EN

Case No COMP/M.3191 - PHILIP MORRIS / PAPASTRATOS

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REGULATION (EEC) No 4064/89
MERGER PROCEDURE

Article 6(1)(b) NON-OPPOSITION
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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 02/10/2003

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PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying parties

Dear Sir/Madam,

Subject: **Case No COMP/M.3191 - PHILIP MORRIS/PAPASTRATOS**
Notification of 2.9.2003 pursuant to Article 4 of Council Regulation No 4064/89[1]

1. On 2.9.2003, Philip Morris Holland BV notified its intention to acquire control of the whole of Papastratos Cigarette Manufacturing SA ("Papastratos") within the meaning of Art 3(1)b of the Merger Regulation.

2. The Commission has concluded that the notified operation falls within the scope of the Merger Regulation as amended and does not raise serious doubts as to its compatibility with the common market and with the functioning of the EEA Agreement.

I. THE PARTIES

3. Philip Morris Holland BV is a subsidiary of Philip Morris International Inc. ("Philip Morris"), an affiliate of Altria Group, Inc. ("Altria"). Certain companies within the Altria family manufacture and sell cigarettes in many countries. Other companies in the Altria Group include Kraft Foods, Inc., which manufactures and markets food in many countries. Cigarette brands produced by Philip Morris and other companies within the Altria family include *Marlboro*, *L & M*, *Chesterfield*, *Philip Morris*, *Bond Street*, *Lark* and *Parliament*.

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1 OJ L 395, 30.12.1989 p. 1; corrigendum OJ L 257 of 21.9.1990, p. 13; Regulation as last amended by Regulation (EC) No 1310/97 (OJ L 180, 9. 7. 1997, p. 1, corrigendum OJ L 40, 13.2.1998, p. 17).

4. Papastratos is active in the field of the manufacture and distribution of cigarettes in Greece and Romania and, in a very limited way, in the sale of duty-paid and/or duty-free cigarettes in certain non-EU countries. Cigarette brands produced and distributed by Papastratos include *Assos*, *Assos International*, *Santé*, *President*, *Papastratos*, *Old Navy*, *Saga*, and *Classic*. Papastratos also distributes cigars and cigarettes which are imported from international companies (Ritmeester: Royal Dutch, Corona (cigars/cigarillos), Pikeur and Livarde; Altadis: Gauloises and Gitanes (cigarettes), Fleur de Savanne, Longchamps, Havanitos and Cruzeros (cigars/cigarillos); Dannemann: Al Capone, Special Sumatra, Tubes, Tip, Moods (cigars/cigarillos). Finally, Papastratos manufactures and distributes Philip Morris' products in Greece on the basis of long term agreements.

II. OPERATION

5. Philip Morris Holland BV will acquire approximately 76% of the shares of Papastratos. The shares will be purchased at a maximum price of euro 18.15 per share, representing a total cash consideration of up to approximately euro 371 million.

III. CONCENTRATION

6. The operation will result in Philip Morris Holland BV acquiring control of Papastratos and, therefore, is a concentration within the meaning of Article 3(1)(b) of the Merger Regulation.

IV. COMMUNITY DIMENSION

7. The undertakings concerned have a combined aggregate world-wide turnover of more than EUR 5 billion[2] (Altria 65.7 billion EUR, Papastratos 414.95 MEUR). Each of the undertakings have a Community-wide turnover in excess of EUR 250 million (Altria […] EUR, Papastratos […] EUR), but they do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension but does not constitute a cooperation case under the EEA Agreement.

V. COMPETITIVE ASSESSMENT

A. Relevant product market

8. Both parties are active in the market for manufactured cigarettes produced in Greece or other Member States for distribution and sale in Greece. The parties have therefore submitted that the relevant product market is the market for factory manufactured cigarettes.

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2 Turnover calculated in accordance with Article 5(1) of the Merger Regulation and the Commission Notice on the calculation of turnover (OJ C66, 2.3.1998, p 25). To the extent that figures include turnover for the period before 1.1.1999, they are calculated on the basis of average ECU exchange rates and translated into EUR on a one-for-one basis.

9. The parties have nevertheless submitted that, although there are no reasons to define the relevant product market by reference to different cigarette segments, for brand marketing purposes the market is divided into various segments differentiated according to brand characteristics such as price, physical characteristics of products, flavour, tobacco blend, and size of pack. According to the parties, this segmentation of the market is common to all cigarette markets. For marketing purposes [cigarette manufacturers use the following segmentation of the Greek market]:

- *by price category*: above-premium, premium, International Big Pack (international brands offered in packs of more than 20 cigarettes), Medium, Local Big Pack (local brands offered in packs of more than 20 cigarettes), and Low.

