TOBACCO
Research Brief

Sustainable Industry Classification System™ (SICS™) #CN0301
Research Briefing Prepared by the
Sustainability Accounting Standards Board®
June 2015
TOBACCO

Research Brief

SASB’s Industry Brief provides evidence for the disclosure topics in the Tobacco industry. The brief opens with a summary of the industry, including relevant legislative and regulatory trends and sustainability risks and opportunities. Following this, evidence for each disclosure topic (in the categories of Environment, Social Capital, Human Capital, Business Model and Innovation, and Leadership and Governance) is presented. SASB’s Industry Brief can be used to understand the data underlying SASB Sustainability Accounting Standards. For accounting metrics and disclosure guidance, please see SASB’s Sustainability Accounting Standards. For information about the legal basis for SASB and SASB’s standards development process, please see the Conceptual Framework.

SASB identifies the minimum set of disclosure topics likely to constitute material information for companies within a given industry. However, the final determination of materiality is the onus of the company.

Related Documents

- Tobacco Sustainability Accounting Standards
- Industry Working Group Participants
- SASB Conceptual Framework

INDUSTRY LEAD

Quinn Underriner

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INTRODUCTION

Tobacco companies have more than one billion customers worldwide.¹ This global industry produces a recreational substance that has increasingly become the focus of public health campaigns as it has been linked to various diseases and higher societal health care costs.

While specific regulations vary widely by country, the industry has faced rising excise taxes from governments looking to curb tobacco use among its citizens.² The way this industry markets itself, especially to children, has also been the focus of regulation and public attention. This scrutiny has led to strict rules governing the placement of cigarette packages in stores, in what medium advertisements can be made, and what can be displayed on the packaging.³ These regulations have led to generally lower smoking rates worldwide, especially in developed countries, where they tend to be strictest and the most heavily enforced. However, in some developing countries, tobacco use is growing as incomes rise.⁴

Many companies in the industry are working to create tobacco products that have lower health risks than traditional cigarettes. If these products are successful (and regulators allow them to market them as healthier alternatives to cigarettes), they could lead to positive health benefits for consumers as well as a financial boon for investors.

Management (or mismanagement) of material sustainability issues, therefore, has the potential to affect company valuation through impacts on profits, assets, liabilities, and cost of capital.

Investors would obtain a more holistic and comparable view of company performance if they reported metrics on the material sustainability risks and opportunities that could affect value in the near- and long-term in their regulatory filings. The filings would include both positive and negative externalities and the non-financial forms of capital that the industry relies on for value creation.

Specifically, performance on the following sustainability issues will drive competitiveness within the Tobacco industry:

- Reducing the harmful health effects of tobacco product use; and
- Marketing and advertising tobacco products in a responsible way, particularly to youth.

INDUSTRY SUMMARY

The Tobacco industry is comprised of companies that farm tobacco and manufacture tobacco products including cigarettes, cigars, and smokeless tobacco products.¹ Many large tobacco companies operate globally and serve both international and U.S. customers.⁵ Cigarettes make up the largest segment of the industry, representing approximately 90 percent of global tobacco consumption.⁶ International cigarette shipments totaled approximately 6.11

¹ Industry composition is based on the mapping of the Sustainable Industry Classification System (SICSTM) to the Bloomberg Industry Classification System (BICS). A list of representative companies appears in Appendix I.
trillion units in 2014, 1.6 percent higher than in 2010. Cigarette manufacturing is a global enterprise; East Asia and Europe are the two largest manufacturing centers, followed by the U.S. and South Africa. Major tobacco product manufacturers typically sell their products through subsidiaries in various markets and may choose to focus domestically or internationally. The majority of the U.S. domestic tobacco crop is exported, while the majority of tobacco products consumed domestically are imported. Companies may obtain or sell exclusive rights to sell certain brands of cigarettes in diverse markets. Revenues are derived primarily from sales to wholesalers and distributors, as well as retailers including grocers and gas stations.

The Tobacco industry is highly competitive. Companies compete on factors including product quality, brand recognition, brand loyalty, consumer taste, product innovation, packaging, service, marketing, advertising, and retail price. The total global industry revenue of publicly listed companies was approximately $170 billion in fiscal year (FY) 2014. Increasingly, higher retail prices due to excise taxes, shifting consumer demand, and more stringent regulations are adversely affecting revenue opportunities. However, new products such as electronic cigarettes (e-cigarettes), which grew from a segment of less than $39 million to roughly $1.6 billion in 2014, may present growth opportunities.

