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Nature of Business and Main Objective of the Company

The Tobacco Institute of Southern Africa ("TISA") is a voluntary trade association with limited liability, which operates on a non-profit basis. The company’s main aim is to further the interests and assist in protecting all the rights, inter alia the constitutional and common law rights, of the tobacco industry in South Africa, and in accordance with free marketing principles to the advantage of the tobacco industry as a whole.

TISA also co-operates and liaises with neighbouring countries, more specifically to strengthen the initiative to effectively combat the illegal trade of tobacco and tobacco products in Southern Africa.

Organisation Status and Taxation

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.

Financial Review

The attached financial statements are prepared on the basis of accounting policies applicable to a going concern.

General Review

TISA’s membership currently comprises the following:
- Afgri Tobacco (Pty) Ltd
- British American Tobacco South Africa (Pty) Ltd
- Dimon South Africa (Pty) Ltd
- JT International South Africa (Pty) Ltd
- The Cigar Company South Africa (Pty) Ltd
- The Philip Morris South Africa Group of Companies, comprising:
  - Philip Morris South Africa (Pty) Ltd
  - Leonard Dingler (Pty) Ltd
  - Best Blend Tobacco (Pty) Ltd
  - Brasant Enterprises
- Tobacco Traders CC
- Universal Leaf South Africa (Pty) Ltd
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General Review (Continued)

In terms of the Statutes, the following are appointed members of the board:

Manufacturers:
- British American Tobacco South Africa (Pty) Ltd (2 Directors)
- JT International South Africa (Pty) Ltd (2 Directors)
- Philip Morris South Africa (Pty) Ltd (2 Directors)

Leaf Dealers:
- Universal Leaf South Africa (Pty) Ltd (1 Director)

Grower Organisations:
- Afgri Tobacco (Pty) Ltd (1 Director)
- Growers’ Representative (1 Director)

The TISA Chief Executive Officer serves as a director on the board.

The day-to-day 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 prior financial year, i.e. December.

Project specific funding is provided by the following members, by way of an internal arrangement, as amended at the 03 December 2010 e-board meeting, as follows:
- British American Tobacco South Africa (Pty) Ltd (50% of required funding);
- JT International South Africa (Pty) Ltd (20% of required funding);
- Philip Morris South Africa (Pty) Ltd (30% of required funding).

Business Activities

Primary Industry

The flue-cured virginia tobacco (FCV) crop size for the 2009/10 season yielded 9.7 million kilograms, a significant improvement over the past two years in the yields per hectare, as well as improved quality of the leaf. This improvement has stimulated renewed interest from individual commercial farmers to return to tobacco farming, however entry barriers remain challenging: land acquisition, input costs and the capital cost of infrastructure. Overall, South African leaf production volumes are steadily increasing and growers are generally positive about the 2010/11 season. Although substantial hail damage took place and rainfall was excessive for some periods, crop estimates for the new season are still expected to increase to approximately 11.8 million kilograms.
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Business Activities (Continued)

Primary Industry (Continued)

Grower prices have increased over the past seven years (R13.10/kg – R16.45/kg – R17.50/kg – R18.40/kg – R22.40/kg - R28.90/kg) to R32.00/kg in 2009/10. The FCV price is expected to remain at the same level for the 2010/11 season. Indications are that prices will remain under pressure for some time, mainly due to increased global production.

Dark air-cured tobacco (DAC) production also experienced improved growth over the past two years. The number of tobacco farmers increased to 77 in the 2009/10 season (up from 52 in 2008/9), and it is expected that this will further increase to 92 in the 2010/11 season.

The DAC yield per hectare has almost doubled in the last three years, with the crop size reaching 2.65 million kilograms for the 2009/10 season. The crop is estimated to increase to around 3.28 million kilograms for the 2010/11 season, produced from 1,000 hectares. Currently, there are concerns about the presence of heavy metals in irrigation water as well as an expected increase in production costs, issues which also impact the FCV industry.

