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"Tobacco Talk" -- Q4 U.S. Vapor Retailer Survey

Wake Up Call! Action Needed To Keep Vapor Category Momentum Alive

Tobacco

- **Vapor Category Remains Promising Long Term But We're Increasingly Concerned That Action is Needed For Momentum to Continue** – We recently conducted a survey of our tobacco retailer and wholesaler contacts representing about 20,000 U.S. c-stores. We observed a few “calls to action” from our retailer contacts pertaining to the vapor industry: **(1)** the FDA must take leadership and act soon to improve consumers’ perception of the relative risks of vapor and uncertainty surrounding the category; **(2)** the industry must align, particularly to push for modified risk claims so that public perception doesn’t deteriorate further; and **(3)** vape shops need to be regulated more closely as they are “playing by their own set of rules” potentially harming the industry’s reputation. We believe it’s imperative these factors are addressed promptly; if not, we’re concerned that vapor category growth could continue to moderate. **Bottom line, we remain bullish long term and still believe consumption of vapor and other non-combustibles (such as heat-not-burn) could surpass consumption of combustible cigs in the next decade (by 2023).** We continue to believe that technological innovation is crucial and that Big Tobacco will be pivotal in shaping the non-combustible nicotine industry.
- **Vapor Category Growth Remains Strong at 17% but Continues to Moderate in C-Stores** – Despite continued growth, the vapor category has not yet resulted in a deceleration of combustible cig volume. This has been very perplexing to us but we believe could be due to: **(1)** high prevalence of dual use; and **(2)** vapers consuming more (vapers tend to vape more since current vaping technology is a less efficient way to deliver nicotine and it’s easier to vape more places currently). **Other key takeaways** from our survey include: **(1)** Vapor category growth in c-stores remains robust (+17% in 4Q14) but decelerating relative to 3Q14’s 21% growth, likely driven by continued heavy promotions on both Vuse and MarkTen which is driving unit momentum but not necessarily accelerating \$ sales; **(2)** Vapor continues to displace about 4% of combustible cig volume; **(3)** Repeat vapor purchases have accelerated to 60% in 4Q14, up from 57% in 3Q14; **(4)** E-cig sub category growth continues to decelerate--our contacts estimate about 5% growth in 4Q14--down from 7% last quarter and 19% in 4Q13; **(5)** blu continues to cede share to Vuse, LOGIC and MarkTen which is expected to continue given heightened activity (particularly on Vuse & MarkTen); and **(6)** Our retailer contacts are increasingly disenchanted with NJOY, noting issues with product returns and the company generally overpromising and under delivering.
- **Retailers Have Low Expectations on “Advanced” Devices Coming from NJOY, LOGIC, Mystic and Blu** – Retailers seem somewhat underwhelmed by the larger devices that are meant to “bridge the gap” between “traditional” e-cigs and VTMs--such as those from NJOY, LOGIC (Pro), blu (+) and Mystic. Our contacts feel that about 75% of the sales of these products will cannibalize existing sales rather than generate incremental sales. A few retailers noted the higher price points could discourage consumers. One retailer noted, “at a time where retail prices are falling on traditional e-cigs, the price point on advanced systems will discourage sales.” However, others noted that the technology improvements will benefit the category and are necessary. **Bottom line – we remain cautiously optimistic by new e-cig/vapor technological innovation.**

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Key Takeaways from “Tobacco Talk” Survey

We recently reached out to several of our industry trade contacts to get a sense of vapor category trends during 4Q14 including category growth and current brand dynamics. Below are some of the key takeaways from this survey including direct quotes from a number of tobacco retailer and wholesaler contacts, representing approximately 20,000 U.S. retail locations.

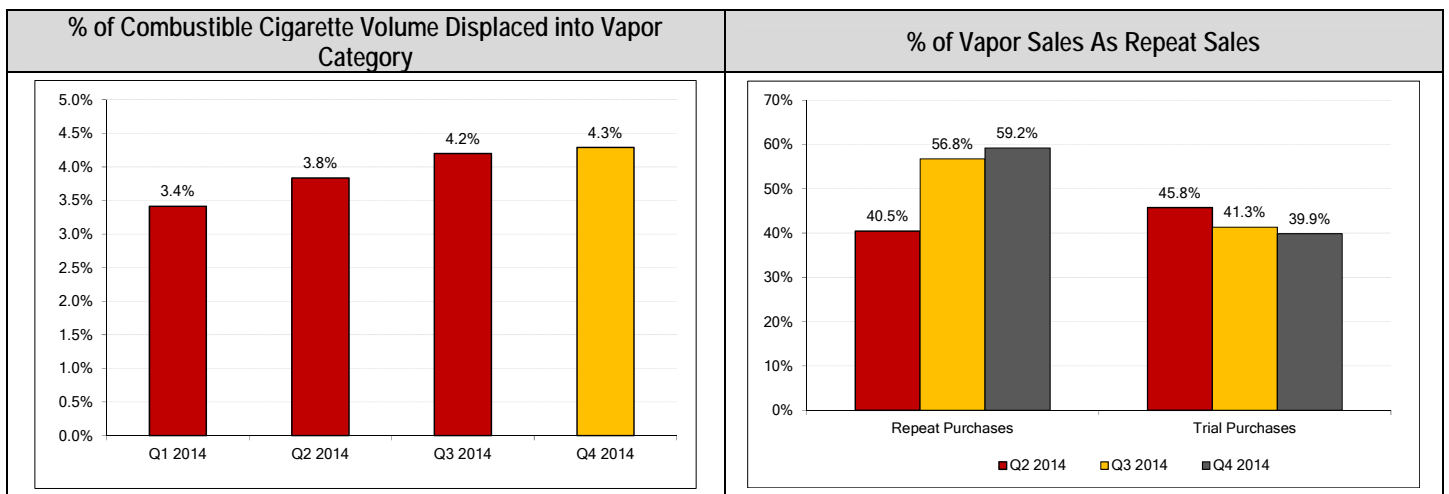
Vapor Category – Vape ‘Em If You Got ‘Em – Robust Growth Continues but Moderates

- **Combustible Volume Being Displaced to Vapor Reaches 4.3% – Relatively Flat to Q3 – Repeat Vapor Sales Comprise Nearly 60% of Vapor Sales**
- **Dual Use of Vapor Products (With Combustible Cigs) More Prevalent Than Full Conversion – More Conversion with VTMs**
- **Public Perception Mixed With Regards to the Safety of the Vapor Category**
- **RJR’s Vuse – Nearly 80% of Retailers Carry – Trial Strong – Driven in Part by Heavy Couponing – Though Retailers Note Vuse Has Helped Re-accelerate E-Cig Category Growth**
- **Overall Response Lackluster to Altria’s MarkTen – 100% of Retailers Carry MarkTen – Sales Driven by Coupons and Free Product**
- **Retailers Warming Up to VTMs – Nearly All Either Currently Carry VTMs or Plan to Soon – All Respondents Currently Carry E-Cigarettes**
- **Vapor Category Growth Moderating in C-Stores – Though Annual Growth Still Estimated to be Quite Robust at 17% - Retailers Excited About New Vape Products – Vuse and MarkTen Accelerating Category Growth**
- **“Maturing” E-cigarette Category (Subset of Total Vapor) Continues to Decelerate Despite Heavy Discounting/Couponing From New Entrants**
- **New NJOY and Mystic Vaporizer Products – Feedback Mixed – Some Retailers Seem “Distrustful” of NJOY**
- **“Advanced” E-Cig Offerings Such as blu+ and LOGIC Pro Could Cannibalize Existing Sales According to Most Retailers (76%)**
- **Most Consumers Are “Somewhat Loyal” to Their Preferred Vapor/E-Cig Brand – But Loyalty Is Expected to Increase In Time**
- **Sequential Sales Momentum Continues for Vuse, LOGIC, Mystic and blu – Challenges Mount for NJOY and FIN**
- **E-Liquids Taking the Most Incremental Shelf Space (+12.4%), Followed by VTMs (+12% y/y), Smokeless (+3%), and Cigars (+2%) as Snus (-1%) and Cigarettes (-5%) Lose Incremental Shelf Space**
- **Vape Shops Having Incrementally More Negative Impact on E-Cig Sales According to 62% of Retailers – Consumers Drawn to Vape Shops for A More Robust Assortment That C-Stores Cannot Support – Regulation Needed**
- **As Vapor Category Becomes More Focused at Retail, Retailers Carrying Fewer SKUs – (30 E-Cig SKUs in Q4 – Flat to Q3) – Liquid SKUs Growing Slightly**
- **Big 3 Vapor Margins Expected to be Below Mystic, LOGIC, FIN and NJOY – but Still in the Mid-20s/Low 30s vs. High Teens for Combustible Cigs**
- **Average Penny Profit per bottle of E-Liquid is About 2.50**
- **Retailers Most Concerned About Vapor Manufacturers Not Taking Back Returns, Too Many SKUS and Traffic Displacement to Vape Shops**
- **VTM Momentum Continues – E-Cig-VTM Mix Expected to be About 55/45 in 6 Months vs. Roughly 65/35 Today**

