

SOUZA CRUZ
TSG - 11TH MAY 1994

MANUFACTURING CAPACITY

B & W REPORT

According to latest sales estimates and after the closure of Bonfim Factory, the projected reserve capacities in Souza Cruz Cigarette Factories are as follows:

	1994	1996	1998
KS - Soft Cup	15 / 19%	25 / 30%	23 / 28%
KS - Box	19 / 108%	17 / 77%	14 / 57%
Other Styles	9 / 108%	8 / 101%	8 / 88%
Total	43 / 41%	50 / 44%	45 / 38%

(Reserve capacity in billions / % of sales forecast)

As explained in previous notes, reserve capacity increase indicated in 1996 (in relation to 1994) is a consequence of keeping old machinery installed, occupying available floor space, thus generating an additional emergency capacity at zero cost and zero investment.

Once deducted a failsafe of some 15% to cope with Souza Cruz volume fluctuations, these reserve capacities should be regarded as Group capacities and opportunities should be explored to obtain Group benefits from the low conversion costs and the low cost of leaf in Brasil.

A rationalization of production within South America is already under consideration, and could result in a transfer of some 7 billions/year, Soft Cup, to Souza Cruz. Contract manufacture to origin insensitive markets could also be explored.

The B&W report refers again to the limitations imposed by the dispersion of product physical specifications within the Group. Souza Cruz is second in the line (after ITL), due to our low cigarette circumference (24.3 mm), that affects both Soft Cup and Hinge Lid pack sizes. Although previous studies have indicated that investments to standardize sizes within the Group would reach unacceptable levels, with no positive impact on individual markets, it seems that some medium/long term solution covering for example new brands and/or new machinery acquisitions should be pursued in order to create better conditions in the future for Group resources planning/utilization.

LSMBA/S37

202723841