Most tobacco is grown by independent farmers, who typically sell their crops to tobacco merchants or to manufacturers under contract. Alliance One is a leading tobacco leaf merchant serving major U.S. manufacturers. Though there are thousands of independent growers in the U.S., few have substantial market share. This is in stark contrast to tobacco product manufacturers, as described below.

Typically, tobacco products earn fairly robust profit margins due to relatively low material and labor input costs. The median net income margin for tobacco companies was 17.59 percent in FY2014. Tobacco product manufacturing is initially capital-intensive, as companies must purchase manufacturing machinery. These costs, coupled with the difficulty of reaching distribution channels (e.g., gas stations), result in a high barrier to entry for new or smaller manufacturers. Tobacco leaf is generally the primary input for cigarettes and cigars, followed by fine paper, packaging materials, filter materials, and additives. Labor costs are significant for tobacco growers, because seasonal workers are required during the growing season. Tobacco product manufacturing, however, is highly automated, which keeps labor costs low. Manufacturers are still burdened by lingering costs from legal settlements and regulations governing product health impacts and marketing. As a result of shifting consumer tastes and increasingly demanding regulatory health requirements, companies also invest significant resources into research and development (R&D).

The industry produces roughly 6 trillion cigarettes a year in more than 600 processing facilities in a majority of the world’s countries. Tobacco leaf is a hearty plant that is grown in more than 125 countries, although five countries, Brazil, China, India, Turkey, and the U.S., produce two-thirds of the world’s tobacco. Tobacco takes up under one percent of worldwide farmland. The global nature of this industry means that companies source tobacco from a wide range of countries, making a catastrophic supply issue unlikely.
The U.S. tobacco product manufacturing market is highly concentrated. In 2013, the top three U.S. manufacturers had a combined 94 percent domestic market share. Altria Group captured approximately 56 percent of the market in 2014, while Reynolds American Inc. had 20.5 percent, and Lorillard had 17 percent. In June 2015, Reynolds American purchased Lorillard for $25 billion. To appease regulators worried about decreased competition in the cigarette market, Reynolds sold its Kool, Salem, and Winston brands, as well as Lorillard’s Maverick brand, to Imperial Tobacco Group for $7.1 Billion. Post-merger, the new Reynolds American, will present a stronger competitive challenge to the dominant Altria Group.

The U.S. smoking rate has declined steadily since the 1960s, when the Centers for Disease Control and Prevention (CDC) first reported that smoking has negative health impacts, including lung cancer. In the U.S., demand for cigarettes has decreased due to health concerns, diminishing social acceptance, federal, state, and local smoking regulations, which limit the ability to smoke in public places, rising consumption of e-cigarettes, and higher prices due to excise tax rates and settlement costs. However, smoking rates are on the rise in some emerging markets due to increasing disposable incomes, and in some cases, less stringent or poorly enforced governmental regulations. Despite social and regulatory headwinds, the industry is growing overall. Globally, cigarette consumption grew at an annualized four percent between 1960 and 2000.

The 2006 Fair and Equitable Tobacco Reform Act ended U.S. federal tobacco price supports and production quota programs. The programs, much like subsidy programs for other crops, kept domestic prices artificially high, raising domestic revenues, but reducing the international competitiveness of domestic producers. Following deregulation, exports rose approximately 12.6 percent, to nearly 85 percent of revenue. Imports also rose. In 2005, the Tobacco Transition Payment Program replaced the quotas and price supports with a ten-year, $9.6 billion direct compensatory payment program to tobacco farmers to assist with the transition to deregulated international trade. This program caused many smaller domestic tobacco growers to exit the market. Rapid consolidation followed, creating larger farms with greater economies of scale. Industry revenue and profits rose after deregulation due to consolidation and increased international sales, especially in emerging markets.

The Tobacco industry is in a state of transformation as public health perceptions shift and drive regulatory changes. Companies will have to navigate the significant environmental and social issues affecting the industry and its customers in order to protect shareholder value over the long term. Companies that manage these trends will be able to successfully capture opportunities for growth and attain a stronger competitive position.

