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TRADEMARK DIVERSIFICATION

INTRODUCTION

Over the course of every brand's life, trademark equity is built through the activities of the brand owner. This equity consists of consumer goodwill towards the product's quality and reputation, as well as consumer awareness of the trademark resulting from the marketing investment of the owner. This trademark equity is an intangible, but nonetheless real and valuable asset.

In a global environment of ever increasing restriction in the availability of traditional advertising media, parallel communications devices such as sponsorships and trademark diversification now represent the only major alternatives for tobacco marketers in a growing list of markets. Where traditional advertising media are available, their use should be maximized. However, in markets where these media are no longer available or are threatened in the foreseeable future, parallel communications should be seriously considered as part of a brand's marketing mix.

Sponsorships have a parallel communications role and can often add vitality to the consumer's perception of a brand. But, however well targeted, Sponsorships as a rule cannot adequately communicate a brand's creative positioning. It is possible for properly selected and managed Trademark Diversifications to accomplish this objective. Each potential T.M.D. being considered should be measured against this brand creative communications objective, first and foremost. Additionally, each TMD selected should meet the following criteria:

1. Provide Advertising Opportunities which are naturally present and of significant magnitude in the TMD business category.
2. Image Compatibility with core brand creative.
3. Logical Products which are a natural extension of brand values.
4. Legal Feasibility to be defensible; able to survive outside scrutiny and challenge.
5. TMD products/services should be in Fragmented Markets with no dominant operator.
6. Ideally, the products/services should provide High Margins; and,
7. Low Financial Risk, with manageable start-up costs.

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Over the past several years, tobacco TMD has experienced explosive growth. Nearly 100 different tobacco TMD programs are now in existence across scores of markets. Conservatively, these programs now account for over \$100 million in annual spend by the industry. By not considering TMD as part of the marketing mix, we must determine whether we may be putting our brands at a competitive disadvantage now and in the future. Exhibit A provides a rough estimate of industry TMD advertising spend.

SITUATION ANALYSIS

COMPETITIVE ENVIRONMENT

A worldwide survey of BWI Regions and BAT Operating Companies was recently conducted in an effort to develop a comprehensive summary of competitive TMD activities. Responses were received from 28 markets, of which 25 reported current competitive TMD activities. By far, the most active are U.S.I.B. competitors: Marlboro and Camel.

MARLBORO

Marlboro is currently being supported by five major TMD's as follows:

Marlboro Classics - Men's Western design clothing

Marlboro Leisure Wear - Men's casual clothing and accessories

Marlboro Sports Shoes - Men's athletic shoes

Marlboro Adventure Store - Direct mail retailing of Western style gadgets and accessories.

Marlboro Adventure/Country Travel - Tours of the Western U.S.

CAMEL

There are currently seven major operational Camel TMD's as follows:

Camel Boots - Men's shoes and boots

Camel Collection - Men's outdoor casual wear

Camel Fragrance - Men's cologne and toiletries

Camel Trophy - Off-road rally related holidays

Camel Trophy Watches - Men's wristwatches

Camel Trophy/Adventure Store - Direct mail retailing of men's accessories

Camel Adventure - Unique, exotic holiday travel operation

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OTHER INTERNATIONAL BRANDS

Over 30 other TMD's involving both international and local brands were reported in our survey with a concentration in clothing and travel.

DIVERSIFIED INTERNATIONAL PRODUCTS

Brown & Williamson's TMD subsidiary, Diversified International Products, Inc. (D.I.P.), began actively pursuing trademark diversification of strategic brands in the BWI portfolio in late 1988. Since that time, five international TMD's have been developed. There are now 15 separate D.I.P. trademark diversification business operations in a total of 11 markets around the world. Following is a brief summary of each of these TMD's.

1. KENT Leisure Holidays

KENT Leisure Holidays is a holiday travel business offering upscale package tours to resort destinations, featuring activities consistent with KENT's core brand values. The business is managed by a U.K.-based travel specialist company, KENT Leisure Holidays, Ltd., who has been granted a license by D.I.P. to use the KENT name in the travel category in return for a royalty on sales.

KENT Leisure Holidays is now operational in 7 markets, having been launched in Hong Kong in June of 1989 and followed by Colombia in August. In 1990, it was expanded to Israel, Thailand and Korea. During the First Quarter of 1991, KENT Leisure Holidays was introduced in Japan and Paraguay.

This TMD is supported in market, with a full range of film and print advertising materials available from D.I.P. All advertising and collateral materials are compatible with KENT's creative positioning, featuring 4-color photography of social situations in resort settings and utilizing ample blue and white color cues.

KENT Leisure Holidays is offered to the consumer by local general sales agents in each market who are supplied with centrally developed sales brochures.

