



Economic Impact Analysis: Minneapolis Menthol Tobacco Ban

August 2017

Notice

This presentation is based on an analysis conducted by Management Science Associates Inc. (MSAi) and does not necessarily reflect the opinion of any client. The definitions and analysis used in the presentation are based on general industry knowledge and typically represent the way a tobacco retailer may refer to the broad tobacco and nicotine delivery industry.

Purpose of this analysis

- ◆ In August 2017, the Minneapolis City Council approved an ordinance that will restrict the sale of menthol cigarettes, as well as other menthol, mint and wintergreen flavored tobacco products, to adult-only tobacco stores and liquor stores. These restrictions will take effect on August 1, 2018.
- ◆ This analysis evaluates the potential economic impact of the ordinance on the retailers within the city limits of Minneapolis (“MPLS”) who will be subject to these restrictions.

About MSAi

- ◆ Management Science Associates (“MSAi”) was founded in 1963 by Dr. Alfred A. Kuehn, a faculty member at Carnegie Mellon University
- ◆ MSAi has been providing tobacco-related reporting and analysis for over 40 years
- ◆ Named in the 1998 Master Settlement Agreement as a neutral 3rd party and tasked with confirming the cigarette volumes for those manufacturers that have agreed to the settlement
- ◆ MSAi’s confirmed shipment volumes are used to determine the payment amounts made by manufacturers as defined in the Master Settlement Agreement

Data Sources

- ◆ Wholesale shipments to retail in Minneapolis covering all trade classes
- ◆ Store-level transactional Point of Sale (“POS”) data
- ◆ Review of published literature, analyses and surveys regarding the convenience store industry and tobacco regulations

Notes & Considerations

- ◆ When the MPLS city council approved the restrictions on menthol tobacco products in early August 2017, it was decided that the enforcement of these restrictions would not begin until August 1, 2018. For the purposes of this study, however; the estimated annual impact of the menthol restrictions is calculated presuming the ban started in July 2017.
- ◆ The MPLS ordinance defines tobacco outlets as establishments which derive at least 90% of their gross revenue from the sale of tobacco products. The stores identified as tobacco outlets in the shipment data utilized by MSAi may not all meet this requirement. Given that tobacco outlets account for 6% of all menthol tobacco shipment volume in MPLS, we believe the impact of this difference on the results presented in this study would be negligible.
- ◆ The approved ordinance also stipulates that liquor stores, along with adult-only tobacco outlets, will be allowed to sell menthol tobacco products. The exemption of liquor stores was not specifically considered in this study; however, since less than 4% of menthol tobacco volume in MPLS is currently attributed to liquor stores, this is not expected to have a significant impact on the sales estimates presented.
- ◆ The large cigar subcategory is omitted from this analysis due to large cigars' low menthol volume contribution to the subcategory in Minneapolis.

Notes & Considerations, cont.

- ◆ For the purposes of this analysis, any tobacco products with menthol and/or flavor attributes that include the terms “menthol”, “mint” or “wintergreen” are considered to be menthol.
- ◆ The menthol tobacco volume forecasts in this study are based on distributor to retail shipment data and are inclusive of all products that move through the traditional distributor based supply chain.
- ◆ Volume for electronic cigarettes, e-liquids and related alternative products that are shipped through a distributor are included in this analysis. Similar products provided to stores via alternative methods are not represented in this analysis.
- ◆ This analysis is based on empirical data and trends in activity related to distributor to retail shipments and retail sales. While a variety of scenarios are included, this analysis does not present hypotheses regarding all potential consumer behavior changes (e.g., likelihood of consumers switching from menthol to non-menthol tobacco products due to the menthol restrictions).
- ◆ Lastly, the menthol tobacco volume forecasts shown in this presentation assume there will be no significant disruptions to the tobacco industry or the economic climate in general during this time.