Analysts valuing tobacco companies typically examine year-over-year sales growth, which recently has been greatly affected by a company’s exposure to developing markets. Population growth and income trends can help predict future revenue growth in these markets. These highly global operations can also expose tobacco companies to currency fluctuations. Tobacco stocks are generally characterized by high dividends. They are seen as relatively safe investments, making investment in this industry somewhat inversely related to the current interest rate as investors seek out predictable,
low-risk returns. There are some funds and individuals that purposefully do not invest in tobacco stocks, along with other so-called “sin stocks,” which lower the amount of overall capital available for investment in this industry.33

LEGISLATIVE AND REGULATORY TRENDS IN THE TOBACCO INDUSTRY

Regulations in the U.S. and abroad represent the formal boundaries of companies’ operations, and are often designed to address the social and environmental externalities that businesses can create. Beyond formal regulation, industry practices and self-regulatory efforts act as quasi-regulation and also form part of the social contract between business and society. In this section, SASB provides a brief summary of key regulations and legislative efforts related to this industry, focusing on social and environmental factors.

The Tobacco industry is subject to multiple regulatory standards and frameworks related to health impacts, advertising, labeling, distribution, and product ingredients. Furthermore, many states, cities, and municipalities have banned or limited smoking in public and private places, which may reduce the number of users or the volume of products used.34 Given the international presence of the industry, global regulatory frameworks are in some cases relevant, and regulations may differ considerably from state to state or country to country.

The 2009 Family Smoking Prevention and Tobacco Control Act (FSPTCA) granted the U.S. Food and Drug Administration (FDA) broad authority to regulate the domestic tobacco market, including manufacturing, distribution, and advertising. The FSPTCA builds upon previous laws such as those set by the Federal Comprehensive Smoking Education Act (1984) and the Federal Comprehensive Smokeless Tobacco Health Education Act (1986), which outline the requirements for warning labels on cigarette and smokeless tobacco packages.35 Smokeless tobacco products such as e-cigarettes also fall under the jurisdiction of the FSPTCA, however the FDA has not indicated whether it will introduce additional regulations.36 The FSPTCA focuses on safeguarding public health, and has implemented new guidelines designed to prevent underage consumers from smoking. Measures include stricter rules on product labeling and sales.37

The World Health Organization’s (WHO) Framework Convention on Tobacco Control (FCTC, 2005), signed by 168 countries, is the first international public health treaty on tobacco.38 Although the U.S. is a signatory, Congress has not yet ratified the treaty. The treaty’s objective is to promulgate a cohesive approach to tobacco regulation. Manufacturers anticipate that the treaty will lead to further regulatory developments in markets worldwide.39 In February of 2014, E.U. member states approved a revised E.U. Tobacco Products Directive, which informs rules for tobacco product manufacturing and marketing. The directive addressed the emergence of e-cigarettes, the efficacy of health warnings, and the use of flavored tobacco products.40

In the U.S., tobacco products are heavily taxed at both the federal and state levels. In 2009, President Obama raised the federal cigarette tax from $0.39 to $1.01 per pack. In 2013, state taxes ranged between $0.17 (Missouri) and $4.35 (New York).41 Excise taxes represent a substantial ongoing cost for tobacco
manufacturers. For example, in 2014, Altria Group spent 27 percent of net revenue, or 46 percent of total costs, on excise taxes. Because consumer demand for cigarettes is relatively inelastic, much of this cost can be passed onto consumers. However, prices do have some effect on demand (especially among low-income smokers). A U.S. Congressional Budget Office study found that, on average, a ten percent increase in price reduces adult smoking rates by three to seven percent.

As described above, the regulatory and legislative environment surrounding the Tobacco industry emphasizes the importance of sustainability management and performance. Specifically, recent trends suggest a regulatory emphasis on consumer protection, which will serve to align the interests of society with those of investors.

The following section provides a brief description of each sustainability issue that is likely to have material implications for companies in the Tobacco industry. This includes an explanation of how the issue could impact valuation and evidence of actual financial impact. Further information on the nature of the value impact, based on SASB’s research and analysis, is provided in Appendix IIA and IIB.

