Item 'F' : Introduction to Tobacco Session

1. The first slide shows the contributions to the Group's 1988 Turnover and Trading Profits from each of the Tobacco businesses.

   It also shows the forecast growth rates for volume, sales turnover and profits over the period 1988/1993, taken from the plans.

   These figures differ slightly from those shown by David Allvey earlier in that the BATCo. 1988 figures in the plan were adjusted to eliminate the distortion due to the overvaluation of the Venezuela Bolivar and the starting points for BATIG and Souza Cruz are also slightly different. What is unchanged, however, is the relativity with Trading Profits consistently forecast to grow faster than Sales.

2. Key features of the table are:-

   (a) The importance of Brown & Williamson accounting for almost half the Tobacco profits in 1988.

   (b) The relatively low margins in BATIG, Souza Cruz and Amatil.

3. Looking into the future:-

   (a) BATUS is showing a marginal increase in volume with a 6.8% p.a. increase in exports compensating for a 2.6% p.a. decrease in domestic volumes.

   (b) This decrease in domestic volumes is still less than that for the market overall and the market share is actually forecast to rise from 11% to 12.5% over the period.

   (c) The other main feature of the BATUS figures is that, despite some downtrading to a higher proportion of Value-for-Money grades, prices are still forecast to rise significantly faster than inflation and this also feeds through into profits.

   (d) BATCo. are forecasting a gain in world market share from 9.5% to 10.1% giving a volume increase of 1.8% p.a. However, their sales forecast shows price increases lower than inflation and the main gain in profits is from lower costs.

   (e) BATIG are also forecasting a gain in market share from 22.8% to 23.7% but this is offset by a contraction in the total market to give volumes staying approximately constant. Prices are forecast to rise roughly in line with inflation (which will be lower than for BATCo.) and here again profits are forecast to increase faster through lower costs.

   (f) Souza Cruz is forecasting some growth, in line with the market, with market share held constant around 79%. The trends for prices and profits are similar to those for BATCo. and BATIG.

   (g) Although Imasco is showing a volume drop of 2.5% p.a., this still represents a share increase of around 1% p.a. in a market which is forecast to contract quite sharply. Here again, though, although prices are expected to be under pressure, profits are still forecast to increase significantly faster.

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4. A common feature of all the forecasts, except Souza Cruz, is the assumption that market shares will increase and, except for Imasco, this will involve a reversal in the trends experienced over the past few years.

5. A key assumption in the case of BATUS is that prices will continue to increase significantly faster than inflation but in all other cases prices are forecast to be under pressure with profits growth being achieved mainly through cost reduction and improved efficiency.

6. The key issues which the Chairman suggested might be discussed are shown on the next slide.

7. There is a degree of overlap between the first two issues since the ability to achieve the rates of growth that have been forecast will obviously depend on the competitive environment and the overall size of the market.

8. Some of the key market assumptions are shown on the next slide:-

   (a) Anti-smoking pressures contained.

   (b) Tax rates will increase but will be moderated by the need to preserve cigarettes as a major source of revenue.

   (c) The total market will be maintained at current levels extending the trends established over several years. However, within this total, there will be increases in Latin America, the Indian sub-continent, the Middle East and Africa, offsetting slow declines in the markets in North America, Europe and the Far East.

   (d) There will be improved access to monopoly markets in Asia and Europe. In addition, the changes associated with the Single European Market initiative will have a significant effect on the individual markets within the EEC.

   (e) For the product, there will be a continued fall in levels of deliveries but at a slower rate than in the past. Full flavour products will continue to dominate with a continuing trend in consumer preference towards US-type blends.

   (f) There will be some increase in the polarisation of markets with International Brands increasing at one end of the price range but with emphasis also being given to Value-for-Money segments in many markets with competition increasingly using pricing or the postponement of pricing as a competitive tool.

   (g) However, overall profit levels will also be influenced by the strategic need for Philip Morris and R.J. Reynolds to maintain the cash flow from their tobacco businesses - lending some support to the critical assumption about price levels in the US market.

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9. Reverting to the other issues identified by the Chairman, it was suggested that another subject for discussion should be the likely technological trends in products and processes within the industry and, linked with this, the adequacy of the current R&D programmes as a means for enabling the the Group to establish a competitive advantage through having the capability to build on the recent good record in launching innovative new products and in establishing facilities for lowest cost production.

10. It was also suggested that opportunities for strengthening the current rather weak position in Europe might be discussed.

11. Finally, it was suggested that this could be an opportunity to discuss how far the expanded Tobacco Strategy Review Team meets the need for co-ordinating Group policies and strategies and to discuss whether any further strengthening of co-operation might be desirable.

[The Chairman to remind delegates that the end object of the session is to consider what needs to be done to ensure that we pursue strategies giving us the best chance of growing our Tobacco profits and of maintaining the healthy cash flow from this activity.]

RS/DJA
29th April 1989