranded tobacco in cartons?
Well, can you provide an estimate of when your most recent purchase of unbranded tobacco in cartons was?
How many packs of unbranded cigarettes did you buy?
How much did it cost in total?
How long ago was your most recent purchase of unbranded tobacco in packs?
Well, can you provide an estimate of when your most recent purchase of unbranded tobacco in packs was?
How do you usually consume unbranded tobacco?
How many suppliers have you ever purchased unbranded tobacco from, since you turned 18?
Do you find unbranded tobacco easier or harder to obtain than a year ago or has there been no change?
If you cannot get unbranded tobacco do you not smoke or do you purchase duty paid tobacco products?
Why do you smoke unbranded tobacco?
Do you know the country of origin of the unbranded tobacco that you purchased?
Where does it usually come from?
Contraband cigarettes are legitimate brands of cigarettes purchased in shops without duty paid.
Are you aware that contraband cigarettes can be purchased?
How did you become aware of the availability of contraband cigarettes?
Since you turned 18, have you ever purchased contraband cigarettes?
Appendix
Questions asked by the consumer survey

A10 Roy Morgan Research questionnaire

Do you purchase contraband cigarettes for your own use currently?

Have you purchased contraband cigarettes in the last 12 months?

If you think you might have purchased contraband cigarettes, which brand(s) was it? Any others?

What would you do if contraband product were not available where you usually purchase it from? (Options provided)

How would you rate the overall quality of the contraband product(s) you purchase compared to the non-contraband version(s)?

Counterfeit cigarettes are packs of cigarettes labelled with a brand name that are not really that particular brand. They have been smuggled into the country without duty paid.

Are you aware that counterfeit cigarettes can be purchased?

How did you become aware of the availability of counterfeit cigarettes?

Since you turned 18 have you ever purchased counterfeit cigarettes?

Do you purchase counterfeit cigarettes for your own use currently?

Have you purchased counterfeit cigarettes in the last 12 months?

If you think you might have purchased counterfeit cigarettes, which brand(s) was it? Any others?

What made you believe the cigarettes were counterfeit?

What would you do if counterfeit product were not available where you usually purchase it from?

How would you rate the overall quality of the counterfeit product(s) you purchase compared to the non-counterfeit version(s)?

You have indicated that you have bought counterfeit product. What does the availability of the brand(s) in counterfeit form make you feel? (Options provided)

You indicated that you would feel more negative towards the brand knowing that it is available in counterfeit, can you please explain why you feel this way.

What would you do if counterfeit product were not available where you usually purchase it from? (Options provided)

How would you rate the overall quality of the counterfeit product you purchase compared to the real legitimate brand?

The most recent time you purchased counterfeit cigarettes, did you buy them by weight, by packs, or by cartons?

When you bought the counterfeit cigarettes by weight, how much did you buy?

How much did it cost in total?

How long ago was your most recent purchase of counterfeit cigarettes by pack?

When you bought the counterfeit cigarettes/carton, how much did you buy?

How much did it cost in total?

How long ago was your most recent purchase of counterfeit cigarettes by carton?

Do you find counterfeit cigarettes easier or harder to obtain than a year ago or has there been no change?

Why do (or did) you smoke counterfeit cigarettes?

The most recent time you purchased contraband cigarettes, did you buy them by weight, by packs, or by cartons?

When you bought the contraband cigarettes by weight, how much did you buy?

How much did it cost in total?

How long ago was your most recent purchase of contraband cigarettes by carton?

Do you find contraband cigarettes easier or harder to obtain than a year ago or has there been no change?

Why do (or did) you smoke contraband cigarettes?

It is sometimes possible to purchase cigarettes for less than the normal retail price. The price of these 'cheap cigarettes' is several dollars or more below the normal retail price, (for example, a price of AUD10 or less for a pack of 25, or AUD8 or less for a pack of 20).
A10 Roy Morgan Research questionnaire

Before today, were you aware of packs of cheap cigarettes that can be purchased for less than the normal retail price?

Since you turned 18 have you ever purchased cheap cigarettes for your own use?

Do you purchase cheap cigarettes for your own use currently?

Have you purchased cheap cigarettes for your own use in the last 12 months?

How did you become aware of the availability of cheap cigarettes?

If you think you might have purchased cheap cigarettes, what brand(s) were they?

What would you do if cheap cigarettes were not available where you usually purchase them from?

What did you do if cheap cigarettes were not available where you usually purchased them from?

How would you rate the overall quality of the cheap cigarettes that you have purchase(d) compared to the full price product(s)?

The most recent time you purchased cheap cigarettes, did you buy them by packs, or by cartons, or both?

When you bought the cheap cigarettes by pack, how many packs did you buy?

How much did it cost in total?

How long ago was your most recent purchase of cheap cigarettes by pack?

When you bought the cheap cigarettes by carton, how many cartons did you buy?

How much did it cost in total?

How long ago was your most recent purchase of cheap cigarettes by carton?

From what outlets do/did you usually buy cheap cigarettes?

Do you find cheap cigarettes easier or harder to obtain than a year ago or has there been no change?

Why do (or did) you smoke cheap cigarettes?

Why did you stop smoking cheap cigarettes?

You have indicated that you have purchased either contraband or counterfeit cigarettes in the past.

Sometimes people refer to contraband or counterfeit cigarettes as 'cheap' cigarettes. These people may or may not know that the 'cheap' cigarettes are contraband or counterfeit.

Whilst you are familiar with the terms contraband and/or counterfeit, do you also know contraband or counterfeit cigarettes as 'cheap' cigarettes?

Do you purchase rolling papers, tubes, or both for the purpose of smoking loose tobacco?

When you purchase rolling papers for smoking loose tobacco, what is the once pack size of rolling papers you usually purchase?

What percentage of that pack of rolling papers do you use before the pack is damaged, lost or discarded? (Options provided)

When you purchase tubes for smoking loose tobacco, what is the one pack size of tubes you usually purchase?

What percentage of that pack of tubes do you use before the pack is damaged, lost or discarded? (Options provided)

Have you travelled outside of Australia in the last 6 months?

Did you bring back any manufactured cigarettes or any other tobacco products to bring back to Australia on any of your trips to other countries in the past 6 months?

How many trips in the last 6 months did you make where you purchased manufactured cigarettes or any other tobacco products to bring back to Australia?

For each type of product listed below, indicate how much you brought back into Australia on average per trip? (Options provided)

What one type of tobacco product did you receive most recently?

When did you last receive manufactured cigarettes or roll your own tobacco from abroad?

What one type of tobacco product did you receive most recently?

When did you last receive manufactured cigarettes or roll your own tobacco from abroad?

How much did you receive? (Please enter a 0 if you did not receive any of that type of product.)

From which countries were the manufactured cigarettes or roll your own tobacco posted from?

On your most recently received manufactured cigarettes or roll your own tobacco, did you declare it to customs or pay any additional taxes?
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