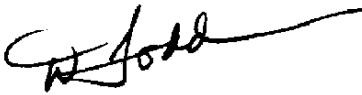




MEMORANDUM

TO: R. Spell
FROM: D. Todd 
DATE: July 25, 2000
SUBJECT: New York State Tax Increase

The following report summarizes the impact of New York State's 3/1/00 cigarette excise tax increase on the industry, cigarette manufacturers and specific brands. This update encompasses the 6 months ending June 2000.

Background

Effective March 1, 2000, the cigarette tax in New York State was raised from 56¢ to \$1.11, an increase of +55¢ or +98%. As a result, New York's tax is now the highest in the nation.

In conjunction with this increase, the New York Department of Tax and Revenue announced that they would also actively begin enforcing their 1985 "Cigarette Marketing Standards Act" (CMSA) that requires all cigarette promotions be offered to every store in the state. As a result, tobacco manufacturers had opted to remove all retail non-off-invoice price promotions from New York stores.

Key Findings

Average weekly EXCEL volume in New York for the 6 months ending June 2000 is down approximately -9% versus the same period last year. In contrast, average weekly EXCEL volume for the same period in the remaining U.S. is down approximately -1% compared to YAG.

In addition to the volume decline in New York State, there appears to be a noticeable share change from full price to discount brands. Discount brands' share in New York for YTD June 2000 was 19.78, representing an increase of +1.80 share points or +10% versus YAG. The opposite trend occurred in the remaining U.S. as discount brands were down -0.31 share point for this same period.

Most of the YTD June 2000 share growth in the discount segment is attributable to the minor manufacturers. Compared to YAG, their YTD share in New York State was 6.47, representing an increase of +3.16 points or 95.4%. This may be traced to New York State's enforcement of the CMSA as the major tobacco companies temporarily ceased most of their product promotions.

YTD June 2000, Basic (-0.25 share point), Doral (-0.65) and GPC (-0.57) all lost shares compared to YAG in New York State. It appears that B&W's \$5.00 per carton list price reduction on GPC, however, has stimulated GPC share growth in this State since April.

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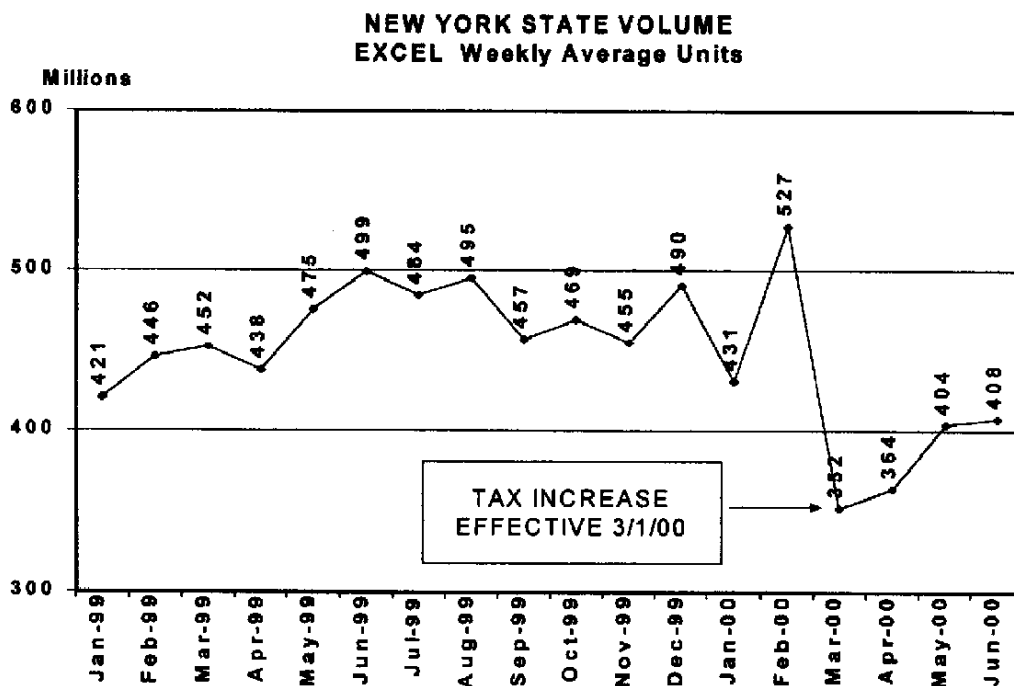
Native American outlets in New York State have seen a significant increase in volume, as they are not subject to the State's \$1.11 per pack excise tax. For the 6-month periods ending December 1999 and June 2000, EXCEL volume growth in New York's Native American outlets outpaced these outlets in the remaining U.S. by 32% and 39% respectively.