"Tobacco Talk" -- Q4 U.S. Vapor Retailer Survey

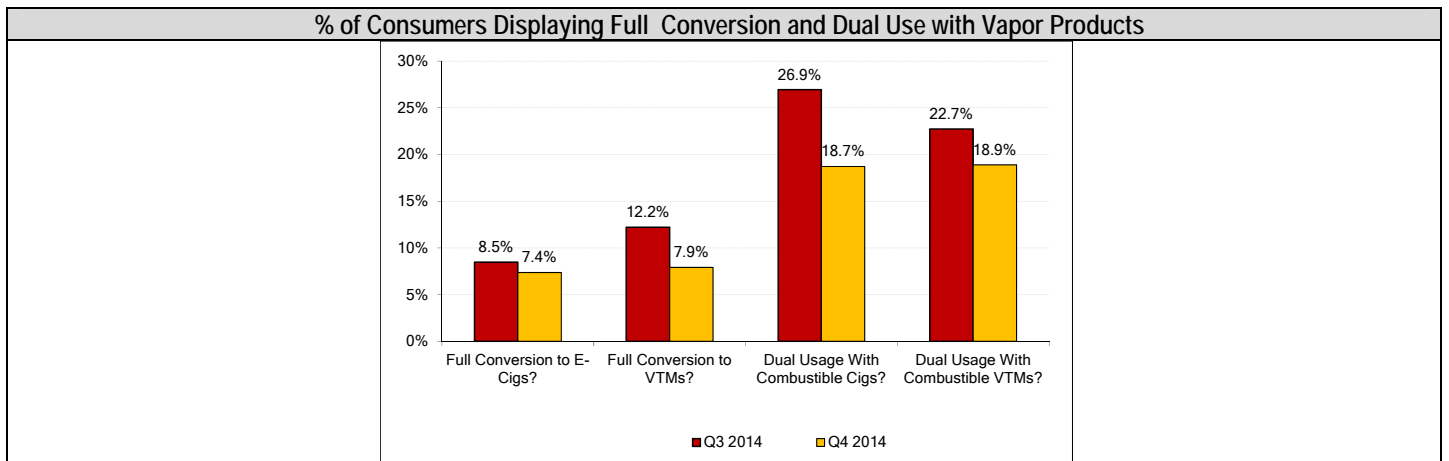
- **Blu & Vuse Represent >50% of Retailers' Vapor Revenue - Expected to Moderate in 6 Months As LOGIC, MarkTen, NJOY, Mystic and FIN Gain Share**
- **Could Take Longer For Vapor Margin Dollars to Surpass Combustible Cig Margin Dollars - 70% of Retailers Believe Gross Margin from Vapor Products Will Surpass Gross Margin Dollars from Combustibles After 2018 – 26% Believe Vapor Will Never Surpass Combustibles**
- **Vapor Pricing Dynamics Expected to Remain Pressured in 2015 – Though Some Retailers Optimistic On Pricing Environment Due to Pulled Back Promos**
- **Retailers' Biggest Excitements/Concerns/Predictions – Retailers Remain Excited About Vapor's Potential for Growth and Profitability, Technology Improvements – Concerns Continue Around Legislation, Regulation, Margin Compression Driven by Big Tobacco**

Combustible Volume Being Displaced to Vapor Reaches 4.3% – Relatively Flat to Q3 – Repeat Vapor Sales Comprise Nearly 60% of Vapor Sales



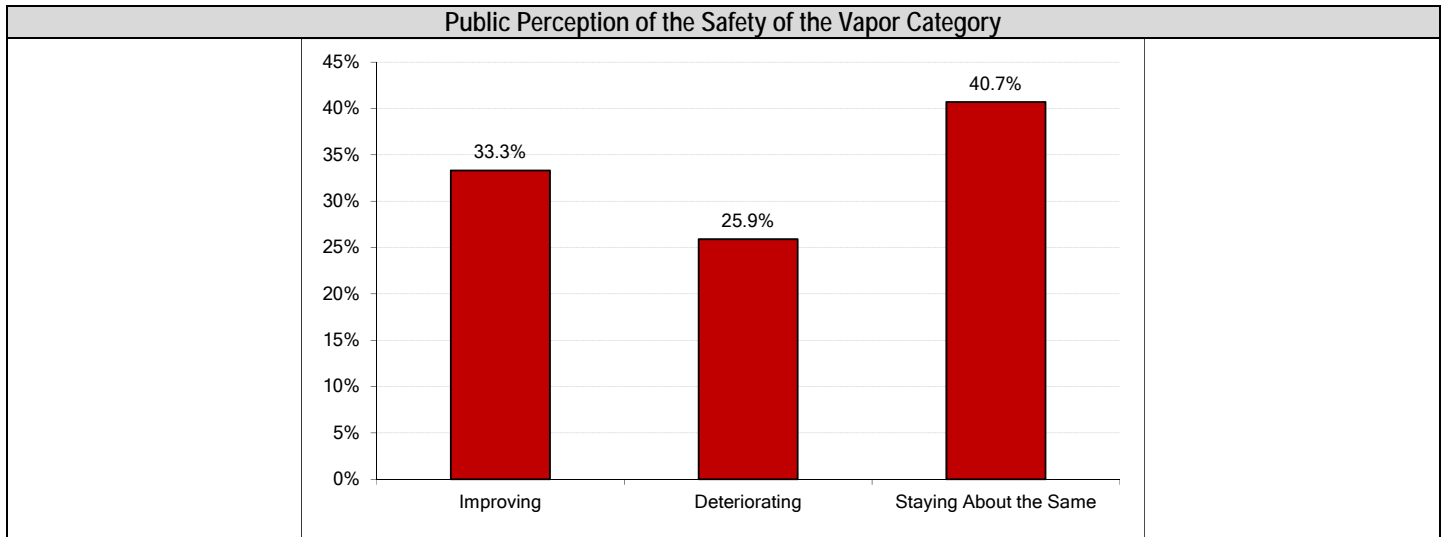
Source: Wells Fargo Securities, LLC

Dual Use of Vapor Products (With Combustible Cigs) More Prevalent Than Full Conversion – More Conversion with VTMs



Source: Wells Fargo Securities, LLC

Public Perception Mixed With Regards to the Safety of the Vapor Category

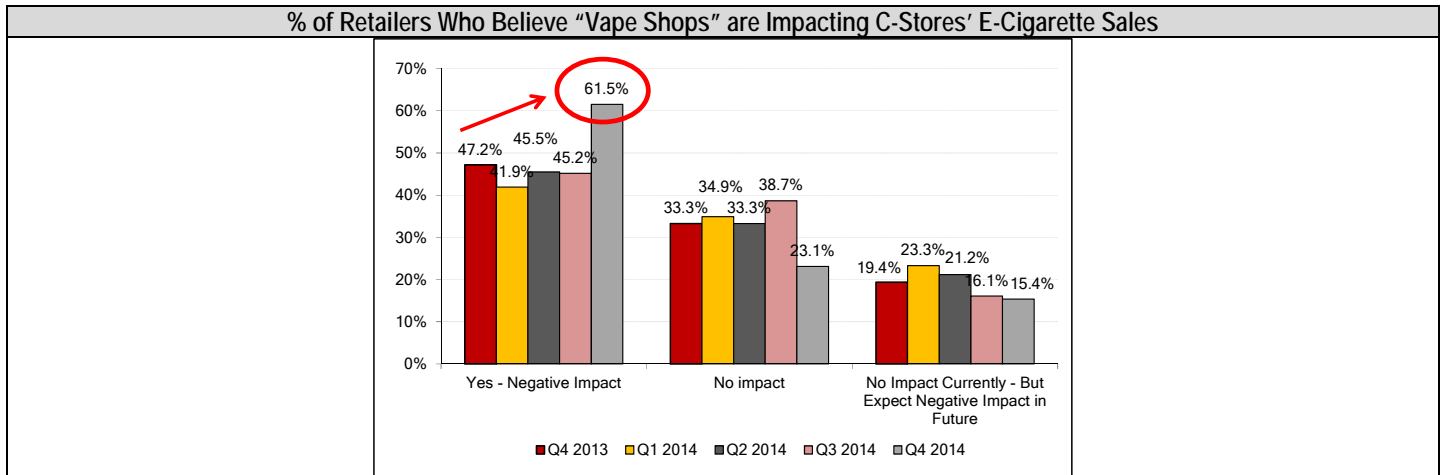


Retailer Comments

- "New ads on TV sponsored by the state, saying all sorts of negative things about e-cigs, so that may change in the next few months."
- "Very little concern about open systems."
- "Public needs more awareness of vaping before regulations take hold and restrict use."
- "Because of the relatively low numbers of people using e-cigarettes and VTM's, the general public does not realize some of the safety concerns."
- "They are starting to get on peoples radar as a local problem. Vaping in Public places."
- "I believe consumers are disillusioned with the segment, expecting more and getting less. The mistake they make is trying to compare apples to apples when comparing vapor to combustible. It's not the same."
- "Users are getting more educated on VTM options and use. They are discussing it with their friends and are becoming more comfortable with its use. Unfortunately most of the negative information is circulating from non-users who just want anything remotely tied to tobacco to be negative. 90% of the information from these sources is incorrect and many times down right lies."
- "Additional restrictions on public consumption."
- "The industry has basically let the anti-e-cig movement say what they want without rebuttal."
- "It has fewer additives so people think it is better for you."
- "I believe there is a level of uncertainty regarding the use of products with in the vapor category"
- "The lack of any regulation of substance is allowing local and state governments to take matters, which they believe to be true, in their own hands. The industry needs alignment to push for modified risk, or some sort of pros related to the business before the floor falls out."

