

**DIRECTORS' INCENTIVE SCHEME
FINANCIAL CRITERIA - 1990 PERFORMANCE**

Suggested ratings are set out below, based on latest estimated 1990 figures. The final outcome is not expected to vary significantly.

	RECOMMENDED RATING
1. <u>SHAREHOLDER OBJECTIVES</u>	
1.1 GROWTH IN EPS (NOMINAL) (Budget growth 14.8% adjusted for demergers)	
Expressed in constant 1989 average exchange rates, EPS fell from 63.2p to 27.8p (56%), though performance is distorted by the "exceptional" element in Eagle Star's investment result and an increase in the effective tax rate from 39.9% to 53.7%. Adjusting for these latter factors would increase 1990 EPS to 44.3%, a 30% fall from 1989.	I
1.2 GROWTH IN DPS (NOMINAL) Budget growth - 21.2% nominal (adjusted for demergers) 6.7% nominal (unadjusted)	
Based on a total dividend for 1990 of 31.1p, the actual underlying growth on an adjusted basis is 17.8%. The 'C' rating was 10%. Average DPS growth for UK companies in 1990 is expected to be 5%.	O
1.3 SHARE PRICE RELATIVE Objective +5% per annum (O)	
The movement in the share price relative 31.12.89 - 31.12.90 was -5.9%, but the relative has since recovered strongly (+2.2% at 7.2.91). The relative has shown great resilience in the face of negative factors (exchange rate movements, UK general insurance market and equity values). In the light of this a higher rating is appropriate.	E-
1.4 MARKET PERCEPTION/P/E RELATIVE Objective 95% of FTAS00 P/E (C)	
Based on forecast EPS of 25.4p for 1990 and the 31st December 1990 share price of £5.77 the prospective P/E ratio of 22.7 is at a relative of 170% to the market average (FTAS00). While there are doubts about the usefulness of the measure, the high rating at present reflects the considerable resilience of the share price.	E

20178863A

1.5 DIVIDEND COVER

Objective - maintain cover between 2.0 and 2.5x

The forecast total payment of 31.1p for 1990 is covered 0.82x by expected earnings, which would rise to 1.2x if the exceptional Eagle Star investment loss of £170 million were eliminated.

I

1.6 DIVIDEND YIELD

Objective. Yield to be above FTA All Share Growth yield B.A.T yielded 6.9% gross at 31.12.90 compared with 5.47% for the Index.

2. OPERATING OBJECTIVES

2.1 TOBACCO

a) TURNOVER

Objective nominal growth of 22% in 1990 (C)

At constant 1989 average exchange rates gross and net turnover (excluding Inasco) grew by 25.7% and 27.6% respectively in 1990. Excluding Brazil, gross and net constant rate growth was 20.9% and 23.6% respectively. The relatively high rate of growth is partly accounted for by the inclusion of Wills Australia for a full year in 1990, in accordance with the budget.

C+

b) TRADING PROFIT

Budget nominal growth 15% (excluding Brazil) (C)

Trading profit at constant average exchange rates increased by 9.9% in 1990 (6.2% excluding Brazil).

I

2.2 FINANCIAL SERVICES

a) TURNOVER

Budget 8.8% nominal growth (I - budget - 9% or less). Actual 1990 turnover at current exchange rates grew by 3% (2.2% life, 4.6% non-life). At constant rates the growth was 4.2%. Including Farmers exchanges premium income in place of fees, the constant exchange rate growth would have been 4.4%. It should be borne in mind that 1989 turnover was inflated by large Eagle Star single premium/annuity sales which have a much lower value to the business than new annual premiums of the same amount. Attainment needs to be judged against the overriding requirement that additional turnover should be adequately profitable.

I

201788635

b) **TRADING PROFIT**
1990 Budget 7% (I)

The result for 1990 is dominated by Eagle Star's general business which turned round from a trading profit £251 million in 1989 to a loss of £354 million in 1990, the latter including an "exceptional" element of £170 million reflecting insufficiency of post acquisition DIG. Excluding Eagle Star general business, constant rate trading profit rose by 3.8%.

I

2.3 **RONA**

a) **TOBACCO**
Target and budget 60% (C)

Actual RONA excluding Imasco in 1990 was approximately 48%. The shortfall is mainly attributable to lower trading profits than budgeted in local currency terms and to an increase of DM150 million in BATCF's trading assets compared with budget. The exchange rate movements which reduced the relative weighting of B&W with its very high RONA account for a small part of the shortfall.

I

b) **FINANCIAL SERVICES**
Target and budget 17% (C)

The actual rate of return was approximately 5% in 1990.

I

2. **GROUP RESOURCES OBJECTIVE**
NET DEBT/EQUITY RATIO
Target for end 1990 65 - 70% (C)

The net D/E ratio at 31st December 1990 in the published accounts is likely to be approximately 53%. The budget assumed a higher level of buy-back, the savings on which are partly offset by other factors including a lower equity base than budgeted due to the shortfall in profits. A major feature has been the completion of the reshaping including the demergers at better than forecast parameters.

E+

RHL/CRW/DIS-
20 February 1991

201788636