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Reynolds American Inc. F4Q08 and Full Year Earnings Call Transcript

Question-and-Answer Session

Operator

(Operator Instructions) Your first question comes from Judy Hong with Goldman Sachs

Judy Hong - Goldman Sachs

Susan, I know there is a lot of uncertainties out there and you're not giving specific '09 guidance, but I'm just wondering if you can give us some perspective as we think about the tax increases. If we compare this period versus some of the years in the past where there's been significant price increases do you think the price elasticity factor could be more different this time around than in the past? As the price gap narrows between the premium and the discount do you think that the premium will hold up in this environment? I'm just trying to get some perspective on those issues.

Susan Ivey

I think, Judy that actually you've hit the nail on the head as to why we're not giving specific guidance, but let's think about the environment. A lot of people have tried to liken this tax increase, for instance, back to the MSA. That was the last time there was a large national price increase. The environment today is very different though on a couple of fronts. Obviously the economy is in a very different situation and so how consumer behavior will or will not change will be very interesting. Fortunately this tax is on all cigarette products, so the MPMs will not have any distinct advantage.

We also are in a situation where for the last five to seven years the smokeless category has been growing at 6% to 7% a year. There are a lot of dual users in the smokeless category and actually the price gap between smokeless and cigarettes will grow with this tax increase; so will consumers migrate at an accelerated pace to moist snuff or other smokeless product like Snus, like Dissolvables?

I think we're in a different situation today. We have always said from the time of the merger that we felt it was important in R.J. Reynolds business to have a strong value brand, because economics can change and Pall Mall has certainly demonstrated, in 2008, it's strength in this category, growing almost a sheer point quarter-over-quarter a year ago. So, I think it is different because we could see more movement across categories. You also have differential taxes. So, roll your own now becomes tax equivalent to cigarettes and so will those people move to value manufactured cigarettes? Where will they go?

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