

**DIRECTORS INCENTIVE SCHEME  
 1991 FINANCIAL CRITERIA**

**1. INTRODUCTION**

The thrust of the criteria is the same as in 1990. To focus on the objective of above average shareholder returns over time, comprises capital and dividends in appropriate proportions.

1991 is a recovery year in terms of profitability and the targets need to be set in a way which recognises this and does not put longer term growth at risk. Where relevant, performance should be measured at constant exchange rates.

**2. FINANCIAL PERFORMANCE TARGETS**

**A SHAREHOLDER OBJECTIVE** **SUGGESTED RATING**

**(a) EPS growth (nominal)**

Latest forecasts suggest that earnings of the UK	O	60p
corporate sector will be flat in 1991. The Group	E	57p
budget shows an increase from 23.4p to 34.4p (214%)	C	54p
at constant average 1990 exchange rates. The budget	A	51p
1991 EPS is 9% below the 1989 ex-demerged EPS in	I	48p
constant exchange rate terms.		

It is considered appropriate to set the 1991 ratings in money terms, around a central C target of 54.4p.

**(b) Dividend per share growth (nominal)**

Dividend growth for the corporate sector in 1991 is	O	14%
forecast to be 5% or less, versus expected flat	E	12%
earnings. Taking into account the strong underlying	C	10%
growth of 18% in B.A.T's 1990 dividend versus	A	8%
5% for the market the guideline level of cover,	I	6%
and the long term objective of 15% pa growth the		
central target might be an above average increase		
of 10% for 1991 in line with the budget.		

**(c) Share price relative**

Relative share price performance should be assessed	O	+10%
over the year in the light of the long term	E	+ 8%
objective of a 5% p.a. improvement relative to the	C	+ 6%
All Share index. The suggested target for 1991	A	+ 4%
therefore takes account of the 3.9% adverse movement	I	+ 2%
in 1990. To avoid short term distortion the relative		
should be measured over a month from mid December		
to mid January.		

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(d) Market perception (P/E relative)

The prospective P/E ratio for 1990 is very high, because of depressed earnings. At the end of 1991 based on the current share price and forecast earnings the P/E ratio would be approximately 22.3, on the basis used by the FT (last two published half years' EPS), a relative of 183% to the present FIA 500 index P/E. The prospective 1991 P/E based on the full year's forecast EPS is 13.1.

The medium term objective based on a Plan 'B' assessment by the advisers in a normal year is a relative of 90% to the FIA 500 average P/E.

	FT	Prospective
O	200%	110%
E	190%	105%
C	180%	100%
A	170%	95%
I	160%	90%

Actual performance should be measured primarily from the published P/E ratio over the month mid December to mid January to avoid distortion by short term price movements. Because of the difficulty of interpreting this measure regard should also be had to the prospective P/E based on the full year's EPS relative to the prospective market P/E.

(e) Dividend cover

	Including Investment Gains	Excluding Investment Gains
The budget for the 1991 recovery year projects cover of 1.6 times, (1.4 times excluding investment gains) rising within the target 2.0 to 2.5 range in 1992 and thereafter. The appropriate central 'C' target for 1991 would be 1.6 times on the published basis including investment gains.	O 2.0 E 1.8 C 1.6 A 1.4 I 1.2	1.8 1.6 1.4 1.2 1.0

B OPERATING OBJECTIVES

(a) Tobacco Turnover

The guideline average annual growth in gross turnover is 12% for tobacco subsidiaries equivalent to 10% on a net basis (9% if Souza Cruz is eliminated). Budget 1991 growth at constant rates is 10% gross and 8% net (12.1% and 7.3% respectively if Souza Cruz is excluded). These growth rates are broadly consistent with the expected trend over the 5 years of the plan. The criterion should be based on net turnover, excluding Souza Cruz.

O	+13%
E	+11%
C	+9%
A	+7%
I	+5%

(b) Tobacco trading profit

The budget shows 1991 trading profit growth of 12%, consistent with increasing margins but slightly lower than the projected 5 year growth rate of 13.6%.

O	+17%
E	+14%
C	+12%
A	+10%
I	+8%

(c) Financial services turnover

The guideline of 18% pa average annual growth anticipates a significant acquisition and since it relates to the medium/long term is not relevant to an assessment of 1991 performance.

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The budget for 1991 shows growth of 8.4%, below the forecast 5 year growth rate of 13.7%. This is however consistent with the pressure for adding only quality business in the Eagle Star general operation. Account will need to be taken of growth in Farmer's exchanges premium income and the incidence of single premium business which can distort comparisons as a measure of value of business added.

O +12%  
E +10%  
C + 8%  
A + 7%  
I + 6%

(d) Financial Services trading profits

Since 1991 is a recovery year, it is appropriate to set the target in terms of money rather than percentage increase. The budget is for a 1991 trading profit of £621 million and £30 million gradations around this figure are appropriate.

O £680m  
E £650m  
C £620m  
A £590m  
I £560m

(e) Tobacco RONA

In 1991 Rona is budgeted to rise from 48% to 52%. In assessing performance account should be taken of the effect of exchange rate movements on Group RONA given the differing performance levels between the geographically based operating companies.

O 58%  
E 55%  
C 52%  
A 49%  
I 46%

(f) Financial Services return

Return on investment as recorded in the S.A.T balance sheet is forecast to rise from 5% in 1990 to 14.7% in 1991. The basis of computing the return will need to be reconsidered when the final SORP on accounting for life business is issued. For the present, the target will be based on existing accounting conventions.

O 20%  
E 17%  
C 15%  
A 14%  
I 13%

(g) Effective Tax Rate

A guideline objective is to eliminate the current year unrelieved ACT by 1994. For the shorter term, an objective for the effective tax rate is relevant. The effective rate is forecast to fall from 54.6% in 1990 to 43% in 1991 (49.3% and 45% respectively if investment gains are excluded). No credit has been taken in the forecast for the benefit from the Tesco deal. The appropriate 'C' objective for 1991 is an effective 43% tax rate on an accounts basis.

O 39%  
E 41%  
C 43%  
A 45%  
I 47%

2. GROUP RESOURCES OBJECTIVE

NET DEBT/EQUITY RATIO

The future objective should be consistent with a steady underlying fall in the ratio. Allowance will need to be made for special factors such as major investments or acquisitions when interpreting performance against the objective. The projected net D/E ratio at end 1991 is 46.3%.

O 40%  
E 43%  
C 46%  
A 49%  
I 52%

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