- *by local or international brands*

- *by tobacco blend*: American blend (cigarettes produced by blending Virginia, burley and oriental type tobaccos), Oriental blend (produced by blending primarily oriental type tobaccos), Black (produced by blending primarily black tobaccos), or Virginia (produced by blending primarily flue-cured (Virginia type) tobaccos).

- *by taste*: lights (within lights, recognised sub-segments include super-lights and ultra-lights), full flavour or menthol.

- *by pack type*: soft packs, boxes, "shoulder" packs, round corner packs, oval packs, etc.

- *by pack size*: packs of 10, 20, 25 or 30 sticks.

- *by physical characteristics*: King Size (cigarette length 84mm), 100s (cigarette length 100mm), slims (cigarette diameter up to 7.44mm) or super-slims (cigarette diameter up to 6.44mm).

10. The Commission has in previous decisions[3] concluded that, although manufactured cigarettes may be segmented according to a number of different criteria, sub-division or segmentation of the manufactured cigarette market along with particular criterion would in most cases be arbitrary and not meaningful.

11. The parties have provided market shares both for the overall market for factory manufactured cigarettes and also at the level of different cigarette segments. They have nevertheless argued that the degree of substitutability between different segments is very low and that brands within the same price segment are closer substitutes than brands in different segments (see further below).

12. For the purposes of this decision, however, the exact market definition can be left open since on all alternative market definitions considered the operation as notified would not lead to the creation or strengthening of a dominant position.

B. Relevant geographic market

13. The parties have submitted that the relevant geographic market is national, comprising in this case Greece. The reasons for defining the market as national are according to

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[3] Case M.1415 - BAT/Rothmans; COMP/M.1735 - Seita/Tabacalera; Case M.2779 - Imperial Tobacco/Reemtsma

the parties as follows: the preferences of Greek smokers differ from those of smokers in other Member States; there are derogations to certain EU limitations on tar and nicotine content of cigarettes sold in Greece; the retail prices for cigarettes differ in Greece as compared with each other Member State, mainly as a result of the differing tax regimes and taxation levels between Member States; and manufacturers wishing to sell their products in Greece are required to label their cigarette packages with appropriate warnings in Greek.

14. The Commission has found in previous decisions[4] that the geographic dimension of cigarette markets is national. The existence of a national market comprising Greece has been confirmed by the market investigation in this case.

C. Competition analysis

- Market position

15. The Greek cigarette market is one of the few growing markets in the European Union. The parties have estimated the total size of the market in Greece as [€500-600] million (net of tax) in 2002. In volume, the market amounted to 33.3 billion cigarettes, up from 32.1 billion cigarettes in 2000. The largest segment is the Premium segment, which accounts for [45-55 %] of the total Greek cigarette market.

16. The market shares of the main players are illustrated in the following table:

	2000		**2001**		**2002**	
	Value	**Volume**	**Value**	**Volume**	**Value**	**Volume**
Philip Morris	**[25-35%]**	**25.7%**	**[25-35%]**	**25.5%**	**[25-35%]**	**26.8%**
BAT	[10-20%]	16.1%	[10-20%]	15.4%	[10-20%]	15.7%
PAPASTRATOS	**[10-20%]**	**13.7%**	**[10-20%]**	**14.3%**	**[10-20%]**	**14.9%**
JT	[10-20%]	11.7%	[10-20%]	11.4%	[5-15%]	9.3%
KARELIA	[5-15%]	8.6%	[5-15%]	8.7%	[5-15%]	8.8%
SEKAP	[5-15%]	8.0%	[5-15%]	8.0%	[5-15%]	7.6%
GALLAHER	[5-15%]	5.3%	[5-15%]	5.3%	[5-15%]	5.1%
STC	[<5%]	2.5%	[<5%]	2.5%	[<5%]	2.8%
IMPERIAL	[<5%]	4.4%	[<5%]	4.5%	[<5%]	4.5%
ALTADIS	[<5%]	0.8%	[<5%]	0.9%	[<5%]	1.0%
KERANIS	[<5%]	1.6%	[<5%]	1.5%	[<5%]	1.3%
GEORGIADIS	[<5%]	0.6%	[<5%]	0.5%	[<5%]	0.4%
OTHERS	[<5%]	1.0%	[<5%]	1.3%	[<5%]	1.8%

Table: *The market shares of the main players on the Greek market, s*ource: Form CO

17. On the overall market for factory manufactured cigarettes, the parties' combined market share would be according to their own estimate [35-45%] in value (Philip Morris [25-35%], Papastratos [10-20%]) and 41.7% in volume (Philip Morris 26.8%, Papastratos 14.9%). The market shares of the parties have been relatively stable over the past three years. The market investigation has largely confirmed these figures.