Source: Wells Fargo Securities, LLC

Vape Shops Having Incrementally More Negative Impact on E-Cig Sales According to 62% of Retailers – Consumers Drawn to Vape Shops for A More Robust Assortment That C-Stores Cannot Support – Regulation Needed



Impact of Vape Shops on Other (Non-Tobacco) Merchandise Sales

"Vapor customers continue to shop Vape shops for all of their vaping needs. The assortment that traditional c-stores carry cannot match what a Vape shop has. In addition, they are mixing flavors for their customers and also selling higher priced, slower moving tanks, hookahs, etc. that we cannot support in our stores."

"An interesting dynamic we are seeing in our market is Vape shops opening and selling vapor, other smoking devices and cigarettes and near cost prices. It appears they are using the margin from Vape devices to support lower cigarette prices."

"Difficult to quantify impact but number of new store fronts can't be good from a competitive basis."

"Smoke shops have the ability to devote more space to the category, and have the time to "talk it up" and educate customers, vs. c-stores, where it's a quick in and out."

"I don't think that the Vape shops are playing by the same rules. I think that they need to be regulated more closely."

"Not seeing impact on other tobacco sub-categories."

"The current stage of the product life cycle for the category allows for multi-channel growth, and the enhanced offerings of e-liquid available to C-Stores allows for a more competitive stance."

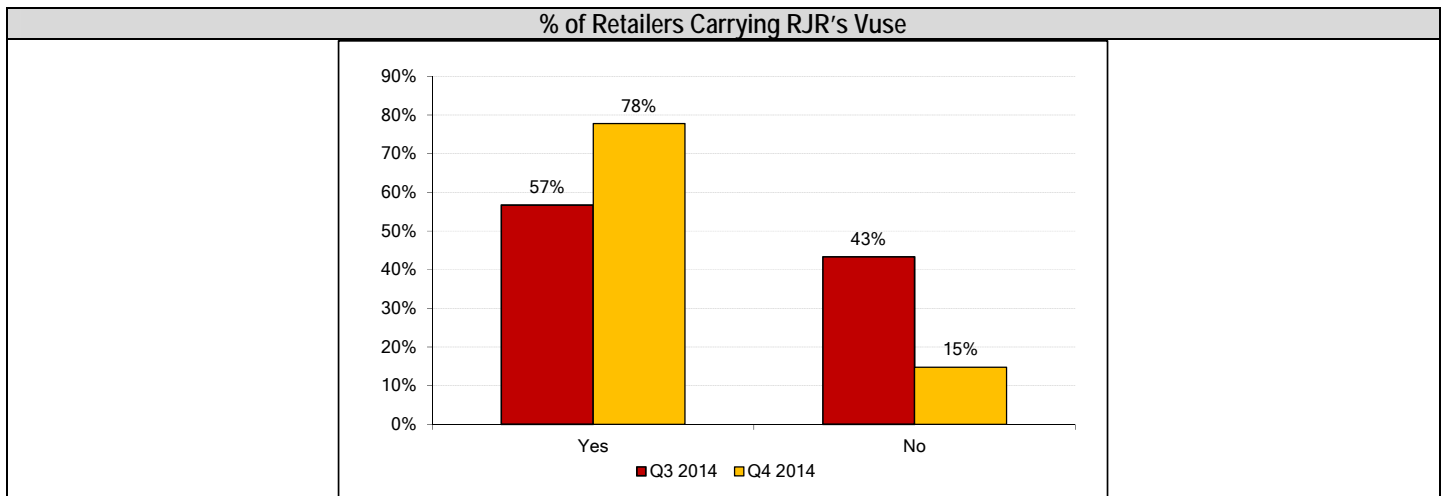
"Eventually, production regulation will drive this business down."

"I think they help the customer learn about the product but then when they see it at a c store; they see it is cheaper so it helps the c-store."

"They are much better equipped to sell the products to customers. They specialize in one segment of the business, with little to no exposure from the legal side. They are not even required to obtain a tobacco license, or participate in any sort of responsible retailers practice with minors."

Source: Wells Fargo Securities, LLC

RJR's Vuse – Nearly 80% of Retailers Carry – Trial Strong – Driven in Part by Heavy Couponing – Though Retailers Note Vuse Has Helped Re-accelerate E-Cig Category Growth

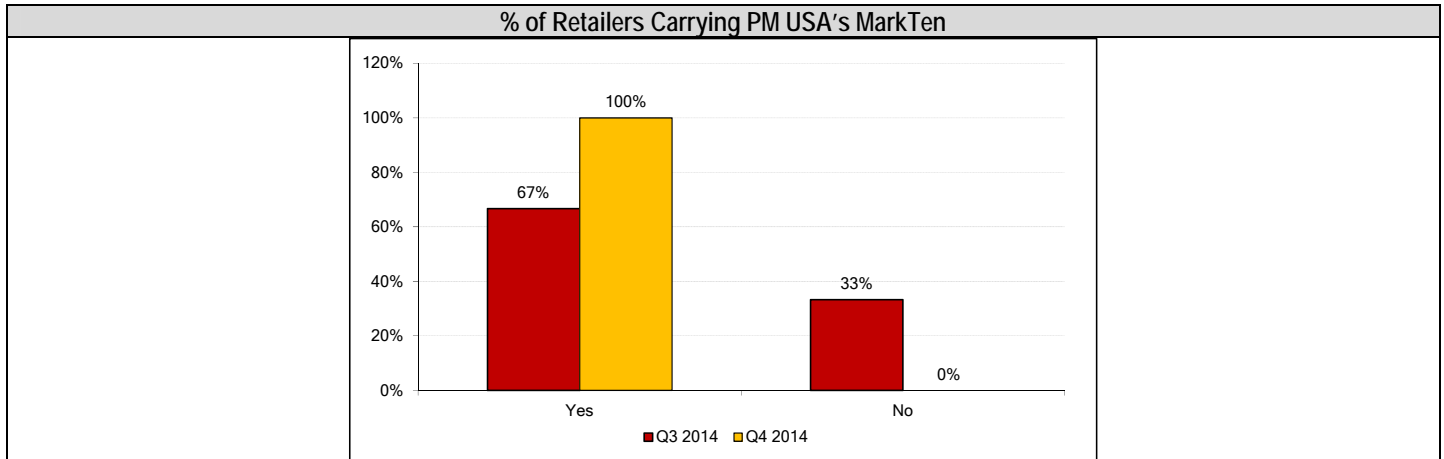


How is Vuse Performing So Far? What is RJR Doing to Drive Trial and Awareness? Are Vuse's new flavors generating incremental sales?

- "No promo support."
- "Free units...and pricing which the retailers are taking a beating on."
- "Vuse is being driven by direct to consumer coupons and in store intercepts. We do not have any new flavor offerings in our market."
- "Vuse is really selling, they have not released it yet to all avenues but, where it is, it is really selling."
- "Hard to tell right now with all the free coupons they are doing. I see a lot of repeat business."
- "Strong entrant. Will be share leader here within 12 months."
- "The direct mail coupon activity is driving trials."
- "They are sending a ton of coupons and sampling at our stores. I haven't seen the "new" flavors."
- "Consumer awareness program and coupons. No additional flavors at this time."
- "Vuse has done a lot of couponing. Time will tell if they keep this volume after the coupons dry up. My Blu sales seem to be holding steady against these coupons."
- "No new flavors, RJR giving the product away."
- "Was outstanding out of the gate. They featured coupons in our market."
- "It is doing well in terms of units per week, especially compared to other brands. Units are down from when they were giving it away or doing heavy couponing."
- "It's out performing all other e-cigs."
- "Performing fair, not up to expectations."
- "Mostly only selling to customers that have a coupon for a Free Trial."
- "I will not carry it due to pricing restrictions"
- "After they forced everything out, it has just sat here at wholesale. Even a few returns."
- "Vuse is doing extremely well. They have flooded the market with coupons. But we are seeing an overall increase in E-cig volume with Vuse in the mix."
- "Very well. A lot of repeat, non-couponed purchase behavior."

