

# The Tobacco Institute of South Africa

## Members Report

*for the year ended 31 December 2006*

### **Nature of Business and Main Objective of the Company**

The Tobacco Institute of South Africa (TISA) is a voluntary trade association with limited liability, which operates on a non-profit basis. The company's main aim is to co-ordinate the tobacco industry within the Republic of South Africa, in accordance with free marketing principles and to the advantage of the tobacco industry as a whole.

### **Organisation Status**

TISA obtained its status as a non-profit organisation (NPO) on 31 July 2003 and has also been confirmed as being exempt from taxation in terms of Section 10(1)(cN) of the Income Tax Act.

### **General Review and Integration of Operations**

Further to information contained in previous annual reports issued by both Tobacco RSA and TISA regarding the integration of Tobacco RSA's operations into TISA, the final stages of this process took effect during 2006. The transfer of Tobacco RSA's audited assets and liabilities as at 31 December 2006, and as formalised in a Transfer Agreement between the two parties in December 2005, was effected on 01 January 2006, being the beginning of the financial year of both entities. Effectively, Tobacco RSA therefore ceased all operations at that time. In terms of the Transfer Agreement, assets in the form of operating and project-specific surplus funds from 2005 were transferred to TISA with the clear understanding that ongoing projects, previously managed by Tobacco RSA, were to be funded from the respective project-specific surplus funds.

Tobacco RSA formally applied for deregistration to the Registrar of Companies, the approval for which was granted and formally gazetted on 08 December 2006.

The Annual General Meeting of TISA took place on 19 April 2006 at which time the integration was finalised. The appointment of bankers and auditors was agreed upon for the new organisation and changes to TISA's Statutes were agreed to allow for the revised structure. These amendments were formally approved on 12 May 2006. Additionally, the accreditation criteria for TISA membership were reviewed and amendments proposed, which were accepted by the board at the 06 December 2006 board meeting with further proposed changes. Final approval will be obtained in the first quarter of 2007.

Former Tobacco RSA members applied for membership with TISA and were approved at the 19 April 2006 board meeting. The membership currently comprises the following:

- Afgri Tobacco (Pty) Ltd
- British American Tobacco South Africa (Pty) Ltd
- Dimon South Africa (Pty) Ltd
- Gamtoos Tabakkoöperasie
- JT International South Africa (Pty) Ltd
- SA Nicecentury Trading CC
- Swedish Match South Africa (Pty) Ltd, comprising:
  - Best Blend Tobacco (Pty) Ltd
  - Leonard Dingler (Pty) Ltd
- Tobacco Traders CC
- Tribac Leaf CC
- Universal Leaf South Africa (Pty) Ltd

# The Tobacco Institute of South Africa

## Members Report

*for the year ended 31 December 2006 (Continued)*

### General Review and Integration of Operations (Continued)

In terms of the Statutes, the following were appointed as members of the board:

#### Manufacturers:

- British American Tobacco South Africa (Pty) Ltd (2 Directors)
- JT International South Africa (Pty) Ltd (2 Directors)
- Swedish Match South Africa (Pty) Ltd (2 Directors)

#### Grower Organisations:

- Afgri Tobacco (Pty) Ltd (1 Director)
- Growers (1 Representative)

The activities of the organisation are financed by means of annual contributions by all members, the amount of which is according to the approved Operating Budget on an annual basis. The structure thereof and amount required is reviewed on an annual basis by the board, usually at the final board meeting of the financial year, ie December.

Project specific funding is provided by the following members, by way of an internal arrangement, the following having been agreed at the 06 December 2006 board meeting:

- British America Tobacco South Africa (Pty) Ltd (60% of required funding);
- JT International South Africa (Pty) Ltd (20% of required funding);
- Swedish Match South Africa (Pty) Ltd (20% of required funding).

### Business Activities

#### ***Restructuring of the Primary Industry***

Prior to 1994, the South African tobacco industry (ie farmers, processors and manufacturers) was primarily controlled by the Tobacco Control Board (TCB). At that time farmers were provided with government assistance, the marketing of agricultural products was controlled by the TCB and minimal restrictions by way of tobacco legislation were in place. Additionally, illicit trade in tobacco products was almost non-existent in South Africa.