Research and Development

TISA coordinates and oversees research and development activities for the flue-cured (FCV) industry, with continued funding from BATSA. The research functions are outsourced by TISA to two research institutions: LARSS and the ARC-IIC. The objectives are managed by a specialist committee, chaired by the TISA CEO, according to Social and Environmental Responsibility principles: SRP (Social Responsibility Programs); IPM (Integrated Pest Management); harm reduction, increased yield and quality by improved and disease-resistant cultivars; and soil conservation, amongst other good agricultural practice issues.

With the primary focus of research being to ensure sustainable, eco-friendly tobacco production in South Africa, research objectives include: cultivar development; fertilization; nematode resistance; production of seedlings; evaluation of tobacco trials; plant nutrition; rotational crops; effective curing; and tobacco beetle control.

South African tobacco research is well-recognised and utilised locally as well as progressively in the region.

BATSA confirmed their continued funding of research and development activities for FCV during 2011. TISA will continue with the overall responsibility for management, monitoring, measurement and revaluation of these and related activities. Research priorities for the 2010/11 season include: cultivar development; improving fertilization and plant nutrition; the use of rotational crops in nematode control; and effective curing to minimise losses in curing barns and to reduce the use of coal and electricity in the curing process. New projects include: remedies for diseases; biological nematode control; and more eco-friendly curing.

With the renewed interest in tobacco farming, capacity at seedling nurseries has become a problem and consideration is being given by tobacco farmers to produce their own seedlings.

Trials have started, on a limited, non-commercial scale, with sun-cured Virginia tobacco. If this is successful, it may create possibilities for small scale black farmers.
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Business Activities (Continued)

Research & Development (Continued)

Trials for the 2010/11 season commenced in late 2010 and farmer field days were held during December in the Loskop and Lowveld areas.

Air-cured (DAC) research and development in the region is conducted by the ARC-IIC on behalf of and managed by Universal Leaf SA. The main activities include cultivar development and evaluation, and fertilization.

Tobacco Control Legislation

Following the enactment of amendments to the Tobacco Products Control Amendment Act (Act 23 of 2007 and Act 63 of 2008) during August 2009, certain sections therein are required to be regulated by the Department of Health (DOH) before being entered into force.

Draft Regulations on Reduced Ignition Propensity (RIP) Cigarettes were published for comment during December 2009 and TISA’s submission was delivered to the DOH on 03 March 2010. As at 03 December 2010, no official feedback had been received on stakeholder submissions.

Draft Regulations on the Display of Tobacco Products at wholesale and retail were published for comment at the end of October 2010. The draft regulations effectively ban Point of Sale advertising, limit the display area of tobacco products, restrict the size and content of price lists of tobacco products that may be sold, and prohibit the colour coding of premises in colours that form part of the packaging of a tobacco product. It is further proposed that the regulations become effective 6 months from the date of publication, giving the industry/trade 6 months to implement and comply. Stakeholders have until 28 February 2011 to submit comments to the DOH.

Draft Regulations are still pending for the following aspects: the clear definition of "public places"; standards of manufacturing; industry information; and packaging and labelling (graphic warnings).

The TISA Regulatory Committee continues to monitor the publication of further draft regulations and will address the issues as and when they arise.

The Conference of Parties (COP), the governing body of the World Health Organisation's Framework Convention on Tobacco Control (FCTC), instituted Intergovernmental Negotiating Body's (INB) to draft guidelines and elaborate on protocols concerning the protection of public health policies, protection from exposure to tobacco smoke, packaging and labelling of tobacco products, and tobacco industry advertising, promotion and sponsorship.