Appendix IIA also provides a summary of the evidence of investor interest in the issues. This is based on a systematic analysis of companies’ 10-K and 20-F filings, shareholder resolutions, and other public documents, which highlights the frequency with which each topic is discussed in these documents. The evidence of interest is also based on the results of consultation with experts participating in an industry-working group (IWG) convened by SASB. The IWG results represent the perspective of a balanced group of stakeholders, including corporations, investors or market participants, and public interest intermediaries.

The industry-specific sustainability disclosure topics and metrics identified in this brief are the result of a year-long standards development process, which takes into account the aforementioned evidence of interest, evidence of financial impact discussed in detail in this brief, inputs from a 90-day public comment period,
and additional inputs from conversations with industry or issue experts.

A summary of the recommended disclosure framework and accounting metrics appears in Appendix III. The complete SASB standards for the industry, including technical protocols, can be downloaded from www.sasb.org. Finally, Appendix IV provides an analysis of the quality of current disclosure on these issues in SEC filings by the leading companies in the industry.

SOCIAL CAPITAL

Social capital relates to the perceived role of business in society, or the expectation that a business will contribute to society in return for its license to operate. It addresses the management of relationships with key outside stakeholders, such as customers, local communities, the public, and the government. It includes issues around responsible business practices in marketing and advertising.

The adverse health consequences of using tobacco products are well established. To maintain the long-term sustainable evolution of the industry, it is important for companies to address consumer health concerns and stay abreast of constantly evolving health and advertising regulations. Increasing consumer awareness of the detrimental effects of tobacco use presents a risk to the industry’s revenues and long-term growth, while the regulatory environment presents ongoing risks for litigation expenses and restrictions on product advertising.

Public Health

Health officials recognize that tobacco products are harmful to both consumers and those around them. Health problems associated with tobacco use include lung disease, cancer, and heart disease. Compounding these health risks is the fact that nicotine, a substance found naturally in tobacco leaves, is addictive. Over the past several decades, as scientific studies have linked tobacco use to cancer and other diseases, tobacco product manufacturers have faced lawsuits from individuals, governments, corporations, and other groups. In some cases this has resulted in multi-billion dollar settlements. These settlements reflect a shift in the U.S. legal system’s perception of tobacco users from people who choose to smoke to nicotine addicts who represent potential legal liability for tobacco companies. Regulations governing the ingredients in and marketing of tobacco products are evolving. Additionally, the industry’s health impacts have led some investors to divest from tobacco companies. In an effort to address these risks, tobacco product manufacturers have created an array of reduced-risk products aimed at minimizing the health impacts from tobacco use and accessing new markets. These products are not without their own health risks, but they are potentially less harmful than cigarettes and therefore may have an overall positive impact on public health. The products include e-cigarettes, snus, chewing tobacco, and nicotine replacement products (e.g., nicotine gum). Future scientific studies could either prove or disprove these reduced harm assertions.

These new products also address shifting public sentiment about tobacco use. The 1964 report Smoking and Health: Report of the Advisory Committee to the Surgeon General, issued by the Surgeon General’s office, caused a sea change in public perceptions of smoking. Prior to the report, 44 percent of Americans believed that smoking caused cancer. By 1968 that number had increased to 78 percent; today it is a
nearly universal belief.\textsuperscript{48} Regardless, many people still choose to smoke and use tobacco products. Given the dynamic regulatory environment, reduced-risk products can insulate companies from rapid regulatory shifts.

Company performance in this area can be analyzed in a cost-beneficial way through the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Revenue from (1) smokeless tobacco products, (2) non-tobacco nicotine-delivery products, and (3) other “tobacco harm-reduction” products; and
- Description of the process to assess risks and opportunities associated with “tobacco harm-reduction” products.

Evidence

The association between tobacco and adverse health impacts is a key variable in the industry’s long-term position. As mentioned above, increasing consumer awareness of this issue is affecting industry growth, while progressively more stringent regulations will require improvements to existing products and the development of alternatives.