Post-1994, a free market system was introduced, the local industry was globally exposed, competition in the world market increased dramatically, as well as a burgeoning illegal trade, all contributing to a dramatic reduction in the demand for locally produced tobacco. Added to this, pressure from the World Health Organisation was brought to bear on the tobacco industry globally, which resulted in a drastic increase in tobacco control in South Africa.

Presently, the major threats to the South African tobacco industry include strict regulation by the government, a drastic growth in the illicit trade corresponding with a decline in the legal trade, pressure for increasing excise duties, high production costs for farmers and a global assault on tobacco use, amongst other issues, all of which are the most challenging issues currently facing the industry.

# **The Tobacco Institute of South Africa**

## **Members Report**

*for the year ended 31 December 2006 (Continued)*

### **Business Activities (Continued)**

#### ***Restructuring of the Primary Industry (Continued)***

Leading up to the integration of Tobacco RSA into TISA in 2006, major restructuring of the grower side of the industry was a process of negotiation by all parties, facilitated by Tobacco RSA and supported by TISA. Instability in this sector continued during 2005, the realities of beneficial restructuring only being successfully implemented late in 2006. At this time, stability and credibility of the local industry was restored. The crop size appears to be stabilising, a reduction in processing costs has been achieved, increased manufacturer orders are expected and the research component is sufficiently poised to continue providing quality products, amongst other beneficial results. Specific objectives have been set for 2007 in anticipation of the final implementation of the principles of the process, which will be to the benefit of the entire industry.

#### ***Research and Development***

Formerly a Tobacco RSA project, the objectives for research and development were carefully reconsidered during 2006, particularly in light of the aforementioned restructuring of the primary industry. A new cost effective model had to be devised to satisfy members who contribute towards research and to achieve effective results whilst containing costs, the desired result being an increased average yield and quality of tobacco grown in the country.

This process was driven by TISA and involved research institutions (ARC: IIC and LARSS), growers, grower organisations as well as the manufacturers. The model was finalised and agreed to by all, with an approximate reduction of 40% of costs being achieved. Based on the new model, continued funding by British American Tobacco South Africa for the 2007 year was agreed to with the understanding that this activity is to be managed and driven by TISA.

TISA will outsource the research functions to two research bodies, LARSS and Afgri Tobacco, but will retain overall responsibility for the management, monitoring, measurement and revaluation of this project during 2007.

Research for dark air cured tobacco, which commenced during the 2003/4 season, is funded and driven by Universal Leaf South Africa and Swedish Match South Africa. Projects currently being run in conjunction with the ARC: IIC include: cultivar development and evaluation; disease and nematode resistance; low cost curing; low nicotine cultivar; TSNA reduction; and the effect of N fertilization on TSNA production.

#### ***Black Economic Empowerment***

Based on the experiences and results of previous BEE projects undertaken by TISA and Tobacco RSA, an external consultant was engaged to provide expertise and assistance for the purposes of providing a sustainable BEE business plan and model for the successful implementation of future BEE projects. The business plan has been completed and will be considered for potential projects in 2007 once the sustainability of tobacco growing has been restored.

The Honingklip project in Mpumalanga was initiated during 2004 and primarily driven by the Mpumalanga Department of Agriculture (MADC). Previously under the auspices of Tobacco RSA, TISA continued with the funding of a full-time project manager until September 2006. Subsequently, and due to a reduced commitment by the MADDC, a part-time project manager has been sourced by TISA to provide ongoing assistance until such time as other potential projects are identified in line with the abovementioned BEE business plan.

# **The Tobacco Institute of South Africa**

## **Members Report**

*for the year ended 31 December 2006 (Continued)*

### **Business Activities (Continued)**

#### ***BEE Students***

Following the success of furthering the practical studies of students in previous years, three promising black Agriculture students from the Tshwane University of Technology were selected to undergo their practical training during 2006. They were based in the Groblersdal tobacco growing region, with funding provided by TISA. An agronomist was appointed as their mentor to guide them through the required aspects of the practical training and they are expected to graduate in 2007.

The TISA board agreed at a board meeting on 06 December 2006 to continue with this activity and further students will be selected and placed for their practical year during 2007.