Source: Wells Fargo Securities, LLC

Overall Response Lackluster to Altria's MarkTen – 100% of Retailers Carry MarkTen – Sales Driven by Coupons and Free Product

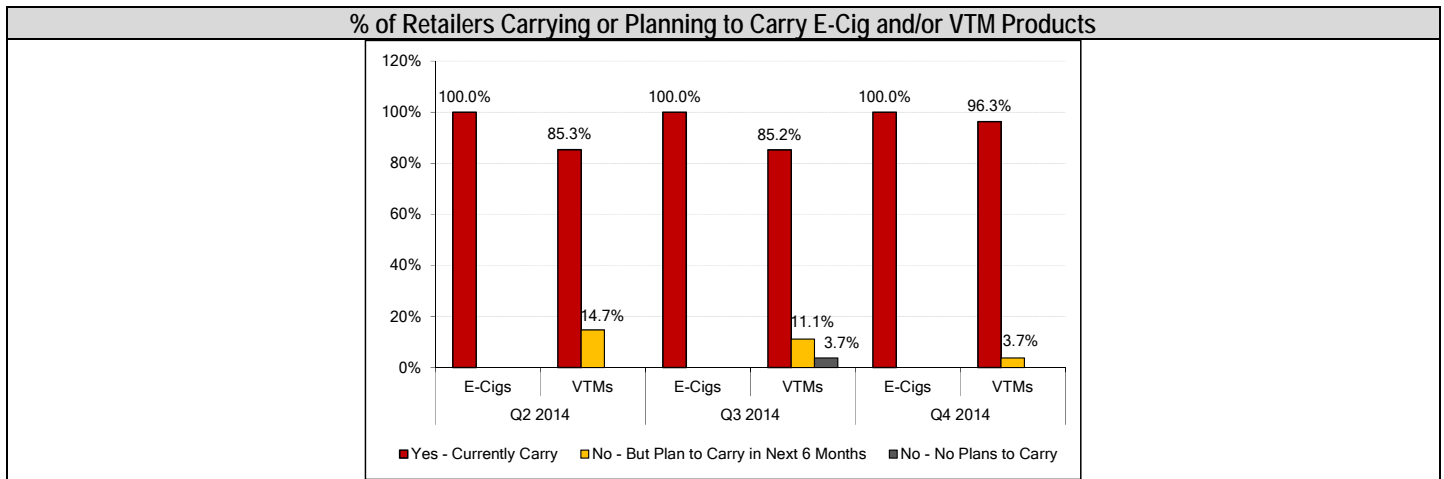


How is MarkTen Performing So Far? What is Altria Doing to Drive Trial and Awareness?

- "Not as well as they would like, but it is starting to get some repeat business."
- "Huge support is driving MarkTen sales."
- "MarkTen is performing similarly to RJR."
- "Very new to our area. Currently, only promotional activity is POS showing product."
- "Only launched in October. We have had some success however, there have been production issues which has caused out of stock situations. We have had coupons direct to consumers and in store coupons."
- "Very poor, short-dated heavy returns, out of date."
- "Not too good. Not much repeat business after the free coupons."
- "Good by virtue of Altria's effort at launch but, see it vying for 2nd position with Blu and LOGIC."
- "There share has declined as Vuse was introduced. They are driving sales through direct mail coupons as well."
- "Just began carrying....Altria is placing on cigarette fixture."
- "Dropping off as coupons decline."
- "#4 brand in our mix. Started strong will heavy couponing and has tapered off. New 2.5% should bring it back."
- "All coupon driven."
- "MarkTen has already seen a sales drop. People are not returning from repeat purchases. Instead, they are going to other products."
- "Just started with in the last month. Poor start."
- "MarkTen is slowly declining. It is still ahead of blu in units, yet it is way down from the launches and when they were doing heavy discounting."
- "Performing fair, slightly up to expectations."
- "Altria is still couponing this product. They recently forced out higher nicotine Mark Ten products which at first just confused everyone. Not selling much of the higher nicotine items just yet."
- "Growing slightly, based on deep consumer discounting. Printing more free coupons than manufactured product."
- "It is OK, but it is so coupon driven I am concerned about future volume."
- "About the same as Vuse. If they don't have a coupon for a free one, they don't want it."
- "Disappointing early on. Not sure why. But Altria is also flooding the market with coupons."
- "It sells great when they give it away."
- "Was outstanding out of the gate. They featured coupons in our market"

Source: Wells Fargo Securities, LLC

Retailers Warming Up To VTMs – Nearly All Either Currently Carry VTMs or Plan to Soon – All Respondents Currently Carry E-Cigarettes



Retailer Comments

"We have a **very limited amount of VTM's** as it is still so **hard to pinpoint the customers' wants without over SKU-ing the stores**. We are not the traditional vapor shop model, which makes it hard."

"Our **vapor device sales appear to be growing at a good pace** and we are seeing **repeat purchases for components and liquids**."

"**4 E Cigs companies 5 Vapor companies**."

"**Just Juice is doing very well for us**."

"**VTM's helped turn the segment from negative to positive**. Brands like **MarkTen and Vuse** are helping to breathe new life into the segment."

"We have **reduced our e-cig offer to 4 companies** and now have them in line with the cigarettes. We are currently **using 2 companies for vapor (Tantus, Trip13)**."

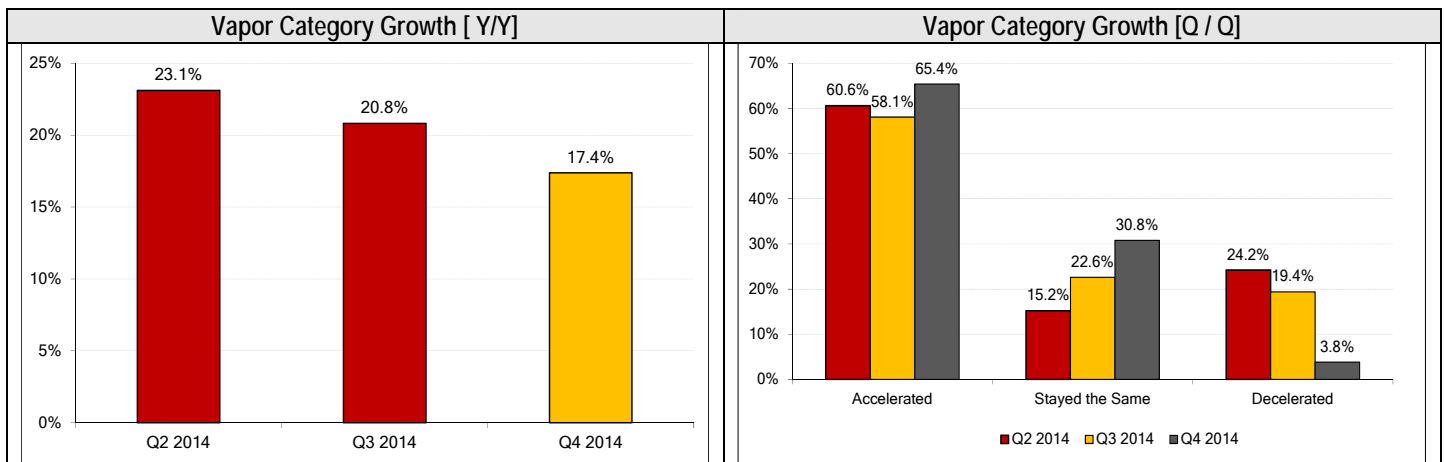
"Top brands we carry: E-cigarettes: blu and MarkTen; Vapor: FIN, NJOY, V2, (National Tobacco), Square Smoke, Tryst."

"**VTM/vaporizers are out selling e-cigs** more and more every day from wholesale."

"**Just scratching the surface with vaping**. Carrying a wide variety of E cigs; Blu, LOGIC, NJOY, Vuse & MarkTen."

Source: Wells Fargo Securities, LLC

Entire Vapor Category Growth Moderating in C-Stores – Though Annual Growth Still Estimated To Be Quite Robust at 17% - Retailers Excited About New Vape Products – Vuse and MarkTen Accelerating Category Growth



Retailer Comments

"**Mostly open system is generating the growth numbers**."