The FSPTCA gives the FDA the authority to regulate tobacco products in the interest of public health. These regulations control many aspects of tobacco product manufacturing and sales, including ingredients, marketing tactics, sales methods, health claims, labeling, and research.\textsuperscript{49}

Tobacco product manufacturers may face considerable difficulties and costs as they develop new tobacco products with more favorable health impacts. For example, in its FY2013 10-K statement, Lorillard stated that “consumer health concerns and changes in regulations are likely to require us to introduce new products or make substantial changes to existing products…We may not be able to develop a reduced risk or reduced exposure product that the FDA allows to be marketed or is acceptable to consumers. In addition, the costs associated with developing any such new products and technologies could be substantial.”\textsuperscript{50}

A growing trend in the reduced-risk product category is the use of e-cigarettes. E-cigarettes are tobacco-free vaporizers; instead of burning tobacco, they heat and vaporize a liquid containing nicotine, which is then inhaled. E-cigarettes have been celebrated for having health advantages over cigarettes and are used both by smokers hoping to quit or looking to cut down on the harmful impacts of smoking.\textsuperscript{51} There is currently no conclusive scientific evidence that e-cigarettes have lower health risks than traditional cigarettes, although the lack of tobacco combustion makes it possible. Current consumer sentiment regarding the relative safety of these products\textsuperscript{52} will likely continue until it is either confirmed or refuted by long-term studies.\textsuperscript{53}

The rise in popularity of e-cigarettes as an alternative to traditional cigarettes has drawn the attention of health officials and regulators. The CDC reported in September 2013 that the use of e-cigarettes among teens had more than doubled, increasing from 4.7 percent in 2011 to 10.0 percent in 2012. The products are a major source of revenue growth for tobacco companies. While traditional cigarette sales fell roughly 30 percent between 2004 and 2014, electronic cigarettes have been projected to have nearly 25 percent year-over-year growth through 2018.\textsuperscript{54} Currently, the FSPTCA does not extend to e-cigarettes. However, in April 2014, the FDA
released a proposed rule for public comment detailing which products meet the statutory definition of tobacco product under the Federal Food, Drug, and Cosmetic Act, as amended by the FSPTCA. Lorillard, in its FY2013 Form 10-K, warns that “legislative, regulatory and other efforts to limit the sale, marketing and use of electronic cigarettes may continue or accelerate, which could have a material adverse effect on our electronic cigarette business.” This disclosure highlights the fact that tobacco’s extremely uncertain regulatory environment means that new products and technologies may not always be successful revenue drivers. In 2015, the CDC launched a public health media campaign that attacked both electronic and traditional cigarettes.

Some public health experts also consider oral tobaccos, such as snus or chewing tobacco, reduced-risk products, although this is a contested view. While U.S. smoking rates declined, smokeless tobacco has had a 12.5 percent growth in per-capita consumption, by weight, between 2005 and 2014. This is likely buoyed by perceived lower health risks and increasing bans on smoking in public places.

**Value Impact**

The adverse public health impacts of tobacco use directly affect the Tobacco industry’s revenue and growth prospects, and can generate litigation costs. Increasing consumer awareness of health impacts is likely to reduce revenues. Furthermore, new regulations could increase costs related to production and marketing, while restricted development of some products, or regulations concerning permissible locations for tobacco product use, could also lower revenues and growth potential.

Companies able to adapt to changing consumer preferences are likely to improve their competitive advantage and increase their intangible assets. By increasing R&D expenditures in the short- to medium-term, companies may be able to expand their product lines, capture new market opportunities, and strengthen their pricing power. On the other hand, risks associated with the evolving regulatory environment and negative image of the industry are likely to increase tobacco manufacturers’ capital costs. This could further lead to outflows of investments from the industry.

Disclosure of a company’s revenues and strategy in the three “reduced risk” product areas mentioned above provides insight into management’s view of the size and scale of the potential market as well as an indication of which type(s) of product are prioritized.

**Marketing Practices**

Tobacco product marketing is heavily regulated, both in the U.S. and abroad. The FCTC has led many countries to introduce new regulatory approaches. Many laws aim to prevent people from adopting tobacco use at a young age as well as ensuring transparent advertising about tobacco’s health risks. The industry has faced costly legal battles related to the marketing and advertising of its products, including the Master Settlement Agreement (MSA), which changed the way tobacco products are marketed and mandated substantial annual payments to U.S. states. The WHO has criticized even Corporate Social Responsibility (CSR) efforts by tobacco companies as being too close to product promotion.