[4] Case M.1415 - BAT/Rothmans; COMP/M.1735 - Seita/Tabacalera; Case M.2779 - Imperial Tobacco/Reemtsma

18. The Greek market is unusual in that it comprises a large number of competitors, including all major international competitors (Philip Morris, BAT, Japan Tobacco International, Gallaher, Imperial, Scandinavian Tobacco Company, and Altadis). As a result, there is an unusually high number of brands on the market: approximately 278 brands, with 85 brands having a market share above 0.2%.

19. On the overall market, the largest competitor is BAT with a market share of [10-20%] in value and 15.7% in volume. Other competitors include JT ([5-15%]-9.3%), Karelia ([5-15%]-8.8%), Sekap ([5-15%]-7.6%), Gallaher ([5-15%]-5.1%). The rest of the competition is fragmented: each of the remaining players has market shares of around 5% or below.

20. If considering the market share on different cigarette segments, it is to be noted that the parties operate largely in different market categories. Philip Morris brands are predominantly in the higher-priced categories (either Premium or International Big Pack), and its sales within the premium segment account for 97% of the total sales of its brands in Greece. Papastratos brands, on the other hand, are predominantly in the lower-priced categories (Medium, Local Big Pack, and Low).

21. The only overlap between the parties' activities is in the International Big Pack category, where Papastratos has the *Papastratos* brand, and Philip Morris has the *Chesterfield* and *L&M* brands. The parties have submitted, however, and the market investigation has confirmed that the Philip Morris brands represent only approximately [less than 5%], by volume and value, of that price category; the Papastratos brands represent approximately 2% by volume and [less than 5%] by value. Therefore, if considering different cigarette segments separately, there is only a *de minimis* overlap between the parties' activities.

- *Pricing*

22. As noted above, the parties operate, within the relevant market for manufactured cigarettes, mainly in different segments. The parties have argued that the degree of substitutability of the great bulk of their production is very low, as brands within the same segment are closer substitutes than brands in different segments. In this respect they have submitted that, if the price of one brand in a segment becomes too high, consumers will consider it excessive and switch to others in the segment. If prices within a segment as a whole become too high, consumers will switch to less expensive segments, and companies may also find it profitable to reposition a brand down into a lower price segment.

23. The parties have argued that the degree of substitution between their products is extremely limited because they operate mainly on different product segments and the brands of the two parties are in different price categories. The market investigation has also revealed that the parties' respective products are made of different tobacco blend; all the Philip Morris brands are American blend (i.e., cigarettes produced by blending Virginia, burley and oriental type tobaccos), whereas the large majority of the Papastratos brands are Oriental blend (i.e., produced by blending primarily oriental type tobaccos). These two different tobacco blends correspond to different smoking patterns. In this light, the parties have stressed, for instance, that the consumer profile of smokers of the main brands of each is very different. *Assos* smokers (an Oriental

blend) are typically much older than those of *Marlboro* (an American blend). This difference in the profile of smokers of the two brands indicates that consumers consider them to have different characteristics, appealing to different sorts of consumer, further demonstrating that they are not particularly close substitutes.

24. Nevertheless, some third parties have argued that a phenomenon of "down-trading" could be taking place, that is, consumers in Greece would tend to switch across price categories, more particularly from premium and medium categories to lower price categories (e.g. from *Marlboro* to *Assos*). These respondents to the market investigation have further argued that, in this scenario, the merged entity would be able to profitably raise the prices of its premium brands above competitive levels, since the lost demand would be re-captured, through down-trading, by its low-segment brands, for instance through a switch from *Marlboro* to *Assos*.

25. In this scenario, a price increase would be commercially less risky for the merged entity than before the merger as the new entity would benefit from both increased profitability on their premium brands (despite a volume loss) and pick up the lost volume by being the only international company to have a significant market share at the lower end of the market.

26. In view of the fact that any incentive to raise price in a post-merger market scenario depends crucially on the degree of substitutability between the merging parties' products, the segmentation of the relevant market and the fact that the parties are active in different price segments suggests that price increases, induced by the enhanced market position of the parties, are unlikely to occur post merger.