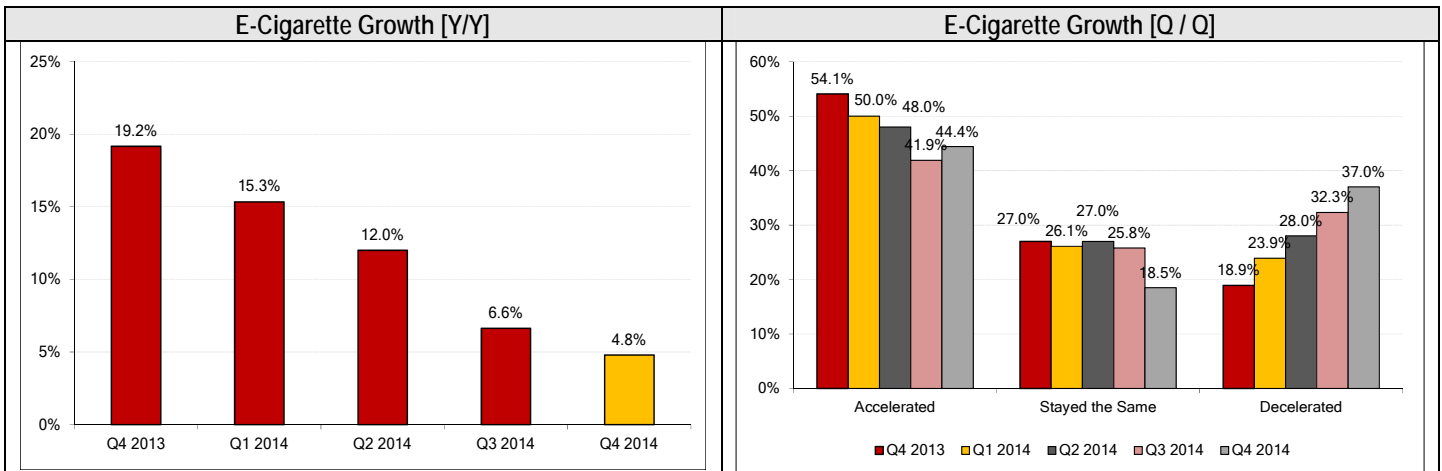
"**Slowing, but still growing**."

"Tobacco Talk" -- Q4 U.S. Vapor Retailer Survey

"This number is way underrepresented because of internet sales and Vape stores that do not report information nationally."
"E-cigarettes have definitely dropped off. VTM's are still growing at a good rate. It is not however as fast as most people would want you to believe."
"It is tough to estimate due to the majors giving away so many products via manufacturer coupons."
"VTMs, personal vaporizers, e-liquids."
"This is really hard to tell. There is a lot sold that is unreported so it is very hard to come up with a real number."
"Seeing a big uptick on E cigs as a result of Vuse & MarkTen entering the market. I anticipate this growth to accelerate based on new technology being introduced by LOGIC & Blu."
What Dynamics are Driving Growth in Vapor and What is Needed to Maintain Robust Growth?
"The new batteries on the open system Vapes."
"Appears to have picked up in December."
"More brands and flavors of e-juice. I think the Vuse system really brings new technology to the e-cig category."
"Added more Vapor products to sets."
"Entrance and marketing support by Altria and RJR, along with accelerating Vape trend, contributing to solidifying trend."
"The growth was fueled by Mark Ten, but mostly Vuse. This growth came because the coupon activity by both companies. Growth will continue as sampling continues through mid-year 2015."
"The addition of VTM's in our chain has allowed us to maintain a 30% + growth rate on the category, without VTM's we would be flat. Without the VTM's AND the new introduction of Vuse and MarkTen in the e-cigs, the total category would be way down (double-digit negative)."
"Negative media reports are stifling growth. In order to maintain the positive growth, I believe the Feds will have to step in and make some national decisions on packaging, age, flavors etc. Once there federal rules, maybe the states and cities will stop their kneejerk reactions."
"Customers getting free or heavily discounted products from RJRT and Altria."
"Education and innovation."
"In our area, that quarter had Vuse from RJR become available to everyone. Also had Mark Ten come out with higher Nicotine %"
"VTMs, personal vaporizers, e-liquids. Need to continue advancements in technology, ease of use, flavor variety, and consumer education."
"Introduction of MarkTen generated incremental growth. The trend looks to fall back a bit when MarkTen coupons subside since MarkTen has put so many of these into the market."
"Customers like flavors and being able to buy bulk."
"Substantial growth based on Vuse & MarkTen."

Source: Wells Fargo Securities, LLC

"Maturing" E-cigarette Category (Subset of Total Vapor) Growing but Continues to Decelerate Despite Heavy Discounting/Couponing from New Entrants



Retailer Comments

"Growth has been driven by the launch of Vuse and MarkTen. Much of this growth has been through free coupon sampling."
"E-cig sales, Blu and MarkTen are negative. Vuse is booming."
"Growth has been entirely due to Mark Ten and Vuse."
"None of the brands we have are showing year over year growth. It will be another 9 months until we overlap the Vuse and 10 months until we overlap MarkTen. Things continue to change rapidly."
"Almost all of my e-cig brands have seen a drop in sales. Some are holding on better than others. Vuse has seen growth, Blu and Cigalectric seem to be doing okay, while NJOY MarkTen and Fin have taken the hardest hits."

Tobacco

What Dynamics are Driving Growth in E-Cigarettes and What is Needed to Maintain or Re-ignite Robust Growth?
"Entry of MarkTen into our market has spurred some additional sales."
"New product launches are driving growth however, repeat business without coupons on Vuse and MarkTen appear to me a small portion of sales."
"New technology. I like the Blu Plus and the Vuse."
"While Vuse and MarkTen added to our e-cigs, they replaced sales from what we had last year with Blu, e-tron, Cigalectric, and NJOY."
"We need for somebody in the media to start covering the products in a positive manner. Interview users, and let them tell how the products have changed their lives."
"Customers getting free or heavily discounted products from RJRT and Altria."
"Vuse has brought growth back to the category."
"Shift to VTMs / personal vaporizers. Irreversible trend."
"The price value impression of the leader in this space, Blu, is very poor."
"Customers want mods. They like to change things and make them however they want. The old E-cigarette is almost a thing of the past."

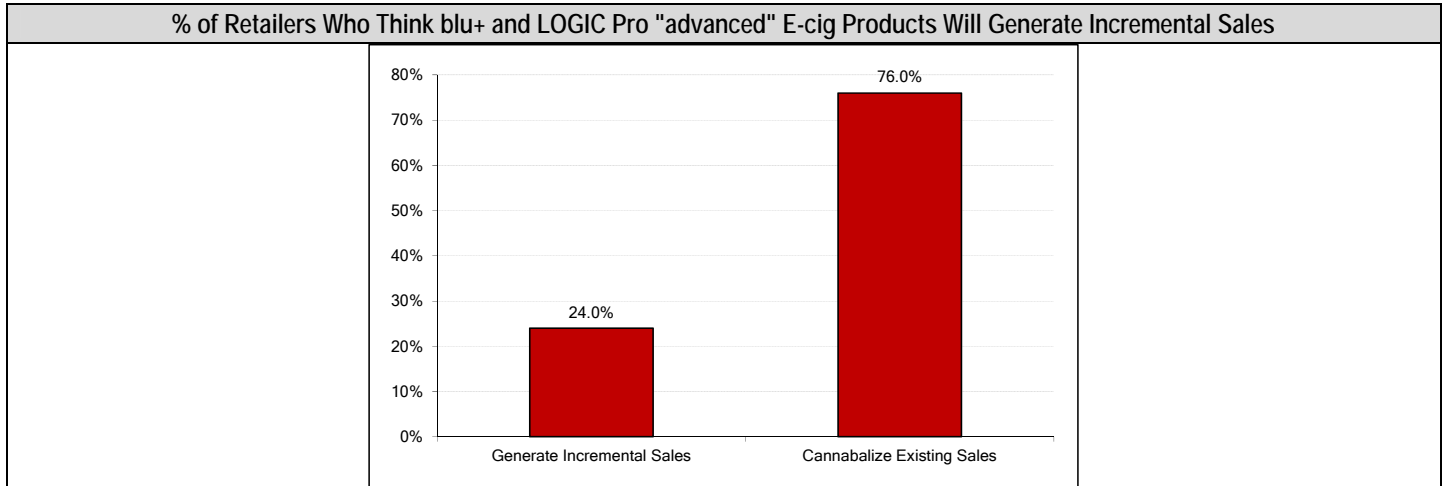
Source: Wells Fargo Securities, LLC

New NJOY and Mystic Vaporizer Products – Feedback Mixed – Some Retailers Seem “Distrustful” of NJOY, Noting Support and Servicing Issues

Retailer Thoughts on New Lineups of Personal Vaporizer and E-Liquid Products by NJOY and Mystic. What Has Been the Consumer Response?
"NJOY has done a better job with packaging. We have in 2 stores currently and sales are very slow."
"We decided to eliminate NJOY due to poor sales and chose not to add their new line. Mystic has never been part of our mix and we have no need for another line at this point in time due to space."
"NJOY I just put them in back in November. Scan data is pretty good for Dec. Do not carry Mystic's."
"NJOY looks good but we don't carry. Was nonplussed by their support. Mystic packaging not as strong but support is greater."
"NJOY is a great looking product."
"Me too products!"
"Don't carry either currently, but considering NJOY."
"I don't carry either of them. I had problems when I tried to return my NJOY e-cigs, so I will not try their Vape products. I don't trust them. Other retailers I know have not had much success with these brands. I have better options."
"NJOY looks appealing I have not seen anything new from Haus."
"Impressed by NJOY's offering. The pen itself is well made and provides a satisfying throat hit and vapor cloud. The e-liquid flavors are cutting edge and well packaged in terms of graphic appeal. Consumers have responded positively to the NJOY offering. Also impressed by the V2 line (National Tobacco)."
"Meh. Not that exciting."
"I don't have them. I have not had very good luck in the past with NJOY. They never follow up with what they say they will."
"NJOY's products look great, but don't trust anything they do. Mystic's products continue to evolve, but closely mimic everything else. No one has a knock-out product to date."