Tobacco product manufacturers face a dynamic regulatory environment. Marketing for new
smokeless tobacco products and traditional tobacco products will have to balance regulatory requirements with the need to reach new markets. It is important to note that companies have differing degrees of exposure to international marketing and regulatory issues. Some companies in this industry are entirely U.S.-focused, such as Reynolds American, while others have diverse international holdings, like Phillip Morris International.

Company performance in this area can be analyzed in a cost-beneficial way though the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Amount of legal and regulatory fines, settlements, and enforcement actions associated with marketing, labeling, and advertising;
- Description of alignment of tobacco advertising, promotion, and sponsorship (TAPS) activities with Article 13 of the WHO Framework Convention on Tobacco Control (FCTC); and
- Description of alignment of tobacco labeling and packaging practices with Article 11 of the WHO FCTC.

**Evidence**

In 1998, the five largest U.S. tobacco companies and the Attorneys General of 46 U.S. states, five U.S. territories, and the District of Columbia reached an agreement termed the Master Settlement Agreement (MSA). The MSA settled litigation related to the marketing, advertising, and promotion of tobacco products, and required the companies to pay a total of $206 billion to claimants over a nine-year period. The MSA pertains only to litigation with states; companies are still at risk of personal claims. These cases generally hinge on the idea that the tobacco companies in a given region misrepresented the health risks of their products. In general, damages and litigation costs awarded for smoking-related injury and death are substantial, although some have later been reduced by appeal. For example, a $28 billion fine levied against Philip Morris in 2002 was later reduced to $28 million on appeal. Individuals, especially in Florida where a 2006 Florida Supreme Court case ruled that members of a class action suit could file individually, have had successful lawsuits against tobacco companies.

In 2013, a Florida man who smoked for forty years and developed a lung disease won a case against Philip Morris and the Liggit Group and was awarded $12.5 million in damages. In July 2014, R.J. Reynolds was fined $23.6 billion in punitive damages in a similar individual suit, although the company is expected to appeal.

In June 2015, the Quebec Supreme Court ruled against Imperial Tobacco, Rothmans Benson & Hedges, and JTI-MacDonald, ordering them to pay $15 billion in a class action suit brought by more than one million people. All three companies have promised to appeal, although the ruling judge in this case demanded $1 billion be paid out before the appeal.

The MSA required the then-top five tobacco product manufacturers to alter the way they advertised their products, especially to young people. The settlement stipulated that outdoor advertising, product placement, sponsorships, cartoons, advertisements targeting youth, and tobacco brand apparel and merchandise were no longer permitted. These restrictions significantly affected the industry’s ability to market and sell cigarettes. Reynolds American stated in its FY2013 Form 10-K that the agreements of the MSA “impose a perpetual
stream of future payment obligations on RJR Tobacco and the other major U.S. cigarette manufacturers, and place significant restrictions on their ability to market and sell tobacco products in the future. They have materially adversely affected RJR Tobacco’s shipment volumes.”

This is not to say that tobacco companies cannot still advertise in the U.S. In 2012, tobacco companies spent more than $9.6 billion on advertising and product promotions nationally. Regulations require this spending to be focused—roughly ninety-three percent is spent on point-of-sale advertising (e.g., branded posters in a gas station) as well as promotional deals. Companies can also advertise in some forums, like magazines, although the MSA stipulates that they not target those below legal smoking age. Interpretation of this rule is left somewhat to the companies themselves, and R.J. Reynolds has recently come under fire from some health organizations for its advertisements in publications such as Rolling Stone and People, which do have significant youth readership. Whether this will be dealt with through further regulation or whether the company’s response will placate the public and regulators is difficult to foresee.

The FSPTCA included several new stipulations for the marketing and advertising of tobacco products. Companies must balance the requirements of the law with the need to develop and market new products that appeal to health-conscious consumers. Lorillard reports that “[t]hese limitations may make it difficult to maintain the value of an existing brand if sales or market share decline for any reason. Moreover, these limitations significantly impair the ability of cigarette manufacturers, including us, to launch new premium brands.” Globally, increasingly stringent requirements are likely to follow, particularly from the WHO’s FCTC. It has two specific articles that offer strict guidance for it signatories, 11, which deals with packaging and labeling, and 13, which addresses advertising, promotion and sponsorship.