27. First, such price increases would not necessarily be profitable, since lost sales due to the price increase would not necessarily be recaptured through sales of the other merging party, but would be lost to the benefit of competitors in the same segment. In this respect, the Commission notes that the market shares on all segments have been relatively stable over the years. As a whole, the relative price between premium brands and cigarette brands located in the low segments has risen. Yet, there is no evidence that the size of the premium segment has declined overtime. Slight growth has taken place in the low price segment due to the rise of immigration in Greece but the growth has not taken market share from the premium segment. The investigation further shows that the recent, failed re-launch of the *Camel* brand in the premium segment led to the market shares to migrate to the other brands belonging to the premium segment (e.g. *Lucky Strike*, *Marlboro* and *Prince*) and not to other brands in the low priced segment. Finally, the Commission observes that although *Marlboro* is some 50% more expensive than *Assos*, the market shares of the two brands have remained relatively unchanged over the years. The Commission has therefore not found any evidence to support arguments concerning down-trading on the Greek market.

28. Moreover, some third parties have suggested that switching would not occur directly from the premium segment to the low priced segment but rather to the International Big Pack segment first. The new entity has a very weak position in the International Big Pack price segment.

29. It also needs to be considered that local manufacturers competing in the low price segments would also likely to be the beneficiaries of down-trading and the parties could not be certain that all sales lost in the premium segment would migrate to their

own products. In this respect, the Commission notes that Sekap has recently introduced a new brand *GR 25* in the low price segment. This brand has increased market share in the low price segment since its launch. While the investigation shows that the market shares have not stemmed from the premium segment, the success of *GR 25* shows that the market shares would not necessarily migrate to the parties' products in the low price segment.

30. In addition, any strategy foreseeing a possible shift from e.g. *Marlboro* to lower price brands e.g. *Assos*, both in the new entity's portfolio, would not necessarily be profitable as it would entail shifting sales from products typically characterised by high margins towards products with lower margins. Unless the merged firm can ensure that an increase of its margins for the remaining sales in the premium segment coupled with additional sales in lower segments could compensate for a loss of premium sales revenues, it would appear unlikely that the new entity would have any incentive to actively engage in such a strategy post-merger. The market investigation did not confirm that the merged firm would be in a position to ensure such a compensation.

31. Price increases of cigarettes in Greece are typically mainly induced by tax raises. Retail price formation is driven by government's expectations of tobacco revenues and is currently typically triggered by government decisions. The investigation shows that the cigarette prices within a given segment are uniform and manufacturers tend to follow price increases (or decreases) of the segment leader, although the parties argue that this is increasingly less true for the lower priced segments. Indeed, a price rise in a premium segment does not necessarily lead to a price rise in a low price segment. The investigation shows that price increases have been more frequent in the premium segment over the last five years compared to the low price segment. This would again tend to suggest that there is no evidence of substitutability between different segments.

32. The parties have provided the results of a merger simulation that shows that on average the market price increase post-merger would be minimal. The simulation model assumes that the merging parties' products compete in different segments, or in other words, that the degree of substitutability between their products is low. The market investigation has confirmed the market segmentation. The results of the simulation confirm that the present merger would not lead to significant price increase in the Greek cigarette market.

33. Finally, the market investigation has confirmed that price is only one of the many variables influencing consumers in their choice of products, and not necessarily the determining factor. Other variables like brand (quality, image, positioning) and advertising/marketing appear still to be more or at least equally relevant for consumers' choice[5]. The particular choices made by a company will reinforce each other – their lower quality brands will be sold at lower prices and relatively little will be spent on creating a brand image; higher quality brands will be sold at higher prices and be supported by marketing aimed at developing a brand identity that appeals to consumers.

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5 The EC legislation banning advertising of tobacco products is not yet applicable in Greece (see Paragraph 35)

34. The parties have further submitted that the need to ensure that all aspects of a brand convey a message about quality and brand values leads prices of high quality brands to be clustered in a limited number of price segments (premium and above). If a brand carries a premium price, consumers will be more inclined to view it as a premium brand, with a quality and brand values similar to others in the same segment. Because the price segment to which a brand belongs is one of the aspects of its image, each cigarette company will tend to keep the price in line with other brands in the same segment in order to preserve consumer perceptions of quality. This is especially true for the premium and above segments.

35. With regard to the forthcoming advertising ban on tobacco in Greece, the market investigation suggests that the ban is likely to freeze the existing market positions. No evidence has been found to support the argument that the advertising ban would be enhancing the market position of the new entity, as suggested by some third parties.

36. In view of the foregoing, the Commission concludes that the new entity is unlikely to have either the ability or the incentive to unilaterally raise prices post-merger to the detriment of consumers.

- *Distribution*

37. Distribution and sale of cigarettes in Greece is carried out in three layers in the sales chain: distributors, wholesalers and retailers. Most manufacturers take themselves care of distributing their products to wholesalers. There are also independent distributors active on the Greek market. There is no legal or *de facto* monopoly as regards distribution of cigarettes in Greece.

