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B.A.T INDUSTRIES p.l.c.

QUARTERLY PROGRESS REPORT: TOBACCO

JUNE 1990

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Operating profit for the Group's tobacco businesses at £478m for the first six months is £20m or 4% above budget. For the full year the forecast stands at £1135m which is £7m above budget. The erosion of the favourable variance in the remainder of the year is due to the impact of reduced year end trade loading assumptions at B&W and reduced margins in Brazil caused by earlier, unrecovered, cost increases.

Compared to 1989 the six months profit is £75m or 19% up and the full year £190m or 20% up. At latest rates of exchange the increase against 1989 falls to £39m or 9% for the six months whilst the increase for the year reduces to £95m or 10%.

Detailed analysis of operating group performance is available in their individual QPR's. This report deals with the overall progress of the Group's tobacco businesses.

VOLUME

Total Group volume for the first half of 248 billion is marginally ahead of budget and 11 billion up on last year although this falls to 4bn if Wills, (previously included as an associate) and BAT Espana (where comparisons with last year are not considered meaningful) are excluded. Within the total the picture is one of declining domestic volume recovered by strong export performance including Hong Kong, B&W and BATCF exports to the GDR which increase exports share of subsidiary volume from the budgeted 18% to 20%.

For the year total volume is forecast at 508 billion and the pattern of performance is an extension of that achieved for the first half with strong export performance recovering adverse variances against budget and last year for domestic volume. The favourable trend shown for associate volume is largely driven by a strong performance by BATCo's Indian associate. The year on year comparison is also distorted by Wills and BAT Espana and if these are excluded volume growth falls from 17bn to 7bn.

TURNOVER

Group turnover on a net basis for the first half is on budget and significantly ahead of last year. However the year on year position for both the half and the full year is distorted by inflation/exchange impacts on Souza Cruz numbers and the inclusion of Wills as a BATCo subsidiary for only part of 1989. When these distortions are eliminated the growth compared to the first half of 1989 falls from 26% to some 9%. For the year there is a small deficit against budget principally from reduced trade load assumptions at B&W and poor market conditions in Brazil.

In the Group QPR the turnover information is based on gross sales and details share of associated companies separately. Year on year tobacco growth on this basis is 29% compared to the 19% growth in net turnover included in this report which reflects subsidiaries and BATCo associates. The difference between the two rates of growth is caused principally by Brazil where the impact of high tax is exagerated by high revenue growth forecast by Souza Cruz. If this is excluded the residual gross turnover increase is similar to that of net turnover at around 20%.

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TRADING PROFIT

Trading profit for the half was £478m, £20m better than budget and £75m or 19% ahead of last year. At closing rates the total decreases to £442m reflecting the weakening of the US and Canadian dollar and Deutschmark against the pound.

Domestic profit contribution for the half year is generally less favourable with B&W and BATCF both reporting adverse variances as a consequence of lower volume and Souza Cruz profit down as a result of pressure on margins. Export performance is stronger, particularly at BATCF where higher sales into Eastern Europe recovered the lost contribution from lower domestic volume. Net exports at BATCo were significantly ahead of budget resulting in positive trading profit variances in Hong Kong and BAT(UK&E).

ELT profit contribution for the first half is ahead of budget though marginally down on last year at B&W. At Souza Cruz leaf operations are showing an unfavourable variance against budget due to unfavourable exchange rates and lower export volume.

For the full year trading profit is forecast to be £1135m, ahead of budget and 20% better than last year. At closing rates the total falls to £1040m.

For the year B&W trading profit is expected to be below budget as reduced trade loading impacts on the P&L. Lower volume and reduced margins exacerbate the shortfall in Brazil. BATCo is forecasting a budget surplus with Hong Kong, BAT(UK&E) and Bigott building on their export success.

COMPETITOR ACTIVITIES

Philip Morris: Agreement was reached between Philip Morris and two Turkish partners including the state monopoly to establish a joint venture to be called Philsa Tutun to produce Marlboro, Chesterfield, Parliament and other Philip Morris brands near Izmir. Philip Morris is acquiring RJ Reynolds' local brands in Brazil following Dibrell Brothers' purchase of the RJR subsidiary. Philip Morris GmbH also announced it was acquiring East Germany's largest cigarette maker, VEB Kombinat Tabak based in Dresden. Terms will be determined after the valuation of the East German company's assets.

On June 22, 1990, Philip Morris announced its intention to pay $3.8bn for Jacobs Suchard, the Swiss coffee and chocolate group.