Governments in some countries have or are considering even more stringent regulation for the advertisement of cigarettes. For example, the U.K., among other countries, is looking to add “plain-packaging” laws like those currently in place in Australia. These laws prohibit anything other than governmentally mandated packaging on cigarettes (brands are differentiated only by name in a uniform font), which generally shows graphic, negative tobacco-related health outcomes. A 2012 study found a thirty-five percent increase in smokers who were attempting to quit following the implementation of Australia’s plain-packaging law.

A University of Cape Town study found that advertising bans have the greatest effects in developing markets—markets that this industry is dependent upon for continued revenue growth. This study found that comprehensive advertising bans reduced per-capita tobacco consumption in these markets by 24 percent, while limited advertising bans reduced per-capital consumption by 14 percent.

The success of restrictive advertising laws in the U.K. and elsewhere could have a significant effect on the revenue of companies with exposure to these markets. Companies could attempt self-regulatory measures, like voluntarily restrictions of certain mediums or markets, to help avoid stricter regulatory outcomes.
**Value Impact**

The marketing of tobacco products can affect the financial performance of tobacco product manufacturers through litigation costs and adverse revenue impacts. Marketing that is not compliant with existing or future regulation could result in personal injury claims or government fines, increasing a company’s contingent liabilities. Furthermore, unified government regulations can reduce companies’ ability to reach customers or sell certain products. Limited advertising possibilities could reduce the accessible market for tobacco products and thus lower revenues or revenue growth opportunities. Significant violations could result in negative reputational effects that could lower the value of a company’s intangible assets.

The magnitude of fines and settlements indicates a company’s ability to comply with marketing, advertising, and labeling regulation. Disclosure of a company’s alignment with the WHO framework provides insight into management’s approach to advertising and marketing relative to an accepted benchmark. This will also provide insight into the company’s behavior in different markets, which may be subject to differing regulations.
This list includes five companies representative of the Tobacco industry and its activities. This includes only companies for which the Tobacco industry is the primary industry, companies that are U.S.-listed but are not primarily traded over the counter, and for which at least 20 percent of revenue is generated by activities in this industry, according to the latest information available on Bloomberg Professional Services. Retrieved on April 15th, 2015.

<table>
<thead>
<tr>
<th>COMPANY NAME (TICKER SYMBOL)</th>
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<tr>
<td>Philip Morris International Inc. [PM]</td>
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<td>Altria Group Inc. [MO]</td>
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<td>Reynolds America [RAI]</td>
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<td>Vector Group Ltd. [VGR]</td>
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<td>Universal Corp. [UVV]</td>
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## APPENDIX IIA

### EVIDENCE FOR SUSTAINABILITY DISCLOSURE TOPICS

<table>
<thead>
<tr>
<th>Sustainability Disclosure Topics</th>
<th>HM (1-100)</th>
<th>IWGs</th>
<th>Revenues &amp; Costs</th>
<th>Assets &amp; Liabilities</th>
<th>Cost of Capital</th>
<th>EFI</th>
<th>Probability &amp; Magnitude</th>
<th>Externals</th>
<th>FLI</th>
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<td>Marketing Practices</td>
<td>55*</td>
<td>71</td>
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<td>1 high</td>
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<td></td>
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</table>

**HM:** Heat Map, a score out of 100 indicating the relative importance of the topic among SASB’s initial list of 43 generic sustainability issues. Asterisks indicate “top issues.” The score is based on the frequency of relevant keywords in documents (i.e., 10-Ks, 20-Fs, shareholder resolutions, legal news, news articles, and corporate sustainability reports) that are available on the Bloomberg terminal for the industry’s publicly listed companies. Issues for which keyword frequency is in the top quartile are “top issues.”

**IWGs:** SASB Industry Working Groups.

**%:** The percentage of IWG participants that found the disclosure topic likely to constitute material information for companies in the industry. (-) denotes that the issue was added after the IWG was convened.

**Priority:** Average ranking of the issue in terms of importance. 1 denotes the most important issue. (-) denotes that the issue was added after the IWG was convened.