Source: Wells Fargo Securities, LLC

“Advanced” E-Cig Offerings Such as blu+ and LOGIC Pro Could Cannibalize Existing Sales According to Most Retailers (76%)

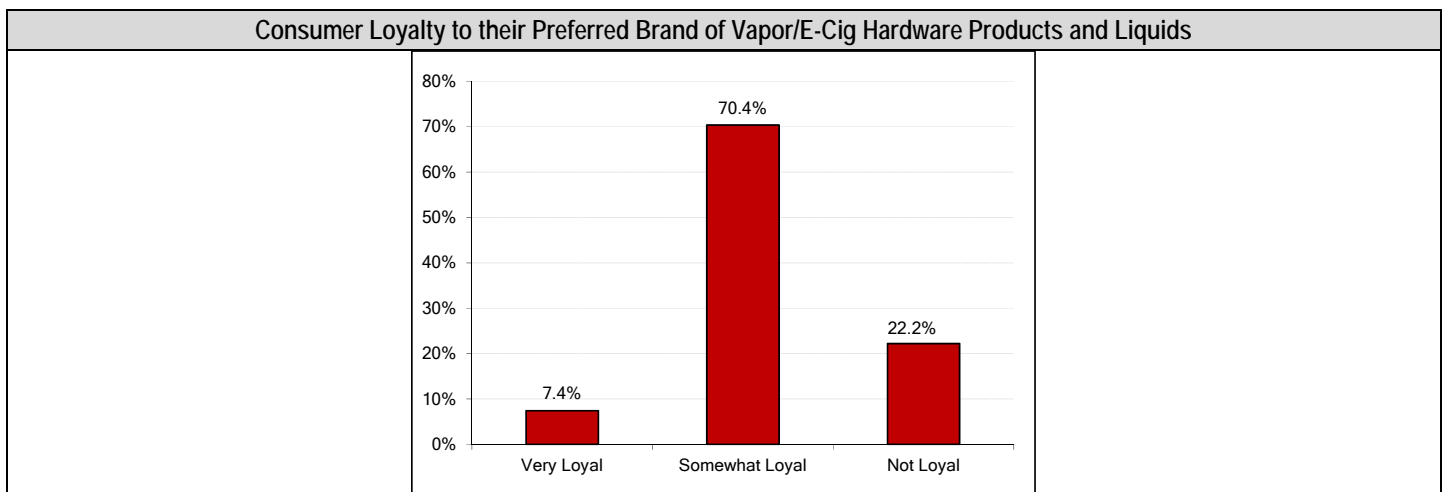


Retailer Thoughts on blu+ and LOGIC Pro "Advanced" E-Cig Products

- "Our supplier has discontinued a few of the lower nicotine products for the new."
- "We eliminated Blu regular, we have not added the new LOGIC items however, if we do we will delist the older product due to space."
- "We do not carry either. The entry retail is prohibitive to the customer."
- "I don't think that consumers will respond to these types of products. Part of the benefit of open tank systems is that the user has complete flexibility on flavor and nicotine strength."
- "In my opinion an e-cig customer and a Vape customer are different."
- "Have yet to see LOGIC Pro (only have some samples and were considering a test of the products). I have been told the launch date has been moved back until March 2015. This is the second delay I am aware of to date."
- "Limited upside. At a time where retails are falling, the price point here will discourage sales."
- "When the FDA steps in, they will do well, but till then they are just taking their own sells."
- "As technology improves so will the consumer that has been hesitant to enter this category."

Source: Wells Fargo Securities, LLC

Most Consumers Are "Somewhat Loyal" to Their Preferred Vapor/E-Cig Brand – But Loyalty is Expected to Increase in Time



Retailer Comments

"I think they are still trying to sort out the marketplace, so they are less loyal than combustible product users."

Tobacco

"They are still willing to try. I compare tobacco loyalty to the guy who won't even try a competitor cigarette if you give them a free pack. E-cig/ vapor customers are willing to try anything so they have not yet, if ever, become loyal to only one product."

"I think "loyalties" are still being established. This will take time."

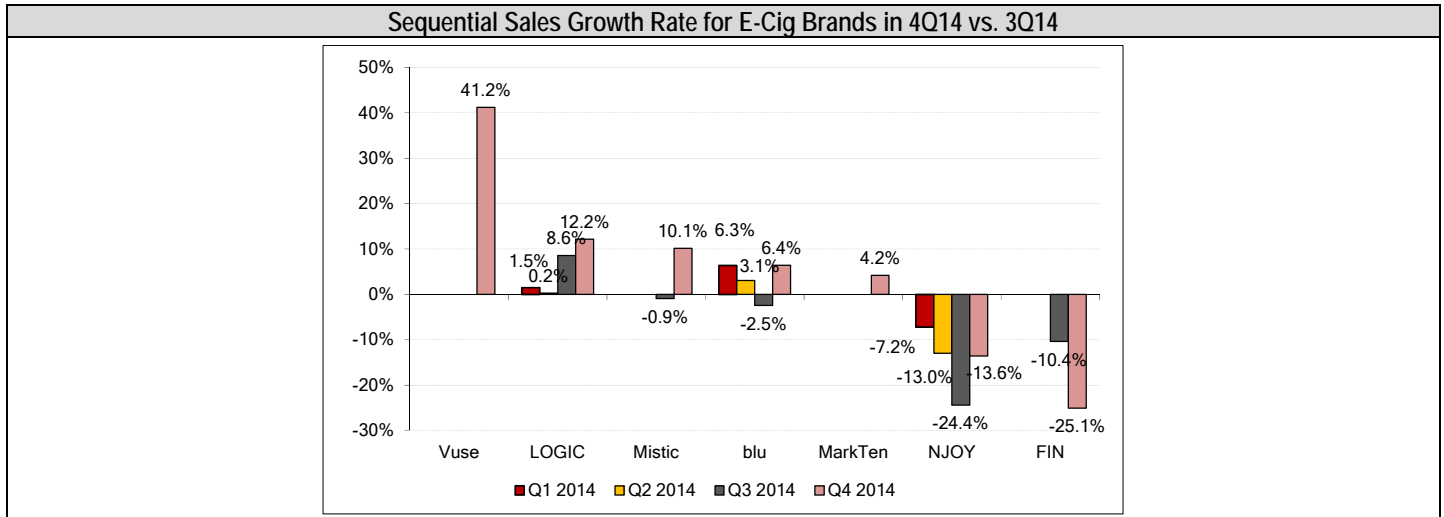
"More loyal to hardware...more likely to increase trial of different liquids."

"Not even a little loyal. This will change with time. Still a very experimental category."

"It is a price driven item. They will try something cheaper, if it looks good."

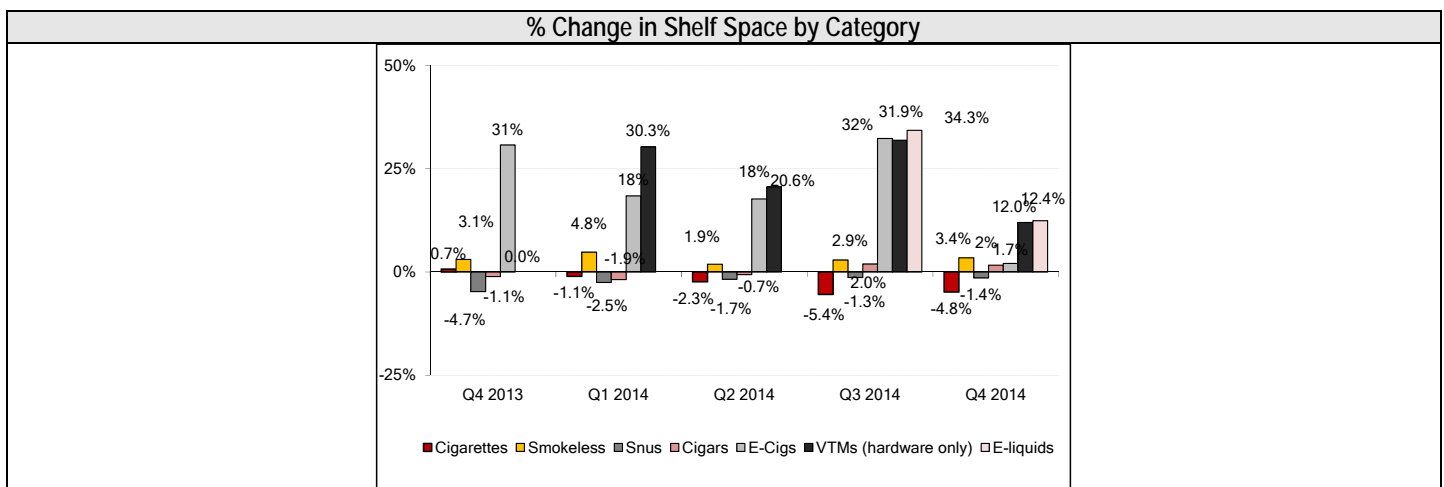
Source: Wells Fargo Securities, LLC

Sequential Sales Momentum Continues for Vuse, LOGIC, Mystic and blu – Challenges Mount for NJOY and FIN