Minneapolis Menthol Economic Impact Study

- ◆ The Minneapolis City Council has approved an ordinance that will restrict the sale of menthol cigarettes, as well as other mint and wintergreen flavored tobacco products, to adult-only tobacco stores and liquor stores. These restrictions will take effect on August 1, 2018.
- ◆ Menthol cigarettes currently account for 43% of total cigarette volume and 88% of total menthol tobacco volume in Minneapolis.
- ◆ The convenience store channel represents 73% of menthol cigarette volume in Minneapolis. Together, tobacco outlets and liquor stores comprise only 9% of menthol cigarette volume.
- ◆ In the U.S., 35% of convenience stores' in-store revenue comes from tobacco. Tobacco is convenience stores' 2nd largest source of in-store gross margin dollars.
- ◆ Management Science Associates leveraged distributor to retail shipment data and retail sales data to develop statistical models and estimate the potential sales impact of the proposed menthol, mint and wintergreen regulations on retailers within the city of Minneapolis.

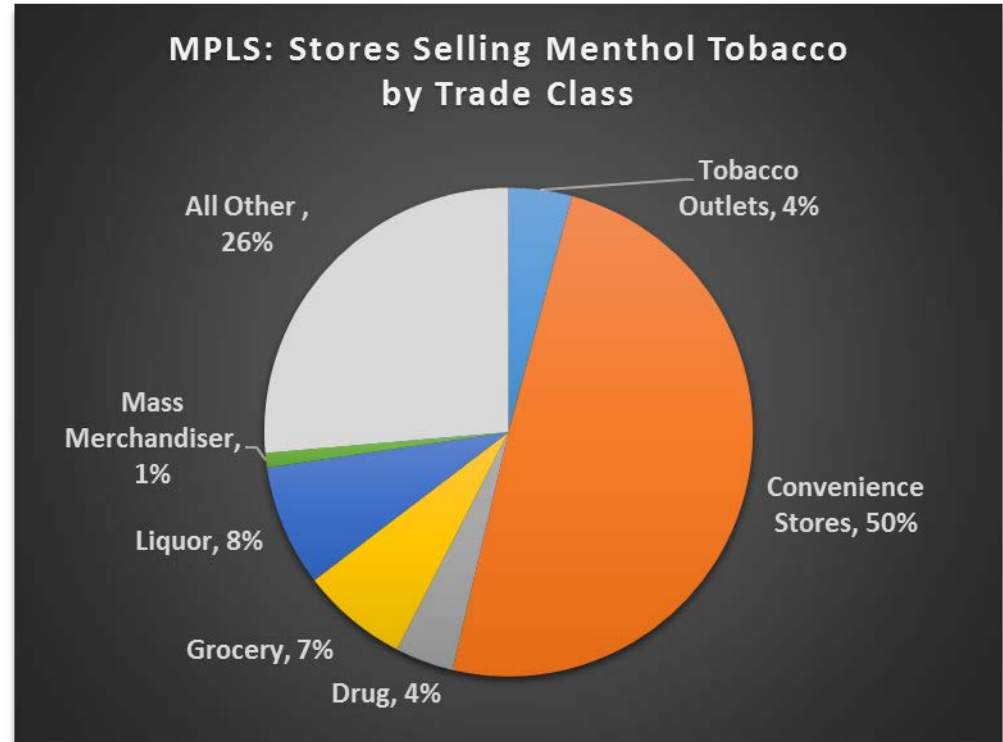
Minneapolis Menthol Restrictions' Impact on Convenience Stores

- ◆ It is estimated that Minneapolis convenience stores would lose \$36.7MM - \$39.9MM annually in menthol, mint and wintergreen tobacco sales and ancillary in-store purchases.
- ◆ This equates to an annual sales loss of \$238K - \$259K and an annual gross margin loss of \$38K - \$44K per convenience store.

