

Recommitting Tobacco



Uncommitted tobacco stocks are a normal part of the leaf trade. A financially sound tobacco merchant should maintain some inventory simply because selling tobaccos is its business. Customers tend to project their purchases on conservative sales estimates, and often, they end up needing more tobacco than initially expected, requiring them to buy additional leaf after their seasonal purchases.

Because tobacco is an agricultural product, stock holding volumes fluctuate with the whims of nature. If adverse weather conditions result in large volumes of unmarketable tobaccos, inventories will rise. The demand side, too, affects stockholdings. Advances in flavoring technology, for example, are allowing cigarette makers to use lower-quality leaf, a development that is changing traditional buying patterns.

For a leaf dealer, the trick is to have in stock the right types of tobaccos. Problems arise when their inventories comprise tobaccos that are not in demand, and stocks start growing to uncomfortable levels. The tobacco merchant then faces an unattractive choice between selling his tobaccos at a discount or paying for storage while waiting for prices to firm up.

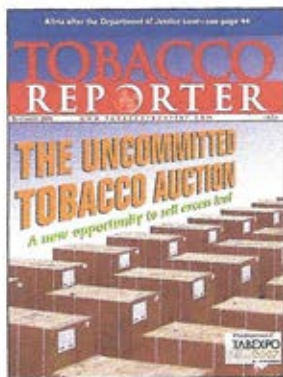
Today's competitive environment means that uncommitted stocks present a greater challenge than they did in the past. Operating on thin profit margins, leaf merchants are under pressure to control cost. Also, with the overall business fundamentals deteriorating, tobacco traders no longer enjoy the easy access to credit they once had. In such an environment, it is difficult to justify surplus tobaccos on the balance sheet.

To help traders move some of this excess leaf, a group of entrepreneurs recently created the Uncommitted Tobacco Auction (UTA). At the end of November, the UTA will give tobacco companies an opportunity to sell their uncommitted stocks at the premises of Tabaknatie in Antwerp, Belgium. Starting in 2007, the group wants to hold two such auctions every year.

Setting up a new tobacco auction is an involved and delicate process. Over the past couple of months, the people behind the UTA have been meeting with industry representatives to collect opinions and come up with a concept that is acceptable to the greatest number of customers.

The group says it's fully committed to confidentiality and transparency in all its dealings. Please turn to page 20 for details about this remarkable initiative. *Tobacco Reporter* will provide regular updates on the UTA between now and the first sale of uncommitted tobaccos in November.

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PLATFORM FOR OPPORTUNITY

The newly created UTA allows tobacco companies to sell their uncommitted excess stocks at auction.

TR Staff Report

A group of entrepreneurs has set out to inject some new dynamism into the world leaf tobacco market. At the end of November, they will offer tobacco companies an opportunity to sell their excess tobaccos at the first Uncommitted Tobacco Auction (UTA) in Antwerp, Belgium. Starting in 2007, the group intends to hold two such auctions every year. While the initiative is still in its infancy, some believe it will provide a platform for many new opportunities in the global leaf trade.

Uncommitted tobacco stocks are nothing new, but they present a greater challenge today than they did in the past. Operating on thin profit margins, leaf merchants are under pressure to control cost. Also, with overall business fundamentals deteriorating, tobacco companies no longer enjoy the easy access to credit they once had. In such an environment, it's difficult to justify surplus tobaccos on the balance sheet.

Excluding oriental tobacco, the UTA estimates the volume of uncommitted leaf sitting in warehouses around the world to be at least 200 million kg—almost as much as the entire crop size of Zimbabwe in its heyday. Flue-cured tobaccos account for the majority (up to 70 percent) of those inventories.

Thus far, tobacco companies have faced a stark choice between selling their surplus tobaccos at a discount or paying for storage while waiting for prices to firm up. In addition, the potential market was limited because of competitive issues—some tobacco dealers would rather not directly sell to or buy from their competitors.

Headquartered in the Netherlands, the UTA allows tobacco merchants to offer their uncommitted stocks to a wide range of buyers in an anonymous auction. Buyer and seller will remain unknown to one another during the auction, and confidentiality is guaranteed.

The UTA is independent from the tobacco sector and has contracted with three servicing parties—Tabaknatie, Trustoffice FTC and NewCo. The UTA organizes the auction from the beginning to the end, until contracts have been satisfactorily fulfilled. The three participating parties take care of transport and logistics, finance and arbitration, and special services to sellers and buyers.

The UTA has outsourced the management of the auction to NewCo, an independent, privately owned service organization. NewCo is responsible for all contacts with buyers and sellers.

Tabaknatie of Antwerp, a specialized warehouse operator, will be responsible for the auction's operation, admin-

istration, logistics and transportation. The auction is supervised and controlled by Trustoffice FIC, which also handles the contracts and invoicing.

THE PROCEDURE. The auction will take place in two phases. In the first week, customers will have an opportunity to view samples of each lot in the inspection rooms of Tabaknatie. In the second week, they will submit bids through the Internet from their home offices.

After approved registration at the UTA by Trustoffice, each company will receive a password to access the UTA's Web site. The offer and bidding page will be available one week before the start of sample viewing at Tabaknatie.

After the viewing week, each registered company will have access to the offer page, and the bidding can begin. On a selection screen, the company can choose the lots in which it is interested.

Companies can follow bidding online and increase their bids if necessary. Sellers are allowed to support their tobaccos by bidding on their lots under the same conditions as buyers. The sale currency is U.S. dollars.

Because the sales procedure is new to some buyers, the UTA will provide training as needed during the viewing week at Tabaknatie.

STRICT CONDITIONS. Buyers and sellers at the UTA are subject to strict conditions, set and supervised by Trustoffice. For example, sellers must submit a guarantee statement of their tobaccos, addressing any invisible

defects, non-tobacco-related materials, use of pesticide and other issues that might raise concern.

Buyers must pay a registration fee of €2,500 (\$3,204), plus a participation fee of 2 percent of the final purchase price.

In the event the buyer doesn't purchase tobacco at auction, the UTA will reimburse €1,000 of the registration fee. Initially, the money the buyer pays for his tobacco goes into an escrow account. The UTA releases the funds to the seller within 14 days after the buyer has received his tobacco.

The UTA has also set up a mediation process for disputes. If a buyer claims the tobacco received differs from the viewing sample, the UTA will negotiate with the seller on behalf of the buyer. If the UTA cannot reach a compromise, the buyer may ask for arbitration.

The UTA will maintain a list of arbitrators, all local tobacco experts. The arbitration commission will consist of one member appointed by the seller, one member appointed by the buyer and a president, who will be appointed by Trustoffice. Along with samples for viewing, sellers are required to submit one sample for arbitration prior to the auction.

The participants in the UTA will continue to fine-tune the process in the run up to the first auction in December. *Tobacco Reporter* will report the details as they become available.

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