Source: Wells Fargo Securities, LLC

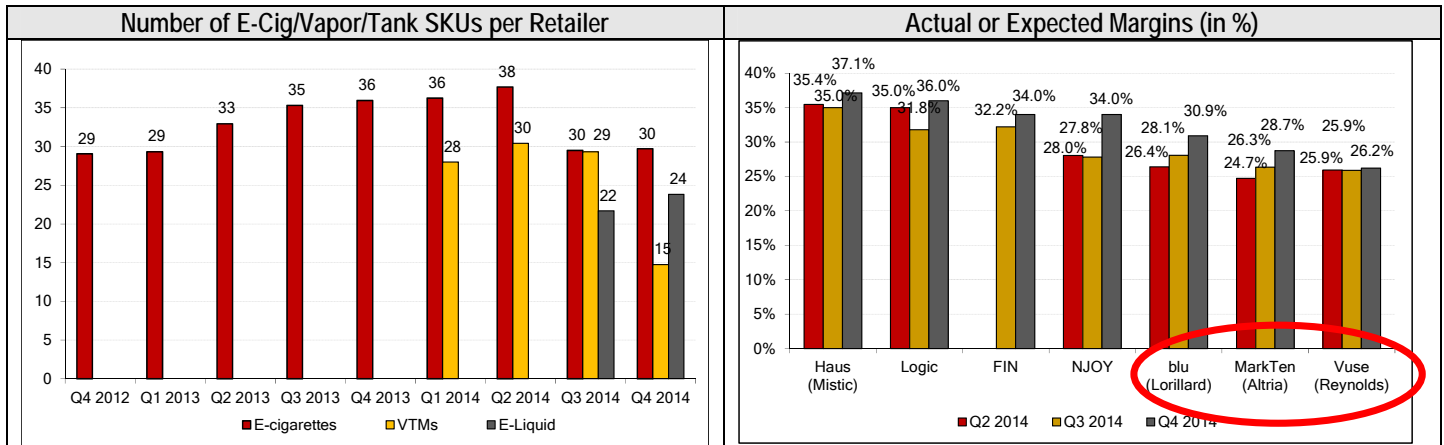
E-Liquids Taking the Most Incremental Shelf Space (+12.4%), Followed By VTMs (+12% y/y), Smokeless (+3%), and Cigars (+2%) as Snus (-1%) and Cigarettes (-5%) Lose Incremental Shelf Space



Source: Wells Fargo Securities, LLC

As Vapor Category Becomes More Focused at Retail, Retailers Carrying Fewer SKUs – (30 E-Cig SKUs in Q4 – Flat to Q3) – Liquid SKUs Growing Slightly –

Big 3 Vapor Margins Expected to be Below Mistic, LOGIC, FIN and NJOY – but Still in the Mid-20s/Low 30s vs. High Teens for Combustible Cigs
Average Penny Profit per bottle of E-Liquid is About 2.50



Source: Wells Fargo Securities, LLC

Retailers Most Concerned About Vapor Manufacturers Not Taking Back Returns, Too Many SKUs and Traffic Displacement to Vape Shops

Retailers are Concerned About These Factors				
	Very Concerned	Somewhat Concerned	Concerned	Not Concerned
Vapor manufacturers not taking back returns	44.0%	36.0%	4.0%	16.0%
Proliferation of too many SKUs in the vapor category & having to carry too much inventory	16.0%	44.0%	36.0%	4.0%
Lower traffic from vapor consumers not having to come in every day	12.0%	40.0%	24.0%	24.0%
Traffic being displaced to vape shops	28.0%	36.0%	24.0%	12.0%
Insurance companies unwilling to insure a vapor product line	16.0%	28.0%	20.0%	36.0%

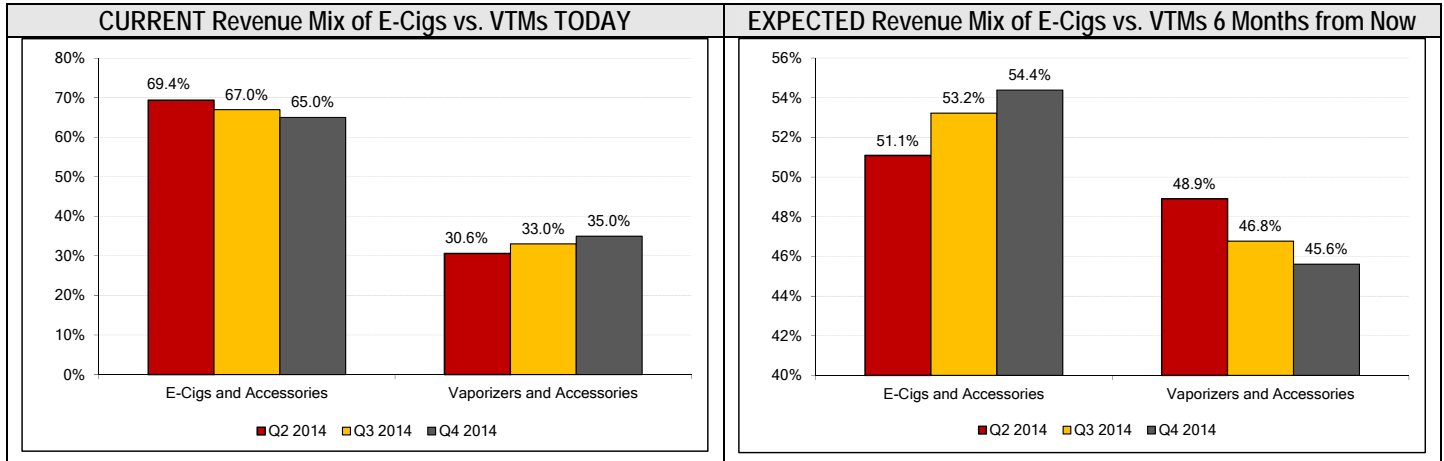
Retailer Comments

"I carry Just Juice vaporizer products, and they carry liability insurance on their products. I am covered by this policy."

Source: Wells Fargo Securities, LLC

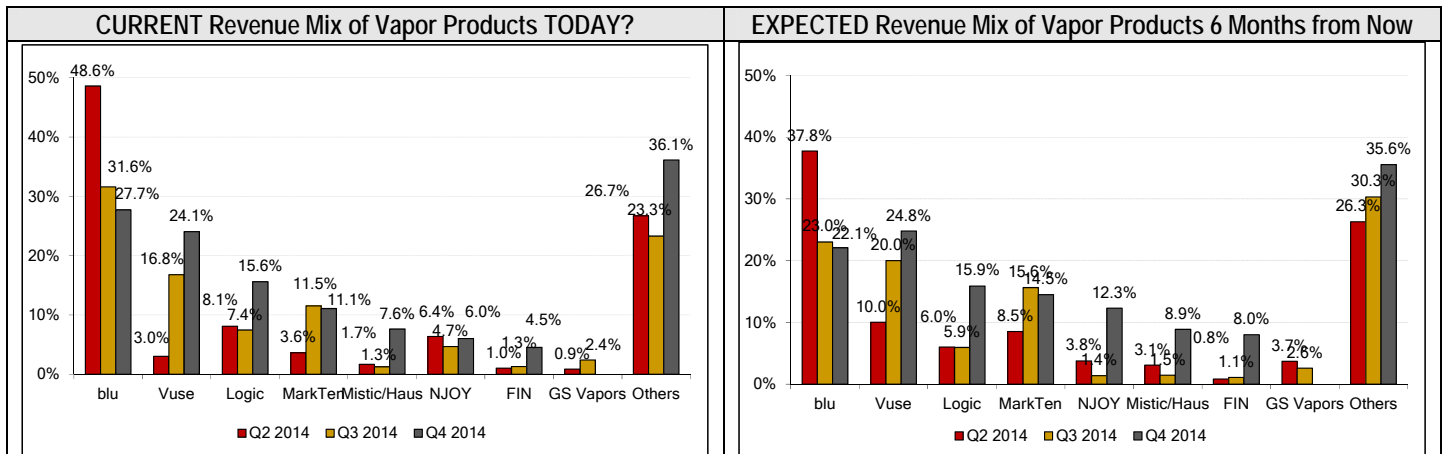
VTM Momentum Continues – E-Cig-VTM Mix Expected to be About 55/45 in 6 Months vs. Roughly 65/35 Today