It is believed that KENT Leisure Holidays is an effective brand communications vehicle. This hypothesis will be tested through qualitative consumer research in June. Additionally, alternative TMD programs for KENT (product spinoffs from KLH) are being evaluated to improve the profit potential of the program.

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2. KENT Championship Classics

The major communications objective of KENT Championship Classics is to create a connection in the consumer's mind between KENT and world famous sporting events, with the brand benefiting from this positive association.

This TMD is an extension of KENT Leisure Holidays and is also operated by D.I.P.'s U.K.-based licensee. Developed under the working title "KENT Grand Slam", KENT Championship Classics is a world class event-based holiday operation. It is currently being pilot tested in Japan, with the following event packages available:

U.S. Open Golf Championships
Wimbledon Tennis Championships
British Open Golf Championships

Most packages are built around a 4-day event core with each booking custom tailored to suit the needs of the individual tourist. General sales agents have the ability to add shopping, sight-seeing, additional golf/tennis play and other activities as desired.

KENT Championship Classics are sold to the consumer via the KENT Leisure Holidays general sales agent network, using centrally prepared selling brochures. The program is being supported in market with 4-color magazine and specialist press advertising.

3. LUCKY STRIKE Open Road Tours

LUCKY STRIKE Open Road is a specialist travel operation offering group motorcycle tours of North America, Europe and Australia. This business is a joint venture between D.I.P. and Edelweiss Bike Travel (E.B.T.), a major motorcycle specialist tour operator based in Mieming, Austria. D.I.P. provides advertising and collateral materials support in return for a commission on sales from E.B.T. Like KENT Leisure Holidays, a general sales agent is appointed by the tour operator in each market and is responsible for handling local bookings.

LUCKY STRIKE Open Road is now operational in 6 markets. The program was launched in Spain in June of 1989 and followed by 1990 introductions in Holland, Belgium, Greece, Switzerland and Israel. LUCKY STRIKE Open Road was launched in Japan in January of this year. A full range of film and print advertising materials, as well as 4-color selling brochures are available centrally from D.I.P. All advertising features the Southwest U.S. tours which are available, and is very evocative of LUCKY STRIKE's core brand creative. Year-to-date the program has met with a high degree of success having sold 67% of targeted tours. Further analysis of the program will include qualitative consumer research which will be conducted in June and September to determine the effectiveness of LUCKY STRIKE Open Road as a brand communications vehicle.

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4. LUCKY STRIKE Clothes

This is D.I.P.'s newest TMD. Developed under the working title "LUCKY STRIKE American Originals", the concept involves production and marketing of a range of young men's, classic American design fashions. The range includes jeans, casual wear and accessories.

D.I.P. has licensed the LUCKY STRIKE trademark to L.S. Quality Garments, B.V., a subsidiary of the Dutch clothing manufacturer Geka. In return, D.I.P. will receive a royalty on sales. A pilot test of this TMD concept is planned for Fall 1991 in Benelux. First retail deliveries scheduled for August 1991. All trade and sales activities are the responsibility of the licensee. D.I.P., with the cooperation of local Operating Companies, will provide consumer advertising support.

LUCKY STRIKE clothes will be supported in pilot with 4-color magazine advertising shot done in a Southwest U.S. setting. The advertising is intended to communicate the young male, American attributes of freedom and independence associated with the LUCKY STRIKE brand. The advertising concept being developed was validated by Qualitative consumer research carried out earlier this year in Belgium and Holland.

If successful, the concept may also be implemented in other (non-European) markets with local sub-licensees.

5. BARCLAY DIRECT

This TMD features an upscale mail-order shopping service offering high-tech and design-led products for the home, office and car. BARCLAY Direct is a co-operative business venture between D.I.P. and N.S.P., one of the U.K.'s largest direct marketing retailers.

BARCLAY Direct was initially pilot tested in Benelux during the Fourth Quarter of 1990. The results of this test market were very encouraging from a business standpoint, with a turnover of US\$140,000 during the three month period. Results of Qualitative consumer research conducted in Belgium and Holland was also encouraging. This research indicates a good fit in terms of consumer perceptions of BARCLAY Direct and the core brand values of BARCLAY.

A second phase of the pilot test is currently underway in Benelux, with a new catalog which began being distributed in mid-May. In both the initial pilot and the current extension, BARCLAY Direct is supported by 4-color consumer magazine advertising, including direct response ads and direct mail packages containing the catalog and a customer letter.

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5. BARCLAY DIRECT (Cont'd)

The advertising creative developed for catalog and print media use was based on communicating the BARCLAY brand values of power, sophistication, innovation and intriguing male/female interaction. A new pool of BARCLAY Direct print visuals has been produced for the extended pilot.