For the second quarter operating revenues, profit before tax and net earnings increased by 12%, 28% and 27%: for the half year these increases were 9.5%, 30% and 29%. In the US tobacco volumes were slightly higher in the quarter and half year. International cigarette volume, including exports, increased strongly for both the second quarter and the half year.

R. J. Reynolds: In September 1989 RJR announced it would end the practice in domestic distribution known as trade loading. The company as a result was said to forego $340mn in operating profits in that year. Reflecting this for the first quarter of 1990 the tobacco business worldwide recorded a 41% increase in operating income with a 15% rise in first quarter sales. As with Philip Morris RJR are also acquiring an East German cigarette manufacturer. The food operations were also ahead but debt servicing charges resulted in a first quarter overall loss. On 16 July RJR started a $6.9bn recapitalisation programme to reduce debt and increase equity: this also involves an equity injection by KKR and some higher interest rates on remaining junk bonds.

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Rothmans: Rothmans International announced the acquisition of Theodorus Niemeyer BV of the Netherlands from Gallaher Ltd. Rothmans said the acquisition would "substantially strengthen" the company's presence in the fine cut and pipe tobacco markets, particulary in Europe.

Rothmans International reported an increase in pre-tax profits of 24% to $405.6m in the year to March 31.

Reemstma: Announced it was taking over a major East German cigarette producer, VEB Tabak Nordhausen, based in Thuringia.

American Brands: First quarter net income up 13%. Tobacco income up 8% and cigarette sales worldwide up 1.3%. Domestic tobacco income up 3% despite lower volumes, while international tobacco income was up 12% with a strong performance from Gallaher.

OPPORTUNITY MARKETS

Japan: Total imports in the full year 1989 were 44.4 billion cigarettes, 25% ahead of 1988. The import segment in the five months to May was 16% ahead of the corresponding period of last year. BAT's share of the segment this year has fallen to 21.2% from 22.9% with Kent and Viceroy down. Philip Morris continued to grow strongly with their share of this segment up to 61.2% from 58.9% for the same period of 1989. Lark (particularly Superlight), Parliament and Merit were all ahead whilst the Philip Morris family was down. RJ Reynolds' share grew fractionally to 12.5%.

China: Exports from Hong Kong were up 27.6% in the six months to June compared to last year. BAT's share of this segment rose to 47.2% from 46.2% for the same period last year with growth from both State Express 555 and Hilton. Hong Kong Tobacco Co.'s share was also up whilst Philip Morris was down although Malboro was ahead.

Taiwan: Total imports were down 18% after four months (having also fallen 8.5% in the full year 1989 compared to 1988). BAT's share of segment fell to 20.6%, compared to 27.0% for the same period last year, with falls in both State Express 555 and Kent. Two competitive brands made significant progress. Philip Morris' L&M Mild, launched at the end of last year, became the largest brand in the segment with a share of over 25%, whilst Rothmans' Craven A, also launched at the end of last year, gained 6.5% segment share.

South Korea: The import segment in the full year 1989 was nearly 3.5 billion cigarettes, significantly ahead of the previous year.The import segment was up nearly 27% after five months of 1990 compared to the same period last year. BAT's share of segment fell to 20.7% from 26.7% where the sharp fall in the Kent family was not offset by gains with Finesse and Benson & Hedges International. Philip Morris gained share of segment overall, up to 32.5% from 31.5% last year, with growth in Virginia Slims, Marlboro Lights and Philip Morris Ultra Lights more than offsetting declines in Lark and Parliament. RJ Reynolds' share was down to 31.5% from 33.7%, with falls in YSL, More 120s and Winston Lights, more than offsetting gains with More Lights 100s and Camel Lights. The Japanese monopoly, who entered the market last year, had nearly 7% of the import segment in the year to May.

Turkey: Total legal imports in 1989, at 11.9 billion, were 21% ahead of the previous year. After five months in 1990 the segment was up nearly 50% over the corresponding period of last year with the growth principally coming from Marlboro 100's. BAT's share of this business fell slightly to 2.2% from 2.4%.

Greece: The import/licence segment in 1989, at 9.7 billion cigarettes, was up 12.5% on the previous year. After four months in 1990 the segment is over 10% ahead of the corresponding period of last year. BAT's share of this segment has rised to 9.5% this year compared to 8.4% for the same period in 1989 with the growth coming from Prince and Cortina Ultra Lights, with some progress from Lucky Strike Filter.

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