	Scenario #1 <i>100% Ancillary Sales Lost</i>	Scenario #2 <i>50% Ancillary Sales Lost</i>
Sales Loss in MPLS C-Stores Tobacco Purchases	-\$33,554,337	-\$33,554,337
Sales Loss in MPLS C-Stores Ancillary Purchases	-\$6,322,077	-\$3,161,039
Tax Revenue Loss in MPLS C-Stores Ancillary Purchases	-\$31,610	-\$15,805
TOTAL	-\$39,908,024	-\$36,731,180

50% of menthol tobacco retailers in Minneapolis are convenience stores

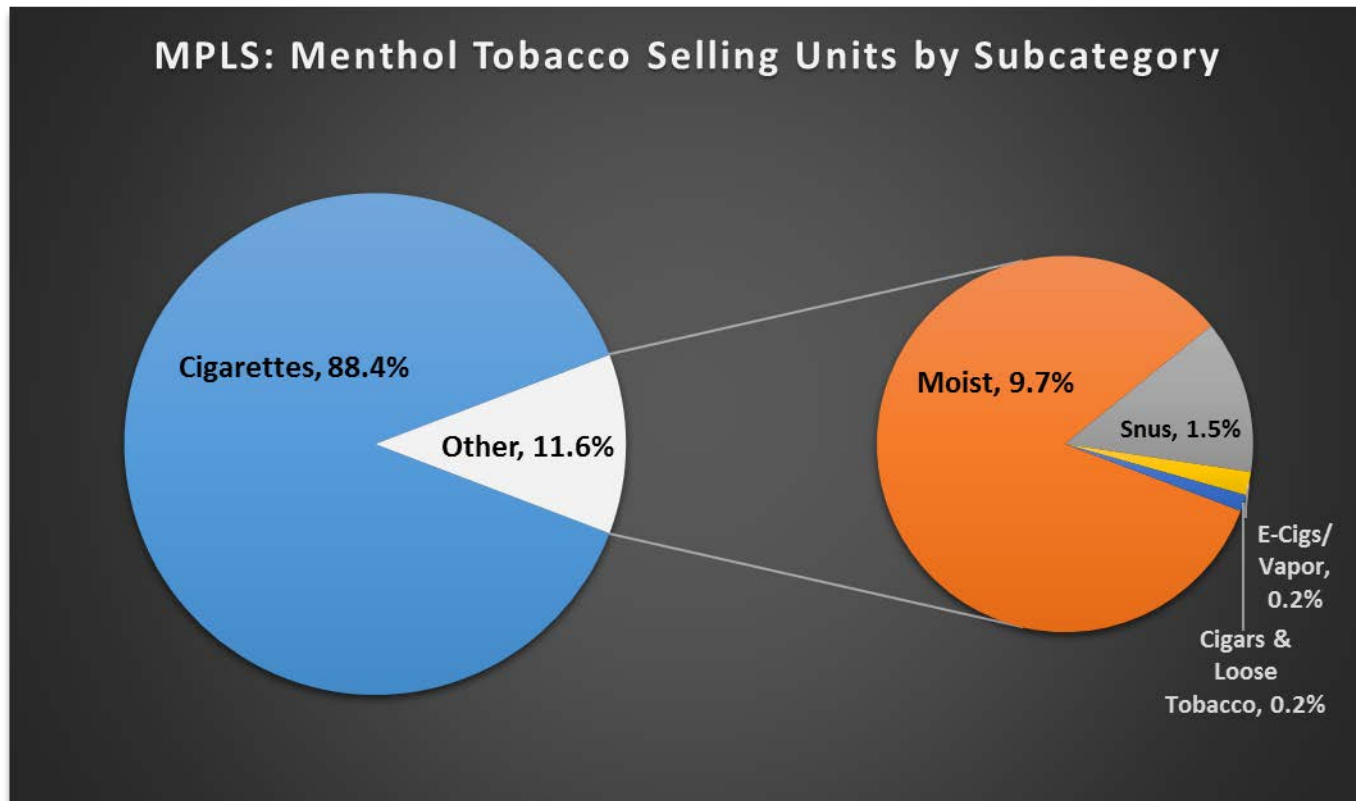
- ◆ The convenience store (“c-store”) channel represents 50% of all stores selling menthol tobacco in MPLS.
- ◆ Together, tobacco outlets and liquor stores comprise only 12% of stores selling menthol tobacco.
- ◆ The “All Other” trade class includes retailers such as dollar stores, news stands, and wholesale clubs.



