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KT&G USA CORPORATION,
BEFORE THE U.S. INTERNATIONAL TRADE COMMISSION

4th Tier Cigarettes from Korea
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Good morning. My name is Candice White, and I am Regional Sales Manager for KT&G USA in the North Central Region of the United States. I started working for KT&G USA in January 2018 as an Account Manager. I was responsible for retail sales in Indiana, where I live. In May 2018, I was promoted to Regional Sales Manager for the Northeast Region, which covers Indiana, Ohio, and Michigan. In January 2019, I started my current role, in which I manage wholesale and retail account managers in Indiana, Illinois, Wisconsin, and Minnesota. In my current position, I work directly with customers at all stages of the process, from initial sales communications to maintaining relationships with regular clients. Prior to joining KT&G USA, I had three decades of experience working in the consumer package industry, including both retail and wholesale.

I'm grateful for the staff's time today and would like to spend the next several minutes providing an overview of the cigarette industry in the United States. I'll begin by summarizing the structure of the cigarette industry and the role played by the Major tobacco companies. I'll then address how cigarettes are marketed and sold in the United States, and I'll explain that there is no clear dividing line between so-called "fourth tier" cigarettes and any other cigarette.

Structure of Cigarette Industry in the United States

To understand this industry, it is critical to begin with the context that the market in the United States is and has long been dominated by the so-called "Majors" – which today means Philip Morris and RJR. These large companies were established long before KT&G entered the U.S. market, at a time when there were fewer restrictions on cigarette advertising. As a consequence, the Majors have been able to develop enduring brands that later entrants into the market could not. Brand recognition, in turn, allows the Majors to command price premiums in the market that are not realistic for less established brands. With these advantages, the Majors have in the past held as much as 98% of the U.S. market, and more recently hold roughly 85%.

Cigarette manufacturers that entered the market later, like KT&G, Xcaliber, and Cheyenne, are thus at a disadvantage compared with the Majors. It is a challenge for us to win and grow market share in the United States. It is important to understand that the combined sales of the Petitioner and KT&G represent market share that at one point belonged to the Majors.

That is why the Petition is wrong to claim that KT&G, Xcaliber, and Cheyenne compete only against one another in a narrow, "fourth tier" sliver of the market. Instead, all 3 companies are in direct competition with producers selling across the price continuum, including the Majors, which fight hard to defend and grow their market share. For example, both Majors offer discount brands, such as RJR's Pall Mall and Philip Morris's Chesterfield. They sell established, premium brands at a large markup. They also compete to retain market share by placing other products at multiple price tiers.

The Majors utilize two main tools to protect their position: everyday low price contracts with retailers, and leaders programs with distributors. Every Day Low Price or EDLP contracts, which RJR uses often, require a retail outlet to set the price for the Major's discount brands as a

floor. No other cigarettes can be sold at a lower price without the retailer losing the benefits of the contract. These EDLP contracts exist because the Majors rightly view discount cigarettes as competitors, and they affect KT&G's ability to price and sell our products. Such agreements are also widespread. I would estimate that over half the retailers in my region have EDLP contracts.

The Majors also use Leaders programs, which require wholesalers to sell their product in a way that maintains their current market share. For these programs, the market share is defined based on all cigarettes across all tiers, including fourth tier cigarettes. This shows how the U.S. market works, and how the domestic industry understands it. The Majors know that they are competing not only against each other, but also against KT&G, Cheyenne, Xcaliber, JTI, Liggett, ITG, and others.

So the Majors compete at a range of price points in a way that directly affects sales of KT&G brands. In addition, there are a number of smaller producers that the Petitioner does not define as fourth tier, but that we compete with regularly. For example, one of our biggest competitors in Minnesota is Liggett's Montego brand, which is not a fourth tier product according to the Petitioner. In Indiana, my home state, we compete with Xcaliber's Edgefield and Berley brands, and also with imports of the LD brand cigarettes made by JTI. JTI stands for Japan Tobacco International, another foreign producer. In Kentucky, two of our biggest competitors are Liggett's Eagle brand and JTI's LD brand. Notably, Xcaliber operates in both Indiana and Kentucky. In these states, it competes not just against KT&G, but also against discount cigarettes produced by Liggett and JTI.

At the same time, U.S. cigarette manufacturers must deal with the reality that the size of the U.S. market as a whole is shrinking. An increasing number of users have quit smoking or moved to other tobacco products, such as e-cigarettes. For instance, I am aware of tobacco shops

in my region that have moved away from tobacco products altogether, offering CBD and vapor products instead. This decline in demand is not the only challenge the industry faces. State and local taxes have driven up the retail prices for cigarettes, and restrictive regulations have also become more widespread. In my region, for example, Minneapolis has imposed restrictions on the sale of menthol cigarettes.

The Minneapolis example illustrates another somewhat unique aspect of the U.S. cigarette market, which is the degree to which competition varies from state to state due to regional preferences and to differences in state and local taxes and regulations. Some brands and products are regional, while others are national. Some states have higher taxes and stricter regulations than others. The result is that competition looks very different in Minnesota than in Indiana.

Having summarized these general features of the U.S. market, I would like to turn to specific aspects of how domestic cigarettes are marketed, sold, and perceived.

Like Product Factors

The Petition claims that so-called fourth tier cigarettes are positioned differently in the U.S. market than all other cigarettes. This claim is not consistent with my knowledge and experience.

First, almost all cigarettes in the United States are sold initially to distributors. As a result, cigarettes at all price tiers pass through the same channel of distribution, and are not sold directly to retail. It is common for U.S. distributors to carry cigarettes brands at all price points. KT&G sells its products exclusively through distributors. We form relationships with these distributors by helping promote KT&G's products to retailers.

After manufacturers sell to distributors, the distributors sell both premium and discount brands to retailers. Retailers market and sell what the Petition calls "fourth-tier" cigarettes alongside premium brands. For instance, national convenience store chain Circle K displays KT&G's products, including THIS, on the same rack with Xcaliber's Edgefield and Philip Morris' Marlboro Reds. In my region, KT&G's products are routinely displayed by retailers alongside both premium and other discount brands.

Consumers and industry participants do not see any clear difference between so-called "fourth tier" cigarettes and other cigarettes. For many consumers, cigarettes are interchangeable. For consumers that don't try different products, this brand loyalty is usually a result of long-term marketing and personal tastes. In selecting cigarettes, consumers primarily search for fulfillment, price, and taste. Our repeat customers choose KT&G cigarettes based more on taste and satisfaction than price.

When it comes to price, there are no defined cut-offs. There is a continuum that varies from state to state. Cigarettes at every price point along that spectrum, with no clear gap. The industry uses different terms to describe the different price levels. Regardless of labels, the pricing categories are not well-defined or absolute, and companies sell at multiple levels. As I discussed earlier, a brand made by a Major can be and often is sold at the same price as a so-called "fourth tier" brand through EDLP contracts. Ultimately, the price paid by consumers is always set by retailers, not by manufacturers or wholesalers.

Closing/Summary

In closing, I hope this overview of competition in the U.S. cigarette market is helpful to the staff. Thank you for taking the time to consider these issues, which are very important to our company. I would be happy to answer any questions you may have.