38. The Greek market is characterised by a very large number of players in the overall distribution network, with over 850 wholesalers and over 40,000 retailers. It is to be noted that under the Greek law,[6] a strict separation must be maintained between undertakings operating at the manufacturing, wholesale and retail levels respectively. In other words, cigarette manufacturers are prohibited by law to be at the same time active as wholesalers and/or retailers (kiosks).

39. A long-running relationship exists between the parties. In 1974, Philip Morris […] entered into a licence agreement with Papastratos for the manufacture and sale of *Marlboro* in Greece. Since then, Papastratos has been manufacturing *Marlboro* under contract from Philip Morris and has been responsible for the distribution and sale of all Philip Morris brands, including those manufactured by Philip Morris and imported into Greece. Under the contract, […].

40. It can therefore be argued that the proposed transaction will not have the same effect as might have been if Philip Morris and Papastratos had had no prior relationship as the brands involved will continue to be distributed by a single undertaking. As a matter of fact, a single undertaking is at present responsible for selling to wholesalers all the brands of Philip Morris and Papastratos, and a single undertaking will carry out the same functions after the completion of the concentration.

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6 Law 590/1937, Law 1994/1952, Law 2805/54, and Law 1044/71.

41. Some third parties have nevertheless argued that, due to its enhanced market position, the new entity may attempt to induce wholesalers and retailers to give its range of products some form of preferential treatment by for instance exclusive stocking of the parties' products, crowding out other competing brands, by granting more shelf space or better visibility at the point of sale, or by allowing the downstream players better terms and conditions than competitors, such as credit terms. This may, it has been argued, lead to a situation that retailers would only purchase from the new entity and thus stock only its products, refusing access to competitors.

42. The market investigation suggests that visibility and shelf space at the point of sale are not crucial factors due to the physical characteristics of the retail outlets. The major form of retail outlet, accounting for 74% of retail sales of cigarettes in Greece, is the traditional kiosk ("peripteron"). These are small trading outlets from which consumers purchase cigarettes through a window or other small opening. Cigarettes are stored inside and are not readily visible to consumers. Kiosk retailers typically carry some 200 cigarette brands and variants, of which only 52 lines belong to the parties post-merger, if all of them are included.

43. Moreover, in view of the fact that the Greek cigarette market is traditionally very fragmented with a large number of products positioned in different segments and appealing to different types of consumers, the Commission considers it unlikely that the parties could post-merger offer such incentives, that the Greek wholesalers and retailers would refuse to stock competing brands and rely on one supplier only, who in any case accounts only for some 40% of the total cigarette sales. In this respect, it must also be kept in mind that one supplier has distributed the same brands since 1974. The Commission also considers that the largest competitors - BAT, JT, Karelia and Sekap - who together account for almost 40% of the market, would be in a position to counterbalance any such measures.

44. Furthermore, brand loyalty appears to be strong on the Greek market, evidenced by the existence of a very large number of brands on the market. Consumers request for products which are differentiated (e.g. Philip Morris One King Size Flip Top Box) thus not seeking to purchase a "premium-priced cigarette", an "American blend cigarette", a "light cigarette", a "King Size cigarette" or a "cigarette in a soft pack". The Commission finds the parties' argument convincing that in this situation, a consumer, faced with the inability of a retailer to supply a particular requested product would simply purchase it from a different retailer, which, given the high density of retailers in Greece, can be easily done. In this light, it appears very unlikely that retailers - and consequently wholesalers - would agree to accept only the new entity's brands, thereby losing trade and revenues from competing products.

45. In view of the foregoing, the Commission has concluded that the new entity is unlikely to be in a position to exploit its market position post-merger in order to foreclose the distribution network from its competitors on the Greek market.

46. With regard to potential co-operative effects arising post-merger, the Commission notes first that the Greek market is relatively fragmented with a large number of competitors present. Second, rather than creating symmetry, the merger creates more asymmetry in the market position of the competitors. Finally, as noted above, competition takes place not only on the basis of the price but also on the basis of a number of non-price parameters. All this taken into account, the Commission

concludes that the merger does not increase the likelihood of coordination on the Greek market.

47. Neither Philip Morris nor Papastratos are present in the upstream markets of the supply of tobacco and non-tobacco materials to cigarette manufacturers. The market investigation has confirmed that the notified operation is unlikely to lead to any negative competition effects on any upstream markets.

VI. CONCLUSION

48. For the above reasons, the Commission has decided not to oppose the notified operation and to declare it compatible with the common market and with the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of Council Regulation (EEC) No 4064/89.

For the Commission

(signed)
Mario MONTI
Member of the Commission