Source: Distributor to Retail Shipments

Cigarettes dominate menthol tobacco sales

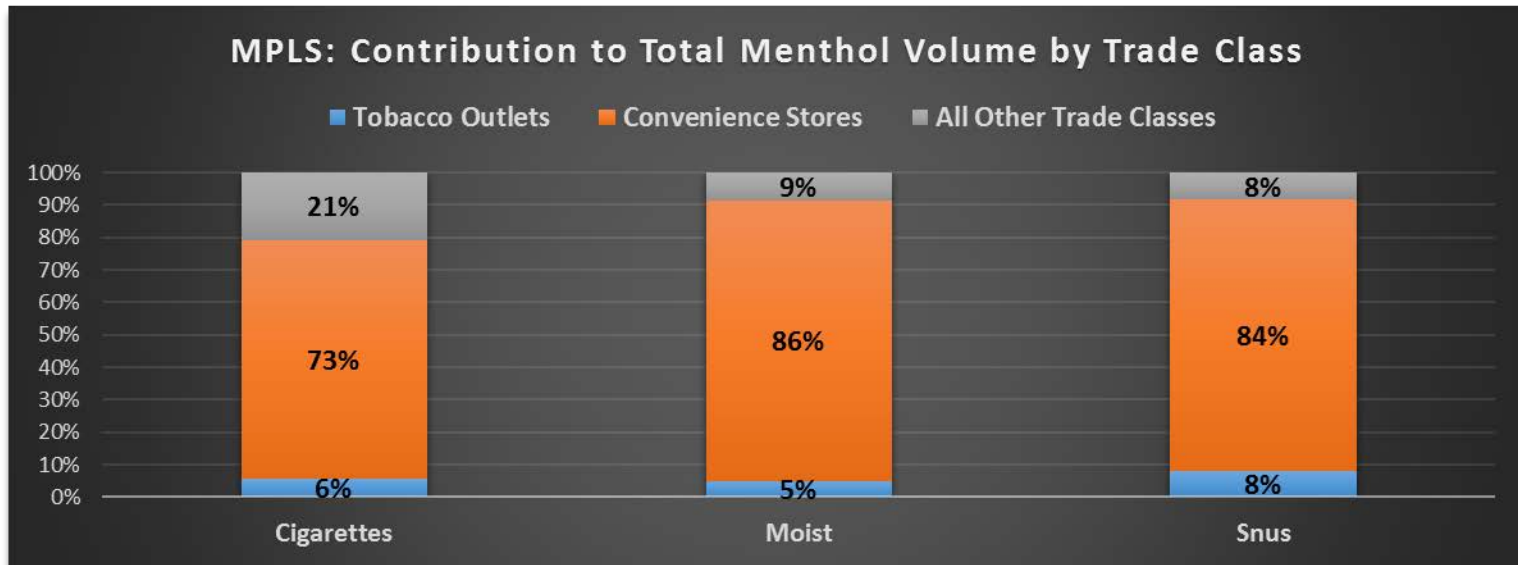
- ◆ Cigarettes account for 88% of menthol tobacco units sold in Minneapolis, with the moist smokeless tobacco product subcategory contributing almost 10%.