The FCTC INB, negotiating a protocol on combating illicit trade in tobacco products held its 4th session in Geneva during March 2010 and made a controversial decision to exclude the public, including tobacco industry role players. The intention of this session was to have the protocol adopted at the Conference of Parties 4th session (COP4) in Uruguay during November 2010. The TISA CEO attended COP4 as a representative of the tobacco sector in general, but also as the Vice President of the International Tobacco Growers Association (ITGA) as well as the Chairman of the ITGA Africa Region. The main issues of COP4 were: Taxation; Anti-Ilicit Protocol; Ingredients Ban; and Alternatives to Tobacco Growing. The various workgroups will continue addressing these issues, with the aim of presenting their proposals at COP5 in 2012.
The aim of banning the use of ingredients in the manufacturing of tobacco products is of particular concern, not only to South African tobacco growers, but globally. The FCTC provided slight relief by agreeing to provide provisional guidelines on the ingredients ban as well as giving further consideration to alternatives to tobacco growing.

Over several months, TISA worked with various industry stakeholders, including the ITGA, in providing information and assistance to the representatives of various African countries who attended the COP4 conference: Malawi; Tanzania; Mozambique; Zambia; and Zimbabwe, amongst others. Trade blocks were similarly assisted and/or made aware of the implications of an ingredients ban: COMESA; SACU; SADC; UEMOA; ACP; and the AU.

Activities relating to developments in regional countries (Swaziland, Zambia, Namibia, Malawi and Botswana) during 2010 include:

Swaziland – TISA assisted the Swaziland Department of Health in providing constructive comments on the draft Tobacco Products Control Bill during August 2010. Indications are that the Bill will be discussed at their Portfolio Committee on Health, before proceeding to Parliament.

Zambia – TISA assisted in establishing a regional function at the Tobacco Association of Zambia, to specifically coordinate the efforts and activities relevant to the FCTC issues mentioned above.

Namibia – The Namibian Tobacco Products Control Act was signed by the President in April 2010. TISA will at the appropriate time address fiscal issues in the Act between the Namibian Health and Finance Ministries.

Botswana – During 2010 the Botswana Government indicated that they intend amending their tobacco control legislation to bring it fully in line with the FCTC, however no further actions in this respect have, to date, been taken.

TISA will become more actively involved in activities in the SACU and SADC regions as new developments arise.

In the National Budget Speech of 2010, the tax incidence remained at 52% of the most popular cigarette retail price class.
Business Activities (Continued)

Illegal Trade in Southern Africa

The illegal trade of tobacco and related products in South Africa is rapidly increasing, with the illicit trade in cigarettes currently comprising more than 20% of the total cigarette market in the country. During 2010, TISA intensified its efforts in trying to curb this immense and very serious threat to the legal industry.

Since the launch of the SARS/TISA Forum (STF) in August 2006, ongoing issues have been addressed: improved regulation of the supply chain, including brand registration; tracking and tracing documentation; fiscal protection marking; and the formation of a SARS-owned information database.

Other activities included: the review of management and governance of State warehouses and the destruction of seized illicit products; increased liaison with SACU/SADC countries; the tightening of rules relating to the import of tobacco and tobacco products; and raising the level of publicity around anti-illicit trade actions and successes.

During 2010, TISA was instrumental in restructuring the STF to a higher level, resulting in senior cross-functional representation from SARS and the involvement of all industry role players, subject to accreditation criteria similar to those currently required for TISA membership. The accreditation criteria are still to be finalised. The STF has since been replaced by the SARS/TISA Joint Tactical Group (JTG), which is expected to result in an improved enforcement process to identify and remove illicit traders from the market.

TISA, in partnership with its appointed service provider Forensic Security Services (FSS), had a number of successes during 2010. These include increased seizures of illicit products, destruction of such products, training of and an overall improvement in the interactions with various law enforcement agencies.

Training for customs and law enforcement agencies was conducted by FSS on behalf of TISA. More than 1,100 officials attended the training sessions during 2010. Certificates of attendance were issued by TISA to all delegates. The result of this ongoing training initiative has seen a marked increase in the awareness around illicit trade, particularly at border posts.

