Russia: PMI and JT buy Megapolis stake

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| Russia | Food and drink | Philip Morris International
Philip Morris International (PMI) and Japan Tobacco (JT) have announced the purchase of 20% stakes in Russian distributor Megapolis, for US$750m apiece.

Russia is the world’s second-largest tobacco market by volume, after China. It is also the third-largest cigarette producer globally, after China and the US, despite importing much of its high quality tobacco. This has not been lost on the "big four" tobacco players, defined as PMI, JT, British American Tobacco (BAT) and Imperial Tobacco Group, who account for some 95% of tobacco production in Russia. As a result their brands also dominate the market, although distribution in Russia remains a largely domestic affair.

This means that the purchase of 20% stakes in Megapolis by JT and PMI is something of a breakthrough. Megapolis is one of Russia’s leading consumer goods distributors, focusing principally on tobacco and beverages. It employs almost 15,000 employees and reaches more than 150,000 points of sale. It also handles around 70% of the cigarettes sold in Russia through distribution agreements with PMI, JT and Imperial Tobacco Group. A mooted US$1.5bn IPO in 2011 failed to come off but could still go ahead. Given that the combined 40% investment from PMI and JT matches the 2011 IPO valuation, Megapolis is certainly seen as going places. This sentiment is compounded by a further commitment from both tobacco firms of US$100m each, subject to Megapolis’s performance over the next four years.

An edge in distribution

Ostensibly the buy in could allow PMI and JT to reduce distribution costs. But more crucially it will raise their profiles compared to rivals BAT and Imperial Tobacco. With Megapolis distributing 70% of Russia's cigarettes this could supply an edge in delivering higher share in a country that is becoming increasingly prominent as sales fall off in developed markets. Buying in early also gives JT and PMI a head start on rivals in the event of any potential IPO, with big tobacco fully aware that control of distribution is a crucial battleground in reaching consumers.

Miroslaw Zielinski, PMI's President of Eastern Europe, Middle East and Africa claimed that the Megapolis stake will bolster PMI's business expansion in a market that remains very profitable, adding "in addition to enhanced earnings and cash flow for PMI, this investment paves the way for infrastructure expansion and improved operating efficiencies in the strategic area of distribution in Russia ". PMI expects the transaction to be completed by the end of 2013 without requiring regulatory approval.

A key market

Russia is proving to be a key market for PMI, where the firm has 4,500 staff. Most PMI cigarettes sold in Russia are produced facilities in Krasnodar and near St Petersburg, which is the second-largest PMI production facility in the world. As a result of this investment global consumer insight firm Nielsen put PMI's market share in Russia at 26.1% in September, led by flagship brands such as Marlboro.

For JT the investment is even more prescient. JT is the largest manufacturer of tobacco products in Russia, with a 36.3% share of the market in October 2013, according to Nielsen. The company's brands include Winston and Camel, and JT has suffered flagging domestic sales as the number of Japanese smokers continues to shrink.

Source: Industry Briefing