Tobacco



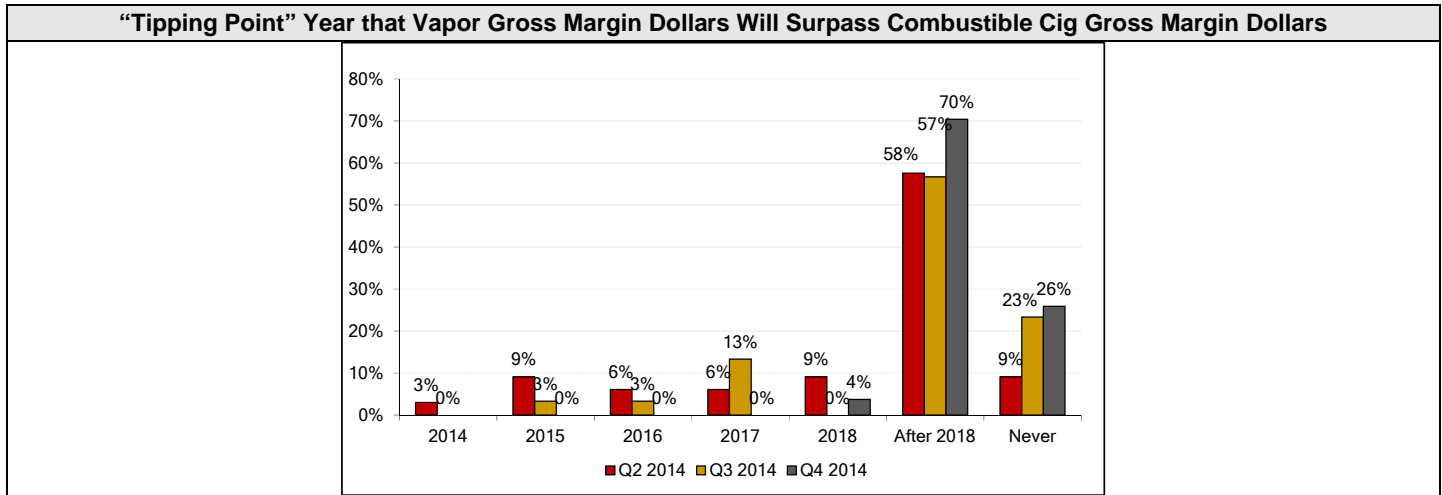
Source: Wells Fargo Securities, LLC

Blu & Vuse Represent >50% of Retailers' Vapor Revenue - Expected to Moderate in 6 Months As LOGIC, MarkTen, NJOY, Mistic and FIN Gain Share



Source: Wells Fargo Securities, LLC

Could Take Longer For Vapor Margin Dollars to Surpass Combustible Cig Margin Dollars - 70% of Retailers Believe Gross Margin from Vapor Products Will Surpass Gross Margin Dollars from Combustibles After 2018 – 26% Believe Vapor Will Never Surpass Combustibles



Retailer Comments

"Way after 2018."

"The conversion rate is still slow and I believe over the next several years, margins will be reduced on vapor products as the market becomes more saturated and competitive."

"I won't say "Never", but it will be long after 2018!!!"

"This will depend on what the government does from a regulatory and tax standpoint."

"Believe we are looking many years down the road before this happens. One item that might tip the scales would be the FDA stating these items are much safer and the risk levels are extremely low. Uncertain that will ever happen."

"It has a ways to go. It is the new age thing. You don't see kids smoking anymore, but you do see them vaping."

"The convenience store class of trade is still the preferred choice for consumers to purchase combustible cigarettes. The demand will increase as other classes of trade exit the category similar to CVS."

Source: Wells Fargo Securities, LLC

Vapor Pricing Dynamics Expected to Remain Pressured in 2015 – Though Some Retailers Optimistic On Pricing Environment Due to Pulled Back Promos

Retailer Comments

"No, I think RJR will continue to compress margins on traditional e cigs."

"I believe that all three majors will continue to provide discounts on their brand in an effort to try and draw consumer their way."

"With increased competition and the suppliers seeking to gain share, I believe margins will come under pressure and there will also be more manufacturer funding for free offers and promotions through coupons."

"I expect pricing to remain firm throughout 2015."

"There will be more pricing pressure as the customer become more familiar with the value of the products they are consuming. Most customers that are starting don't know what the prices are or should be."

"No, pricing dynamics will not improve now that "Big Tobacco" has gotten involved. RJR supported State Taxes for e-vapor, which is detrimental to the VTM business, but beneficial to the closed e-cig business. They will continue to present programs that only support their products and take margin from retailers in this category, just like they have done in cigarettes. They know exactly what they are doing."

"I do, in part, because I believe there will be many improvements to the products that exist today. Promotional activity was necessary because consumers were dissatisfied with the choices they had."

"Three horse racebig boys are going to take control."

"RJRT, Lorillard and PM margins are not as good as smaller companies' margins."

"The profits of e-cigs and vapor products are a dream compared to traditional cigarettes. As soon as RJR and PM got involved, the profitability started eroding. The big guys only care about their margins. They would be just as happy if retailers only made 11% from vapor products. Category pricing will most likely decline as the big guys get more involved."

Tobacco

"No, as Vuse and MarkTen grow it will destroy the once profitable category."
"I believe it will decrease as the manufacturers fight for space. I believe the pricing will become more consistent."
"Believe it will stay about the same. It will depend largely on RJRT and Altria and the retail take away they see in 2015. If e-cigs begin to slow down, the manufacturers will prime the pump again with free and discounted merchandise to keep supply moving through the system and to prevent outdated returns."
"No, more & more retailers are getting into the category and the c-store channel can't compete with the vapor shops."
"I think there are a couple of issues that will affect this category - the dust settling with the mergers of Reynolds, Lorillard & Commonwealth & how much "couponing" Mark Ten & Vuse will send out to gain traction."
"Expect pricing and margin compression as category continues to commoditize, although still well above combustible products."
"Very weak. I expect 30 to 40% deflation in the category."
"I don't think much will change till the FDA steps in. They need to get taxes and regulations on this stuff."
"I do believe pricing dynamics will improve. Promotional activity will decline on traditional E cig products."
"Quickly diminishing from the retailers' side. Competitive pressure among manufacturers and retailers fear among themselves will continue to erode retail selling price. This will erode to the point of another cigarette category. We do it to ourselves..."

Source: Wells Fargo Securities, LLC

Retailers' Biggest Excitements/Concerns/Predictions – Retailers Remain Excited About Vapor's Potential for Growth and Profitability, Technology Improvements – Concerns Continue Around Legislation, Regulation, Margin Compression Driven by Big Tobacco

Retailer Comments – Biggest Excitements/Concerns/Predictions Pertaining to the Vapor Category
"I would like to see the FDA get some regulations out there, so we can get rid of the "fly by nights" and get some sanity into the category."
"Manufacturers not returning product."
"The growth and profitability. Concerned about regulation and the majors' influence on the category."
"Most excited to see some of the thousands of vapor shops close to help get some of our sales back! I suppose that is part of my prediction as well."
"Concerned about more competition, lower margins and regulations. Excited that there is still potential for significant growth."
"VUSE. I predict Vuse will dominate the e-cig market. We carry Tryst e-cigs, e-cigars, Hookah and Shisha, sells very well, especially the e-cigars. I predict that all of the "fly by night" e-liquid mfg. will be gone and only the strong will survive."
"Advance Tech on Vapors. Each year they are getting better. Several companies merging."
"Entrance by RJR/Altria gives a much needed boost to the category (things had stalled and in fact decelerated a bit)."
"I am excited that the VTM's are moving away from the e-liquid to the closed Vape systems with pre-filled tanks. In 2015 there will continue to be consolidation in the industry. The e-cig category will have continued growth through the middle of 2015 fueled by Vuse. Blu e-cig will fall from one of the number one brands to a much smaller player after the RJR / Lorillard merger."
"Most concerned about "Big Tobacco" taking away our margins."
"Need regulations to be stringent.....will decline when the novelty has worn off."
"Homemade e-liquids is a real concern."
"Excited - Product improvements and upgrades; Concerned - Lack of Government regulations; Prediction - VTM's will make huge strides in 2015."
"My biggest concern at this point is the government."
"Where the space is going to come from?"
"I personally believe that vapor products are a prelude to legal marijuana."
"Majors are taking over most of this business. They have the capital to spend and develop new products, gain distribution and acquire space/signage for their products. If the vaping /liquids take off, I believe the major will either buy other companies or develop their own lines of these products."
"The whole category is a joke. This category represents less than 1% of my sales in total nicotine delivery products. Why is everyone so excited? All the growth in this category is reported on purchases, which doesn't mean anything."
"How this category will be taxed by states that feel they are missing out on tax monies when FDA decides to make a decision on how they want to treat this category."
"Further consolidation...far fewer brands as smaller players find it increasingly difficult to establish market share."
"Regulation hits. Bottling of juice will be regulated to FDA facilities Required front counter removal. A ban on sampling. Increases in labeling requirements and enforcement regarding label accuracy. Continued deflation."
"I am excited about the profits in the industry. I think that Nu Mark and Vuse are going to bring the margins down for everyone but themselves."

"As long as the manufacturers continue to offer educational tools to the retailers as well as the consumers, I feel that 2015 will be a break through for the vapor industry."

Source: Wells Fargo Securities, LLC

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