TISA and its service provider held various meetings during 2010 with the National Prosecuting Authority, Cross Border Customs Unit and the Directorate of Priority Crime Investigations. These relations will further ensure the momentum of success in dealing with ever-increasing anti-illicit trade matters. A number of meetings were also held between TISA and relevant authorities in Botswana, Namibia, Angola, Malawi, Mozambique, Swaziland, Zambia and Zimbabwe. The desired outcomes of this initiative are: achieve synergy in the SACU/SADC region; streamline activities; align legislation; and join forces in the combating of illicit practices.
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Business Activities (Continued)

Illegal Trade in Southern Africa (Continued)

TISA presented its view on illicit trade to the ITIC Africa Tax Forum in February 2010. The conference was attended by senior government officials from various African countries.

TISA attended and presented an overview of its activities at the BAT AME AIT Engagement Conference in Dubai in early November 2010, highlighting illicit trade issues.

During March 2010, TISA met with industry role players in Mozambique to assist with establishing a tobacco institute structure/chapter in that country, based on TISA's model. Additionally, a Memorandum of Understanding between TISA and the Mozambique Revenue Authority is in the process of being finalised, to facilitate cooperation in combating the illicit trade in the region.

TISA attended and presented its position on the illicit trade to a meeting in Botswana during April 2010. The Botswana Unified Revenue Service has become increasingly involved in cross-border initiatives to address and combat illicit trade activities in the region. Destruction of confiscated illicit products has already taken place in Botswana, utilising TISA's specialised destruction equipment.

The Malawi Revenue Authority (MRA) met with TISA during June 2010 to discuss TISA's Fiscal Verification project, which was piloted in South Africa. A further meeting was held with Malawi tobacco industry role players where the need for an industry association was identified. TISA was requested to assist with the formation of a structure similar to TISA in that country.

TISA continued to assist authorities with affidavits on the effect of the illicit trade on the South African economy, and in bringing offenders to book. A number of vehicles used in the smuggling of tobacco products have been forfeited to the State as a result of the affidavits presented by TISA.

A Retailer Awareness Campaign was launched late in 2010. A TISA letter, alerting retailers to illicit brands and practices at retail level, was distributed to some 50,000 retailers during October. The following month saw "The Fact is" material distributed to almost 20,000 outlets in the retail trade. A follow up campaign will be planned and launched in 2011.
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Business Activities (Continued)

Youth Smoking Prevention Programme
This programme commenced during 2003 and was aimed at informing retailers about the tobacco industry's long-standing view that people under the age of 18 should not use or be sold tobacco products. The campaign also succeeded in raising awareness of the age of sale legislation, including the penalties for selling tobacco products to the under-aged. The legal age for buying tobacco products at that time was 16 years or older, however current legislation which was amended during 2009 states the legal age is now 18 years or older.

To date, more than 20,000 retailers received display material, communicating a message that as responsible retailers, no sales of tobacco products should be made to customers under 18 years of age.

Due to the current focus on anti-illicit trade campaigns, further YSP activities will be identified for implementation in the future.

Industry Self-Regulation & Code of Conduct
An industry Self-Regulation and Dispute Resolution Mechanism was drafted but has been put on hold, pending the finalisation of tobacco control regulation.

A Code of Conduct was drafted for the industry but has also been put on hold, pending the legislative regulations being finalised.

Promotion of the Image of the Industry

Media
During the course of 2010, the tobacco industry was again highlighted in the media. The CEO, as TISA’s official media spokesperson, dealt with various issues and queries, often in the form of live radio and television interviews. The following areas were amongst the main issues raised:

- Illegal trade;
- Tobacco Control legislation;
- FCTC issues;
- Excise duties;
- Agricultural issues.
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Business Activities (Continued)

Promotion of the Image of the Industry (Continued)

Presentations

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

- Illicit trade in tobacco products;
- Tobacco Control legislation and related topics;
- FCTC regional and international summits/conferences;
- ITGA regional and international conferences.

At the AGM of the ITGA, held in Lexington, Kentucky, USA during October 2010, the TISA CEO was appointed as the global Vice President of the ITGA for a period of two years. In light of this, TISA's membership of the ITGA has been upgraded from Associate Member to full Grower Member.

