

A WELCOME BOOST

NewCo opens a tobacco-expansion facility in Hungary for small- and medium-sized customers.

By George Gay

A new Hungarian joint venture, Leaf NewCo, has opened a factory offering expanded tobacco or the use of expanded tobacco processing capacity to small- and medium-sized tobacco products manufacturers unable to justify the cost of installing their own expansion plants. And while there is no reason why the new plant could not be used to supply additional or backup services to those manufacturers that do have such plants, most of its capacity is expected to be used to help smaller manufacturers, including one of the joint-venture partners, Continental Tobacco Group, compete more effectively against bigger companies.

The new plant, which has been installed by Airco DIET within Continental's premises at Sátoraljaújhely, a small town near Hungary's border with Slovakia, is being operated as a joint venture between Continental, which will use some of the plant's capacity to enhance its tobacco products, and the global tobacco service provider and leaf merchant NewCo, which will commercialize most of the capacity through its recently formed Dutch company, NewCo Leaf Europe.

Smaller manufacturers will no doubt welcome this attempt at partially levelling the tobacco-manufacturing playing field, but the new plant is also about creating jobs and protecting existing jobs.

This story started for me in Budapest, where, on Jan. 23, I took the 6 a.m. train from Keleti station northeast to

Sátoraljaújhely. The 6 a.m. train is an express train, but an express train in the English rather than the Japanese tradition, so it took four hours and 15 minutes to cover the approximately 200–250 km distance.

Of course, being English, I was comfortable travelling at that speed, which allows time for your thoughts to wander over the landscape. Seen through steamed-up windows, the terrain looked flat and uninviting under what I was told was an unusually late first fall of snow. I'm sure that come summer, the villages and fields the train passes would look picturesque, idyllic even, but in January life beyond the train looked hard.

And what I'd seen from the train came back to me after I had arrived at Sátoraljaújhely. Listening to the speeches given by various dignitaries to mark the official opening of the new plant, I was taken by the fact that Continental's general manager, Csaba Fűzi, who was the first to address the visitors, and those who followed him to the rostrum, including Hörcsik Richárd, the member of parliament for the local region, and Szamosvölgyi Péter, the mayor of Sátoraljaújhely, each spoke of the importance of the new plant as an employer. Indeed, the event attracted even Czomba Sándor, Hungary's secretary of state for employment.

The telling point here, I think, is that, since the Airco DIET system is highly efficient, it doesn't need many people to run it—25 in fact. Now each one of those jobs is precious to the



In addition to generating much-needed employment, the Hungarian leaf expansion plant will help smaller tobacco firms take full advantage of the benefits of DIET tobacco.

person who has it, but it is nevertheless the case that if the creation of just 25 jobs creates such a buzz, the view from the train window must have been accurate—life is fairly hard in this region and jobs matter hugely.

So it is important that, as well as creating jobs, the plant will presumably help secure the future of some small manufacturers and their employees in Europe and beyond. Certainly, it will help secure jobs at Continental's tobacco products factory and at least some of those of its other operations: perhaps 550–600 in all, mostly in Hungary but some in other parts of Europe.

So where are all of these people employed? A good number of them work at the Sátoraljaújhely tobacco factory, which, apart from the newly installed Airco DIET plant, has its own primary and secondary departments and produces a range of products that includes cigarettes, roll-your-own and make-your-own tobaccos, machine-made cigars and filter cigars with natural and homogenized wrappers, and filter-tubes. "So basically, everything except large cigars," Continental's group CEO, János Sánta Jr., told me during a short break in his official opening-day duties.

Family firm

Continental is owned by the Sánta and Veszeloyszki families, but only the Sánta family is engaged in the day-to-day running of the business. The two families started in the tobacco

business in 1996, making at a site in the south of Hungary a low-budget cigarette called Pannonia, for which the company did its own sales and distribution. Pannonia was very successful and is still produced in soft-pack format at Sátoraljaújhely.

The Sátoraljaújhely factory, which is 123 years old, was acquired by the Sánta and Veszeloyszki families in 1998 from R.J. Reynolds Tobacco, which, in 1992, took it over from the Hungarian state. Since 1998, Continental has built the business into an integrated tobacco company that is engaged, in the words of Sánta, from seed to smoke.

So now, Continental grows and contracts from local farmers flue-cured and burley tobacco that it processes in a plant at Szolnok, which is in the middle of the country and was part of the former monopoly. The company uses roughly 10–40 percent of local tobacco in its cigarette blends, while importing tobacco from around the world so as to provide the further quantities and varieties that it needs. Those blends are mainly American and European, but Virginia blends play a very small role in the company's portfolio. It also manufactures some American-blend "natural" cigarettes without the use of casings or flavors. One of these it makes under contract for a Swiss business that sells the products in Switzerland and Germany.

Continental's own main brands are Matrix, which is available as a hinge-lid-packed cigarette, make-your-own tobacco and filter tube, and Silverado, which is available as a soft-cup-packed cigarette, a natural-tobacco-wrapped filter cigarillo, a

homogenized-tobacco-wrapped little cigar and as roll-your-own tobacco.