Source: Distributor to Retail Shipments

C-stores account for 73% of menthol cigarette volume in Minneapolis

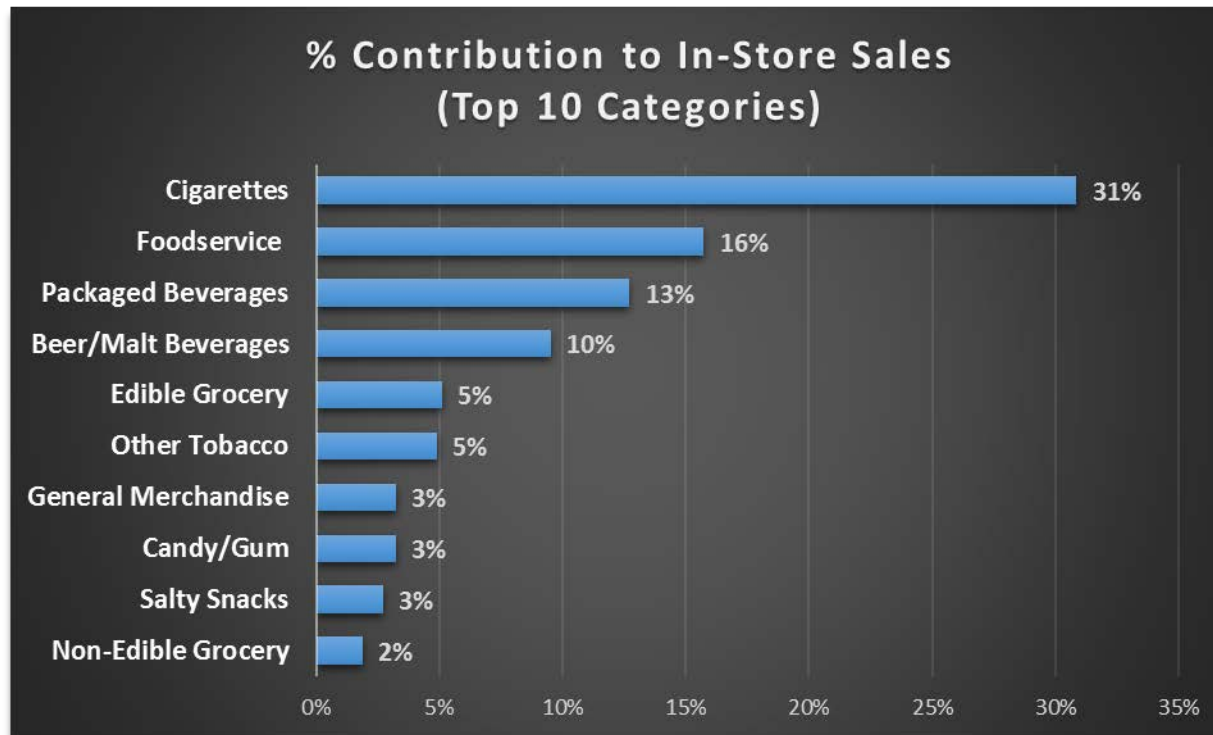
- ◆ 73% of menthol cigarette volume in Minneapolis is sold through the convenience channel, while only 6% is attributed to tobacco outlets. Grocery (9%) and drug stores (6%) are the top contributors in the “all other” group.
- ◆ About 85% of Minneapolis mint and wintergreen volume for moist smokeless tobacco and snus is sold through convenience stores.



Source: Distributor to Retail Shipments

Over 35% of convenience stores' in-store revenue comes from tobacco

- ◆ Cigarettes account for 31% of convenience stores' in-store sales and 37% of their in-store merchandise (i.e., excluding foodservice) sales.
- ◆ Other Tobacco represents 5% of in-store sales and 6% of in-store merchandise revenue.



Source: Convenience Store News, 2016, p. 36; Excludes Fuel & Lottery

Economic impact at the store level

- ◆ Based on the two scenarios presented, the estimated annual sales loss per average convenience store in MPLS ranges from **\$238K - \$259K**.
- ◆ Applying the U.S. average c-store industry gross margin percentages for cigarettes, other tobacco, and total in-store purchases to the projected sales losses for MPLS retailers yields an estimated gross margin loss of **\$38K - \$44K** per convenience store.
 - ◆ The average US convenience store provides 15 jobs, split about equally between full- and part-time workers.
 - ◆ At the current minimum wage of \$7.75 per hour for small businesses in Minnesota, this is equivalent to 2,900 – 3,600 hours of employee wages.
- ◆ There are approximately 30 stores (excl. tobacco outlets) in MPLS that sell at least 7,000 packs of cigarettes annually, over 70% of which are menthol.
 - ◆ If those 30 stores would close and the other remaining stores in MPLS (excl. tobacco outlets) cut employee hours in line with their lost menthol tobacco profits, it is estimated that this would affect approximately 940 employees (a mix of full-time and part-time jobs) or the equivalent of 630 full-time jobs*.

Source: NACS, Distributor to Retail Shipments

*This assumes that any stores that remain open will offset their lost menthol tobacco gross margin dollars by making equivalent cuts to employee hours. The number of employees in MPLS stores is assumed to be in line with the U.S. average (per NACS).