The TISA CEO also served as Chairman of the ITGA Africa region during 2010 and, in addition to his global ITGA appointment, he continues to serve in this capacity.

Trade Agreements/ Minimum Market Entry

Existing Agreements

Minimum Market Entry

The minimum market entry stipulates that a maximum quantity of 16,773 tons of tobacco may be imported at 'full duty less 8.8%’. SA tobacco product manufacturers applied for Market Access permits in October 2010. Apart from companies’ BEE performance, allocations are made based on cutting figures of the previous tobacco season.

SADC Trade Protocol – Free Trade Area (FTA)

The legal basis for the FTA is the SADC Protocol on Trade. The Protocol on Trade commits members to phase out existing tariffs, to harmonise trade procedures and documentation within SADC, to define SADC Rules of Origin and to reduce other barriers to trade.

Apart from the FTA, officially launched in August 2008 and a SADC Customs Union planned for 2010 which has not yet been realised, the SADC regional integration programme includes the establishment of a Common Market by 2015, a monetary Union by 2016 and a single currency by 2018.
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Trade Agreements/ Minimum Market Entry (Continued)

Existing Agreements (Continued)

Southern Africa Customs Union (SACU) Agreement
SACU has been and is currently negotiating a number of agreements with other trade blocks and countries with SA taking the lead in negotiations. Namibia, Botswana, Lesotho, Swaziland and South Africa are members of SACU, the oldest customs union in the world, which was founded in 1910. Under the 2002 SACU Agreement, SACU Member States have agreed to negotiate future trade agreements with third parties as a block.

South Africa has proposed a revision of the allocation of the SACU excise pool which has been met with resistance from Swaziland and Namibia. The proposed formula will see South Africa receiving a larger portion of the excise revenue with cuts envisaged for all BLNS countries except Lesotho. Negotiations in this regard will continue in 2011.

New Agreements

New agreements being negotiated

SADC-EAC-COMESA Free Trade Area
On 22 October 2008, the SADC-EAC-COMESA* Tripartite Summit approved steps that would lead to the establishment of a Free Trade Area encompassing all states represented by the three entities with the ultimate goal of establishing a single customs union. The FTA is expected to be in place by 2012. If agreed to, the FTA will comprise 26 countries representing 700 million people in Africa.

South Africa, through the Independent Development Corporation (IDC), is embarking on a feasibility study to determine the feasibility and the workings of such an FTA. Research agencies were given a deadline of 01 November 2010 to submit proposals in this regard.

*SADC – Southern African Development Community; EAC - East African Community; COMESA – Common Market for East and Southern Africa

SADC-EU EPA (Preferential Agreement)
The EU is on a global drive to negotiate EPA’s with major trading blocs of the African, Caribbean and Pacific (ACP) countries after the expiry of preferential trade deals and to bring them in line with World Trade Organisation requirements. The EU argues EPA’s will direct more European foreign direct investment opportunities to ACP countries. They will also bring about improved governance, regional integration and a trade balance with the countries.

The SADC EPA Group includes Angola, Botswana, Lesotho, Mozambique, Namibia, South Africa and Swaziland. In November 2007, Botswana, Lesotho, Swaziland, Namibia and Mozambique initialled an interim EPA, which was subsequently signed by the same countries except Namibia in June 2009.

The Group is now negotiating a comprehensive regional agreement with the EU. The next round of negotiations is scheduled for February 2011 in Lesotho.
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Chairman

At the Annual General Meeting held on 13 April 2010, Mr ZF van der Merwe was re-elected as Chairman of TISA.

Auditors

KPMG Incorporated
MSC House
1 Mediterranean Street
Foreshore
Cape Town
8001

(Appointment approved at TISA’s Annual General Meeting on 19 April 2006)

Bankers

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

(Appointment approved at TISA’s Annual General Meeting on 19 April 2006)