As is alluded to above, Continental sells its tobacco products abroad, and so some of its employees work at sister companies in Germany, Italy, Romania and Slovakia. And it has importers and distributors in other European countries, so Santa is able to say that his company has Europe “pretty much covered.” Outside of Europe, it’s a different story, but Continental has ambitions elsewhere.

I suppose the question is: What difference will the 300 kg per hour DIET plant make to Continental’s operations and ambitions? Well, Continental will use the DIET tobacco to produce cigarettes with less tobacco, and with lower, more tightly controlled tar and nicotine deliveries, but, importantly, with the flavor of the tobacco maintained. And it will use it to manufacture the highly expanded make-your-own tobacco that is currently much in demand in Germany and that is gaining ground elsewhere in Europe.

Not that Continental is newly setting out on this route. It has been buying and using expanded tobacco for a long time. The trouble has been that such tobacco has been expensive and available only in limited quantities. Now, Continental will be able to produce the tobacco it needs with the characteristics it needs.

Growing interest

Thinking about the project, I found it easy to see where the advantage was to Continental in being part of such a joint venture, but I found it harder to imagine how the advantage to NewCo would outweigh the new responsibilities provided by the DIET plant. And yet, it was NewCo that led the charge. It had already signed up for a plant in 2012 when Continental approached it about a joint venture.

But it doesn’t take long in conversation with Rainer Busch and Birgul Sandal, the joint owners of NewCo Worldwide and the joint executive shareholders of Leaf NewCo, to become wrapped up in their enthusiasm for the project. NewCo was looking to invest in some tobacco-business project and decided that DIET was a good one, Busch told me. The company was getting more and more inquiries from customers, especially European customers, about DIET tobacco. Basically, there were a lot of medium- and smaller-sized companies that were not able to invest in their own plants because they could not make use of all of the capacity of such a plant.

Continental was just such a company, and what had seemed like a worthwhile project became even better when the joint venture was formed and, by building the plant in Hungary, it was able to take advantage of an EU subsidy. In his address, Füzi said the plant had cost HUF1.4 billion (\$6.14 million), while refurbishing the building ready for the plant, additional equipment, utilities and the installation had cost an additional HUF500 million. But the investment had been the subject of an EU 22.49 percent financial assistance subsidy, which reduced the real costs by HUF395 million.

But subsidy or no subsidy, Busch was clearly enthusiastic about providing smaller manufacturers with the wherewithal to compete with the bigger ones. In the past, he said, while these

smaller companies were able to access expanded tobacco, they could not have their own blends expanded and they had to accept tobacco with one-size-fits-all characteristics.

NewCo, on the other hand, wanted to provide a service to all European customers in which they could, if they wanted to, bring their own tobaccos to Sátoraljaújhely and expand them in a way that achieved the characteristics they required, said Busch. This takes some explanation if, like me, you are not familiar with tobacco expansion. Basically, the temperature is the key, so the higher the temperature, the bigger the expansion, but the bigger the loss of tobacco taste and aroma.

Some manufacturers apparently use high temperatures to produce a highly expanded but neutral tobacco to which they then apply additives such as flavors. But, given that regulators seem to be moving increasingly against the use of additives in tobacco, it has to be asked how long such a process can be used.

And this is why Busch and Sandal believe in the DIET product, which, processed at lower temperatures, can still offer good levels of expansion, good control of delivery levels and good taste and flavor retention. Additionally, they say, the U.S. Food and Drug Administration has already ruled that DIET is not an additive.

Busch and Sandal believe that 80 percent of the capacity of the new plant available to Leaf NewCo will be used by customers expanding their own tobaccos, either roll-your-own and make-your-own tobaccos, or tobaccos to be used as a cigarette blend component. And most of them would be using the system at lower temperatures, they said, because they would be looking to retain the quality of their tobaccos.

At the same time, NewCo is willing to work with a company to develop a blend, and it will be developing some standard grades to offer to manufacturers worldwide.

One matter that interested me was the question of smaller- and medium-sized tobacco manufacturers in Europe. You hear about them all of the time, but are there really that many—enough to keep the DIET plant busy? “Plenty,” said Busch. “We are actually surprised that we get so many new people contacting us. These are people we know of but who have never really shown any interest previously.”

Certainly, Busch was able to rattle off a longish list of smaller companies in Europe, the major focus of the plant, while Sandal added the names of some companies just outside Europe but close to the plant, and mentioned, too, the fact that some Asian customers might be interested in taking grades developed by NewCo. Then the talk turned to what might be referred to as micro-manufacturers. “In Western Europe there are some customers who buy less than 100 tons of tobacco [a year],” said Busch. “But in their village they have their own brands and they are interested in this product.”

And Busch emphasized the point that previously smaller manufacturers in Europe had access to expanded tobaccos that, while they had filling power, had little taste and aroma. Once they experienced the DIET product out of Sátoraljaújhely, which could deliver a bigger volume with taste and aroma, there would be no trouble in keeping the plant running. If it was run 24 hours a day, seven days a week, it would produce 2.2 million kg. “We’re not talking about major volumes, so we believe that line will be filled up quickly and easily,” he said.

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