**EI:** Evidence of Interest, a subjective assessment based on quantitative and qualitative findings.

**EFI:** Evidence of Financial Impact, a subjective assessment based on quantitative and qualitative findings.

**FLI:** Forward-looking Impact, a subjective assessment of the presence of a material forward-looking impact.
## APPENDIX IIB
### EVIDENCE OF FINANCIAL IMPACT FOR SUSTAINABILITY DISCLOSURE TOPICS

<table>
<thead>
<tr>
<th>Evidence of Financial Impact</th>
<th>Revenue</th>
<th>Operating Expenses</th>
<th>Non-operating Expenses</th>
<th>Assets</th>
<th>Liabilities</th>
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<tr>
<td>Public Health</td>
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- **MEDIUM IMPACT**: Light gray
- **HIGH IMPACT**: Dark gray
## APPENDIX III

### SUSTAINABILITY ACCOUNTING METRICS | TOBACCO

<table>
<thead>
<tr>
<th>TOPIC</th>
<th>ACCOUNTING METRIC</th>
<th>CATEGORY</th>
<th>UNIT OF MEASURE</th>
<th>CODE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Public Health</strong></td>
<td>Revenue from (1) smokeless tobacco products, (2) non-tobacco nicotine-delivery products, and (3) other “tobacco harm-reduction” products</td>
<td>Quantitative</td>
<td>U.S. Dollars ($)</td>
<td>CN0302-01</td>
</tr>
<tr>
<td></td>
<td>Description of the process to assess risks and opportunities associated with “tobacco harm-reduction” products</td>
<td>Discussion &amp; Analysis</td>
<td>n/a</td>
<td>CN0302-02</td>
</tr>
<tr>
<td><strong>Marketing Practices</strong></td>
<td>Amount of legal and regulatory fines, settlements, and enforcement actions associated with marketing, labeling, and advertising*</td>
<td>Quantitative</td>
<td>U.S. Dollars ($)</td>
<td>CN0302-03</td>
</tr>
<tr>
<td></td>
<td>Description of alignment of tobacco advertising, promotion, and sponsorship (TAPS) activities with Article 13 of the World Health Organization Framework Convention on Tobacco Control (WHO FCTC)</td>
<td>Discussion &amp; Analysis</td>
<td>n/a</td>
<td>CN0302-04</td>
</tr>
<tr>
<td></td>
<td>Description of alignment of tobacco labeling and packaging practices with Article 11 of the World Health Organization Framework Convention on Tobacco Control (WHO FCTC)</td>
<td>Discussion &amp; Analysis</td>
<td>n/a</td>
<td>CN0302-05</td>
</tr>
</tbody>
</table>

* Note to CN0302-03—Disclosure shall include a description of fines and settlements and enforcement actions and corrective actions implemented in response to events.
APPENDIX IV: Analysis of SEC Disclosures | Tobacco

The following graph demonstrates an aggregate assessment of how representative U.S.-listed Tobacco companies are currently reporting on sustainability topics in their SEC annual filings.

![Graph showing type of disclosure on sustainability topics]

**TYPE OF DISCLOSURE ON SUSTAINABILITY TOPICS**

<table>
<thead>
<tr>
<th>Tobacco</th>
<th>0%</th>
<th>10%</th>
<th>20%</th>
<th>30%</th>
<th>40%</th>
<th>50%</th>
<th>60%</th>
<th>70%</th>
<th>80%</th>
<th>90%</th>
<th>100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Health</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>34%</td>
<td></td>
<td>86%</td>
</tr>
<tr>
<td>Marketing Practices</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>81%</td>
</tr>
</tbody>
</table>

IWG Feedback*

*Percentage of IWG participants that agreed topic was likely to constitute material information for companies in the industry.
REFERENCES

2 Ibid., p. 5.
3 Ibid., pp. 5-7.
4 Ibid., p. 4.
7 SASB’s calculation based on data from Bloomberg Professional/service accessed June 16, 2015, using the BI TOBCG <GO> command.
17 Bloomberg Professional/service accessed April 15, 2015, using the ICS <GO> command. The data represents global revenues of companies listed on global exchanges and traded over-the-counter (OTC) from the Tobacco industry, using Level 3 of the Bloomberg Industry Classification System.
17 Ibid., p. 23.
18 SASB’s calculation based on data from Bloomberg Professional/service accessed April 15, 2015, using the ICS <GO> command.
20 Ibid., p. 22.
21 Ibid., p. 7.


59 SASB calculation based on data from Bloomberg Professional service accessed June 15, 2015, using the BI TOBCG <GO> command.


62 Ibid.


71 Ibid.