If success continues in the Spring 1991 pilot test, BARCLAY Direct may be expanded nationally in the Benelux countries. It will also be possible to extend the concept into additional European test markets, when and where appropriate.

MARKETING SPEND

As previously mentioned, during 1990, total industry TMD spend is conservatively estimated at \$100+ million.

In addition to the measured media expenditure, there are significant Brand Owner costs related to program development, management, advertising production, agency/consulting fees and centrally produced materials required to operate TMD's. For example, during 1990 D.I.P.'s central operating costs were approximately \$3 million 1991's central TMD costs will be similar.

COMMUNICATIONS VALUE

It must be recognized that at best, TMD communications are more diffuse and less effective than traditional cigarette brand advertising. Consumer recognition of the trademark and the degree of variance from core brand creative in TMD advertising in large part determines this loss of effectiveness. Consequently, it is D.I.P.'s policy to develop TMD branding and advertising that is unique to each TMD operation, but as close as possible to that of the core brand, while trying to minimize potential public relations backlash and provocation of regulators and local authorities. This approach requires a degree of flexibility depending on local market sensitivities. This is best accomplished by making available a pool of advertising subjects for each TMD that ranges from executions which are very directly identifiable with the core brand advertising to others that are more subtle and creatively distanced. This creative approach is also used by key competitors as evidenced by the range of Marlboro and Camel TMD ads contained in Appendices C and E. However, all TMD advertising should result in a clear consumer association of the TMD with the core brand.

D.I.P. has developed a Qualitative consumer research methodology and plans to evaluate the advertising effectiveness of each of its TMD's. To date, LUCKY STRIKE Clothes and BARCLAY Direct advertising research has been completed. In both cases, consumers clearly associated the TMD ads with the cigarette brands. Additionally, the user imagery communicated by the TMD ads was very consonant with the attributes of the core brands.

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COMMUNICATIONS VALUE (Cont'd)

Communications research reports will be available on the remaining three TMD's by the end of 3rd Quarter 1991.

A further measure of TMD advertising effectiveness can be gained by monitoring in-market brand awareness. Perhaps an ideal test case is Hong Kong, where electronic broadcast of cigarette advertising was banned as of December 1990. Beginning in November of 1990 and continuing to this date, KENT brand TV advertising has been replaced by KENT Leisure Holidays commercials. Initial tests of unaided awareness are encouraging.

TMD VIABILITY

Tobacco trademark diversification is coming under increased scrutiny throughout the world. In markets such as France and Singapore, it is expressly prohibited. However, even in these markets, there are exceptions which are allowed, including the "grandfathering" of existing TMD's at the time of passage of legislative prohibition. In most markets to date, TMD's have gone unchallenged. And in a few cases, such as CAMEL Boots in Sweden, they have withstood legal challenge and been allowed to continue.

To improve chances of being able to successfully defend TMD's, the operations must be structured in a legitimate commercial fashion. Direct involvement of local Operating Companies and Region Offices should be minimized or avoided if possible.

Business profitability will increasingly become a requirement in many markets for TMD's to survive. Without significant investment by the parent tobacco companies, most TMD's are destined to fail against this requirement. On a fully loaded basis (i.e. - revenues sufficient to offset all media and central operating costs), very few TMD's will survive. This is the case with all heavily advertised, low margin TMD's such as most travel operations.

Due to the higher margins available to D.I.P. from such TMD operations as LUCKY STRIKE Open Road, LUCKY STRIKE Clothes and BARCLAY Direct there is some possibility, albeit limited and optimistic, that profitability may be attainable over the medium to long-term. Realistically, if a TMD can generate enough revenue to cover its own central operating costs, without advertising, it would be considered a major success. Multiple TMD programs in a single market can provide advertising synergies that enhance profitability.

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CONCLUSIONS & RECOMMENDATIONS

Due to the ever deteriorating legislative environment for traditional tobacco brand advertising, TMD must at least be viewed as a viable short-term communications vehicle. The list of markets where TMD is one of the few brand communications devices available is certain to grow. If properly selected and structured, there exist possibilities that some TMD's could become profitable in their own right, if advertising support is kept from becoming excessive.

Currently and in the near term, TMD represents the only major viable brand creative communications vehicle available in some markets. In other markets, TMD may allow brand access to otherwise prohibited advertising media. These opportunities should be prudently exploited while they remain available.

In light of the current and anticipated growth of competitive TMD activity, it may be essential to pursue TMD to avoid being put at a competitive disadvantage.

A "portfolio" approach to TMD development should be seriously considered to help spread media weight. New TMD's should be pursued with a critical eye towards profit potential.

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