#### ***South African Tobacco Control Legislation***

Proposed amendments to the Tobacco Products Control Act were announced by the Department of Health (DOH) late in 2003 by way of the Tobacco Products Control Amendment Bill 2004 and comments were invited from all stakeholders. Due to the overwhelming responses received, the DOH proposed alternative amendments during 2006 with the Bill being split into two separate Bills: a section 75 Bill dealing with issues not affecting provinces and a section 76 Bill which will deal with issues directly affecting provinces.

The section 75 Bill was formally published and tabled in Parliament in September 2006 with written submissions invited to be made during October 2006. TISA, amongst other stakeholders, made their submissions by the deadline. The Parliamentary Portfolio Committee also invited stakeholders to make oral presentations to the Committee and these will commence early in 2007. This will be an ongoing process of lobbying and negotiation by TISA, its members and other stakeholders with the government.

It is expected that the section 76 Bill will be formally published only after the finalisation of the Section 75 Bill.

#### ***Illegal Trade in South Africa***

As previously noted, the illegal trade of tobacco and related products in South Africa has increased dramatically in a relatively short time. During the course of 2006, TISA was active in a number of areas in attempting to address the seriousness of this threat to the legal industry in the country. Following three years of relentless efforts by TISA, the SARS Customs unit agreed to provide a platform to curb the illegal trade and the SARS Tobacco Forum (STF) was officially launched in August 2006 to directly address this issue.

The STF is made up of SARS and industry representatives, but SARS have requested that industry players should preferably be TISA members for the forum to be able to work effectively and with one vision. This aspect ties in with TISA's Accreditation Criteria for membership, which SARS believes will start the process of self-regulation and cement the credibility of participants in the STF processes. Non-TISA members may be viewed differently by SARS in this respect. An action plan has been drawn up jointly by SARS and TISA, and a working group was established and activated, with positive progress in the last quarter of 2006.

A contract undertaken between TISA and service providers in 2005 to address illegal activities, specifically for cut rag and raw tobacco, has been changed to a different basis of operation and will be managed into 2007 by the TISA working committee with constant evaluation of progress. The TISA board has mandated the continuation of the service provider's activities, albeit under close supervision.

# **The Tobacco Institute of South Africa**

## **Members Report**

*for the year ended 31 December 2006 (Continued)*

### **Business Activities (Continued)**

#### ***Youth Smoking Prevention Programme***

This programme commenced during 2003 and is aimed at informing retailers about the tobacco industry's long-standing view that young people under the age of 18 should not smoke or be sold tobacco products, as well as raising awareness around age of sale legislation including the penalties for selling cigarettes to the under-aged.

The fourth phase of this campaign was rolled out during 2006, with updated material sent to all retailers through the members' distribution networks. The material included revised point-of-sale displays which coincided with previously supplied plaques, so as to not cause confusion.

To date, more than 20,000 retailers have received material to display in their outlets, communicating a message that as responsible retailers, no sales of tobacco products should be made to customers under 18 years of age, even though the law currently states "under 16 years of age".

The future of this campaign is under consideration, due to the pending legislation amendments mentioned above. It is possible that a ban on this type of activity may be introduced in the revised Bill. In the meantime, the board have agreed that measurement of the effect of the campaign following the fourth phase be commissioned and once the results have been considered, a way forward will be decided upon.

#### ***Promotion of the Image of the Industry***

##### **Media**

During the course of 2006, the tobacco industry was often highlighted in various media. The CEO, as TISA's official media spokesperson, dealt with all issues and queries as they were raised, often via live interviews. The following particularly difficult and controversial areas were amongst the main issues:

- Restructuring of the primary industry;
- Tobacco Control legislation;
- Illegal trade;
- Excise duties.

##### **Presentations**

The CEO of TISA made several presentations to various sectors on the current status and the future of the industry. The following topics are the most relevant and apply to the most active areas:

- Restructuring of the primary industry / South African growers;
- ITGA Regional and AGM conferences;
- Overview of the local industry and the way forward;
- Tobacco Control Legislation and related topics.

# **The Tobacco Institute of South Africa**

## **Members Report**

*for the year ended 31 December 2006 (Continued)*

### **Trade Agreements/ Minimum Market Entry**

#### ***Existing Agreements***

##### *Minimum market entry*

The minimum market entry stipulates that a maximum quantity of 16 773 000 kg tobacco may be imported at an 8.8% import duty. SA tobacco product manufacturers who applied for MA permits in at the end of 2006 were requested to submit information on their BEE scorecards. From 2007 performance on BEE scorecards will become one of the criteria for allocating quotas. Existing criteria include quantity of local leaf purchased on an annual basis.