It appears some consumers from New York State may be purchasing cigarettes in surrounding states at lower prices, but the volume so far is minimal. For the 6 months ending June 2000, only Massachusetts (+35 million units) and Vermont (+7 million units) showed EXCEL volume increases versus YAG. However, these increases are relatively insignificant compared to the volume decline in New York (-1.049 billion units) for the same period.

Detailed Findings

Total Industry

The following graph tracks average weekly EXCEL volume in New York State from January 1999 through June 2000.



In anticipation of the 3/1/00 cigarette excise tax increase, New York State retailers loaded inventory during February 2000 as shown on the graph above. As a result, average weekly EXCEL volume in New York State then declined sharply in March of this year. It now appears average weekly volume has stabilized at a new level in May (404 million units) and June (408 million).

For the 6 months ending June 2000, weekly average EXCEL volume in New York State was down -9% compared to YAG. At the same time, the remaining U.S. had a decrease of -1% in weekly average EXCEL volume for 6 months ending June 2000 as compared to YAG.

Companies/Brands

EXCEL share trends in New York State and the remaining U.S. for key companies and brands are summarized in the table below

	NEW YORK STATE			REMAINING U. S.		
	SOM YTD June 2000	Pt. Diff. Vs. YAG	% Diff Vs. YAG	SOM YTD June 2000	Pt. Diff. Vs. YAG	% Diff. Vs. YAG
<i>Tot Industry</i>	100.00	*	*	100.00	*	*
Full Price	80.22	-1.80	-2.2	72.88	0.31	0.4
Discount	19.78		10.0	27.12		-1.1
<u>Philip Morris</u>	48.71	-0.91	-1.8	50.91	0.97	1.9
Tot Marlboro	34.55		-1.9	38.18		3.8
Tot Basic	2.72	-0.25	-8.5	5.20	0.22	4.3
<u>R. J. Reynolds</u>	13.61	-1.49	-9.9	23.12	-0.52	-2.2
Tot Camel	2.93	-0.04	-1.5	5.32	0.28	5.6
Tot Winston	3.36	-0.16	-4.4	4.78	-0.20	-4.1
Tot Salem	2.56	-0.13	-4.8	2.97	-0.12	-3.8
Tot Doral	2.34	-0.65	-21.6	6.47	-0.17	-2.6
<u>Brown & Williamson</u>	9.69	-1.03	-9.4	11.58	-1.82	-13.6
Tot Kool	2.47	-0.36	-12.8	2.93	-0.35	-10.7
Tot GPC	1.45	-0.57	-28.2	3.85	-1.13	-22.8
<u>Lorillard</u>	19.18	-0.44	-2.2	8.86	-0.63	-6.6
Tot Newport	15.91		1.9	6.75		2.8
Tot Maverick	0.15	-0.07	-30.3	0.78	-0.54	-41.0
<u>Liggett</u>	2.14		49.6	1.37		22.4
Minor Manufacturers	6.47		95.4	4.17		73.3

Overall, YTD June 2000 share for discount brands in New York State grew by +1.80 points or +10% compared to YAG. The opposite share trend occurred in the remaining U.S. as discount brands' share declined by -0.31 point or -1.1% compared to YAG.

Deep discount brands from the minor manufacturers are driving the discount category share growth in New York State. YTD June 2000 share for the minor manufacturers was 6.47, representing a significant increase of +3.16 points or 95.4% compared to YAG.

During this same period Basic (-0.25 share point), Doral (-0.65) and GPC (-0.57) all lost shares compared to last year. Please note, however, that GPC's share in New York State has started to climb since B&W implemented this brand's \$5.00 per carton list price reduction on April 3rd.

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It appears GPC's list price reduction was very timely for New York State, and this is reflected in the brand's recent share growth. For the remaining U.S., however, it appears GPC's list price reduction has not abated the brand's overall share decline.

EXCEL SOM

	New York State	Remaining U.S.
January 2000	1.41	4.12
February	1.25	4.13
March	1.35	3.66
April	1.52	4.00
May	1.62	3.85
June	1.63	3.30

Even though New York's tax hike resulted in higher retail prices for all manufacturers' brands, it appears the State's cost conscious consumers have been switching to the minor manufacturers' deep discount brands.

