

SECRET

General

1. The first priority for BATCo., which should be reflected in the performance criteria for the Number Ones in operating companies, should be to achieve progressive improvements in the results from the existing Tobacco businesses, concentrating particularly on achieving improved profit margins and asset productivity through volume and market share growth (especially in Europe and the International Brand segment) and through overhead reduction (especially in Europe and the UK).
2. Specific consideration should be given to opportunities arising from the rationalisation of the European market and from options to expand into new markets, especially where these arise through relaxations in state controls or through opportunities to acquire an existing market leader.
3. Opportunities for establishing or expanding other activities, including Agribusiness, may also be considered, subject to prior agreement on the availability of resources and also bearing in mind the need to give the highest priority to maintaining satisfactory levels of performance in the Tobacco businesses.
4. In addition to its direct role in the management and development of its own businesses, BATCo. will also be responsible, through the Tobacco Strategy Review team; for formulating and agreeing with the other Tobacco Companies, a Group-wide R&D programme; for the preparation of compendiums on smoking issues; and for initiating and co-ordinating meetings and other activities to promote the Group's views on these issues.
5. The Guidelines, and in particular the Financial Guidelines, do not reflect the impact of the addition of Wills Australia to BATCo. Appropriate modifications will be made when the implications of this have been clarified.

Financial Guidelines

6. Returns : BATCo. should aim to achieve an historic cost return of at least 35% for the Operating Group as a whole, with each individual business achieving at least 25%. BATCo. should also determine from time to time that a 35% historic return equates to a CCA return of at least 20%.
7. Dividends: The minimum dividends expected from BATCo. are:-

	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>
£m	162	183	205	228	255	286
8. Debt:Equity: The gross debt:equity ratio should be kept below the following levels:-

	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>
%	12	13	12	11	12	12

These figures represent an increase on the limit specified in the 1988 Guidelines, reflecting a slightly higher level of borrowings, associated principally with the Cameroon and the financing of higher dividend remittances from other countries. The current asset productivity review should result in lower ratios being achieved. However, projects resulting in a higher debt:equity ratio may also be submitted for approval. In particular, BATCo. should continue to seek to maximise UK cash flow and, where appropriate, should be prepared to incur further increases in foreign borrowings in order to achieve this.

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Specific Priorities

9. A first objective for BATCo. should be to agree with the CPC, strategies and action plans for:-
 - (a) The European Market.
 - (b) Further reorganisation to improve the cost-effectiveness of BATCo. and the other UK based operations.
 - (c) Tobacco R&D, worldwide.
10. Market Share : Priority should be given to achieving improved market shares in the higher margin products, especially in the developed countries in Europe, including France, and in Malaysia. There should also be a continuing emphasis on increasing Exports in accordance with Guidelines agreed through the Tobacco Strategy Review team.
11. Strategies to compete with Marlboro should continue to be developed market by market, using the most appropriate brands for each market and market segment, concentrating on competing for the younger adult smoker through campaigns specifically directed at this customer group, promoting Lucky Strike, Benson & Hedges, Kent, Barclay and Capri.
12. In order to be able to pursue these strategies successfully, it will be important to develop specific plans relating to:-
 - (a) Quality : Aiming to be able to achieve and maintain superior smoking quality, accepting that it may be necessary to consider increasing the proportion of imported leaf in certain overseas companies where the local leaf fails to provide the quality required.
 - (b) Production Costs : Aiming for each business to be the lowest cost producer of quality cigarettes for its markets.
 - (c) Asset Productivity : Establishing tight controls on capital expenditure and leaf durations but also bearing in mind the need to maintain high standards of manufacturing efficiency and product quality.
 - (d) Innovation : Emphasising the need for innovation in product and process design and for the effective implementation and dissemination of new developments throughout the Group.
13. Diversification : Opportunities for diversification may be considered but only in cases where the Tobacco business is already performing satisfactorily and where one or more of the following conditions are met:-
 - (a) The new activity is necessary to support the Tobacco business either directly or in its relations with Government.
 - (b) There are spare funds whose repatriation is either prohibited or uneconomic.
 - (c) The project has been agreed by B.A.T Industries as contributing to the overall development of the Group.

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14. There will be a preference for these new activities to be in Financial Services, Paper/Pulp or Retailing but it is appreciated that in some cases, especially in developing countries, it may be necessary to consider alternative investments, which will preferably be in Agribusiness.
15. The potential for investments in Financial Services and Paper/Pulp should continue to be studied and proposals prepared where the opportunities for investment are sufficiently attractive to justify this.
16. For Agribusiness, the first priority must be to ensure that existing activities are managed efficiently and that the potential for meeting the Group's performance criteria has been evaluated and appropriate action put in hand for any activities which do not have this potential. Proposals for further investments in Agribusiness may be considered, including proposals to improve the marketing of products from existing activities. However, it is not intended that Agribusiness should become a major Group activity and this should be reflected in the scale of any investments proposed.

RS/DJA
19th July 1989

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