##### *SADC Trade Protocol*

The Southern African Development Community (SADC) plans to set up, from 2008, a free trade area following the SADC Trade Protocol signed in Windhoek, Namibia in 2000. Angola will be kept out of the free trade area as the country had not developed efficiently to join the free trade area. SADC countries are: Angola, Botswana, Democratic Republic of the Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

##### *Southern Africa Customs Union agreement*

The SACU agreement entered into force on 15 July 2004. Currently SACU is negotiating a number of agreements with other trade blocks and countries with SA taking the lead in negotiations.

##### *SACU Free trade agreement with European Union*

The trade agreement became effective from January 2000.

The tariff group of the majority of leaf tobacco/tobacco product items was classified as group 3. This means "complete tariff elimination within 12 years after the agreement came into force, starting no later than the 6th year".

Scaling down of tariffs commenced on 1 January 2006, with the last cut on 1 January 2013. The tariff is scaled down in equal cuts on 1 January of each year.

##### *SACU-MERCOSUR agreement*

The SACU-MERCOSUR (Argentina, Brazil, Paraguay and Uruguay) agreement was signed on 16 December 2004. Negotiations to broaden the scope of the agreement commenced on 29 August 2006 between SACU and MERCOSUR. At August 2006 non-product agreements such as rules of origin had yet to be negotiated as part of the preferential trade deal.

#### ***New Agreements***

##### *SACU-EFTA agreement*

A free-trade agreement between SACU and EFTA, which comprises Switzerland, Norway, Iceland and Liechtenstein, was concluded in August 2005. The FTA was tabled in the SA Parliament during October 2006 with the aim of having it ratified in time to come into effect on 1 January 2007. The FTA will be phased in over nine years, but once fully implemented, substantially all trade between the parties will be duty-free.

# **The Tobacco Institute of South Africa**

## **Members Report**

*for the year ended 31 December 2006 (Continued)*

### **Trade Agreements/ Minimum Market Entry (Continued)**

#### ***New Agreements (Continued)***

##### *SACU-US trade and investment cooperation agreement*

Following the breakdown of free-trade agreement talks between SACU and the US, SACU formally accepted an offer by the US government at the end of 2006 to progress a so-called trade and investment cooperation agreement (Tica). While changes to the rules of trade, such as tariffs or the investment regimes, will not be entertained, deals on other trade-facilitation issues, such as improved customs mechanisms and standards alignment, will be sought. In addition, it provides for trade networking events to be organised for SACU and US businesses. The US is believed to be keen to pursue a deal that improves access to the SACU region, particularly given that European Union companies are beginning to receive preferential access to SACU as the SACU-EU FTA matures. The rationale for a permanent trade deal with the US remains as AGOA (African Growth and Opportunities Act) is set to expire in 2015.

#### ***FTA between China and SACU***

SA trade negotiators indicated that far more research and consultation is needed before proceeding with any bilateral talks between SACU and China. Immediate issues in the relationship with China have been dealt with under a recently concluded memorandum of understanding, which seeks to set limits on clothing and textile imports from China so as to protect the local industry from collapse.

With regards SA tobacco exports to China, indications were at the end of 2006 that the Protocol on Phytosanitary Requirements for the Import of SA tobacco into China would be formally signed in early 2007.

#### ***Other Agreements Currently Being Negotiated by the SA Government:***

Free Trade Agreement between SACU and India to begin early 2007.

### **Chairman / CEO**

At the Annual General Meeting held on 19 April 2006, Mr ZF van der Merwe was re-elected as Chairman of TISA.

The contract of the current CEO of the organisation is due to terminate at the end of the financial year, ie 31 December 2006. At the 06 December 2006 board meeting, the current contract with the CEO was extended for a further 3 year period.

### **Auditors**

KPMG Incorporated  
MSC House  
1 Mediterranean Street  
Foreshore  
Cape Town  
8001

### **Bankers**

Standard Bank of South Africa Limited  
Business Banking – Western Cape  
9th Floor  
Standard Bank Centre  
Cape Town  
8001