This may be attributable to New York State's decision to start enforcing the Cigarette Marketing Standards Act of 1985. In reaction to this decision, major tobacco companies have temporarily halted most of their retail purchase incentive promotions for brands in all price tiers.

Retail prices for major company brands increased not only due to the State's tax increase, but also because most major manufacturer retail promotional programs have been pulled back. For New York's cost conscious consumers, the minor manufacturer deep discount brands represent their best option for low-priced cigarettes.

YTD June 2000 share performance of the major company key brands in New York, except for Newport, showed a downward trend compared to last year.

For example, Marlboro's YTD June 2000 share in New York was 34.55, representing a loss of -0.69 point or -1.9% versus YAG. This brand, however, attained share growth in the remaining U.S. gaining +1.39 points or +3.8% for the same period.

New York State remains a strong market for Newport, in contrast to the other major company key brands. Newport's YTD June 2000 share in New York was 15.91, representing an increase of +0.30 point or +1.9% compared to YAG. This share growth in New York outpaced the brand's performance (+0.18 point to 6.75 SOM) for the remainder of the U.S.

It should also be noted that Native American stores in New York State have seen a significant increase in volume as consumers are searching for places to buy all brands at the lowest possible prices.

The table on the next page illustrates the growth in importance for Native American outlets in New York State. For the 6-month periods ending December 1999 and June 2000, EXCEL volume growth in New York's Native American outlets outpaced the remaining U.S. by 32% and 39% respectively.

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In addition, Native American outlets in New York comprised 34% of the total U.S. volume for these outlets for the 6 months ending June 2000. This was up from 29% of the total U.S. Native American outlet volume for the 6 months ending December 1999.

For all other outlets, the impact of New York State's tax increase can be seen in the 6-month period ending June 2000. EXCEL volume for New York State outlets other than Native American stores was down 12% versus YAG, while in the remaining U.S., these other outlets showed no decrease in volume for the same 6-month period compared to YAG.

	New York % of Total U.S. Volume	EXCEL Volume % Change Vs. YAG		
		New York	Remaining U.S.	New York Diff.
Native Amer. Res.				
6 Mos. DEC 99	29	+27	-5	+32
6 Mos. JUN 00	34	+29	-10	+39
All Other Outlets				
6 Mos. DEC 99	5	-3	-6	+3
6 Mos. JUN 00	5	-12	0	-12

Volume in Surrounding States

The table below shows YTD June 2000 EXCEL volume for New York State and the neighboring states of Pennsylvania, New Jersey, Massachusetts, Connecticut and Vermont.

After the March 1st excise tax increase, a concern of retailers in New York State was that consumers would travel to adjoining states to purchase substantial amounts of cigarettes at lower prices. It appears this situation has not developed significantly as of the end of June 2000.

Only Massachusetts (+35 million units) and Vermont (+7 million units) showed EXCEL volume increases for YTD June 2000 versus last year, but these increases are relatively insignificant compared to the loss of volume in New York State (-1.049 million units).

EXCEL Industry Volume (billions)

	NY	PA	NJ	MA	CT	VT	Remain. U.S.
State Excise Tax per Pack	\$ 1.11	\$ 0.31	\$ 0.80	\$ 0.76	\$ 0.50	\$ 0.44	N/A
YTD June 1999	11.785	10.067	4.789	3.392	1.924	0.523	170.810
YTD June 2000	10.736	9.808	4.696	3.427	1.875	0.530	169.504
Vol. Change	-1.049	-0.258	-0.094	+0.035	-0.049	+0.007	-1.307
% Change	-8.9	-2.6	-2.0	+1.0	-2.6	+1.3	-0.8

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Conclusions/Next Steps

Average weekly EXCEL volume in New York has decreased since last year as the State's YTD June 2000 volume declined approximately -9% compared to YAG. New York State's 56 cents per pack excise tax increase (implemented 3/1/00) was a contributing factor to this decline

YTD June 2000 share trends in New York also indicate consumers may be switching to minor manufacturers' deep discount brands. Retail price increases resulting from the 3/1/00 tax hike may explain part of this trend.

However, New York State also recently began enforcing the Cigarette Marketing Standards Act (CMSA), and as a consequence, the major tobacco companies have temporarily ceased most retail product promotions. It can be assumed this is also fueling the share growth of discount brands in New York.

MPID will continue to monitor cigarette volume in New York State and unless otherwise directed will issue a monthly update with data through July on or about August 23rd.

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