

NO COPIES MAY BE MADE**SECRET****Tobacco Strategy Review Team**

A meeting of the Tobacco Strategy Review Team was held on Friday, 29th May 1992.

Present : Sir Patrick Sheehy, Mr. M.F. Broughton, Mr. U.G.V. Herter, Mr. B.D. Bramley, Mr. R.J. Pritchard, Mr. A. Monteiro de Castro, Mr. T.E. Sandefur, Mr. J-L. Mercier, Mr. R.D. Brown, Dr. R. Salter (Secretary), Miss H.C. Barton.

Mr. D.G. Stevens was present for items 13-22 and Mr. J. Rembiszowski for items 41-44.

Minutes of the Previous Meeting/Matters Arising

1. The minutes of the meeting held on 26th February were agreed.
2. FESU Forecasting : Mr. Bramley reported that the problem of the lower than expected call-off from Macon earlier in the year had not been due to poor forecasting of final demand but to a failure in communication regarding stock levels in Hong Kong. Action had been taken to improve communication and to even out the call-off from Macon, thereby improving the efficiency of capacity utilisation.
3. Manufacturing Capacity : It was confirmed that capacity in BATCF, Brown & Williamson, Souza Cruz and Imperial met the Group criterion of exceeding forecast demand by 15%. The situation for Southampton is currently being reviewed and a report on this will be available shortly. The Chairman emphasised the need for manufacturing plans to cover the quality of manufacturing equipment as well as its capacity and asked Mr. de Castro to include an accelerated programme for updating Uberlandia within the Souza Cruz plan for 1993-1997.
4. I.T. in Selling : Mr. Pritchard reported that a summary of the results from the I.T. in Selling seminar had been circulated in March. It was noted that recommendations from this seminar were now being implemented in all Operating Companies.
5. Smoking Quality Booklets : Mr. Pritchard reported that the review of the development of Belmont Ultra-Suave and the booklet describing best practice in smoking quality testing had been circulated.
6. It was noted that while internal panels could be useful as a preliminary check before new products or new formulations were put out to expensive consumer testing, the real key to success lay in having highly skilled blenders who were able to produce products which had a good chance of being acceptable.

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7. It was agreed that each Operating Company should identify their star blenders and that a meeting should then be arranged under Mr. Kuhnhorst to discuss how people with the potential to become expert blenders could be recognised and trained.
8. It was also noted that Mr. Kohnhorst would report in September on progress towards the Smoking Quality team's objectives to recommend methods for matching or improving on Marlboro and for improving quality control on line at Macon.

Group Strategy Review

9. The Chairman presented a draft of the proposed strategies for tobacco, which would be included in the Group Strategy Review, due for discussion by the Board in July. These would include more quantification of the objectives for expanding the volume of cigarette sales, differentiating the contributions to total volume growth from exports, domestic sales and new markets respectively.
10. An important new strategy would be to provide more cover through alternative brands in those markets and market segments which were currently dominated by a single brand (e.g. SE555 in China; Benson & Hedges in Nigeria, etc.).
11. Leaf Trading would be considered as a business for further development. The Chairman would set up a project, probably using an outside consultant, to consider in detail the options open to B.A.T Industries for increasing the involvement in Leaf trading, including the possible acquisition of a dealer, accepting that this might mean becoming involved in selling directly to competitors.
12. Trademarks : It was agreed to consider an additional strategy to strengthen the Group's Trademark position. Mr. Bramley was asked to put together a team, including lawyers and marketing people, to review what action might be taken to extend and strengthen the Group's position in this respect.

Management Training and Development

13. Mr. Steven's proposals for the new scheme of management training and development for the tobacco businesses were approved and it was agreed that they should now be implemented.
14. A principal feature of this scheme would be functional courses in Production, Leaf, Finance and Marketing run by Brown & Williamson, Souza Cruz, BATCo. and BATCF respectively. Selection for these courses would be by the companies sponsoring candidates but the final choice of the course membership would be left to the company running the course.

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15. It was noted that although the scheme would be expensive, it would be a worthwhile investment which would show good returns in the future. The Chairman stressed the importance of ensuring that the people selected for the courses had the potential to profit from them and underlined the need to be selective in recommending who should attend. He also asked that arrangements should be made for him to see courses in action where this could be fitted in with his travel schedule.
16. It was noted that there would be three levels of functional courses:-
 - (a) Level I covering new management recruits in their first 2-3 years with the company.
 - (b) Level II for those who had just entered the lists of people who would be ready to take up a senior functional post within 10 years.
 - (c) Level III for people who were just about to be appointed to one of these posts.
17. There will also be some general business training courses. However, these will be very selective and may be limited to one a year. They are likely to be organised jointly with an outside organisation (e.g. Ashridge or Insead).
18. The Chairman stressed the importance of being able to say to all new management recruits that their first 2-3 years with the Group would be planned as an induction period. While this would vary in form depending on the function (e.g. Marketing and Finance would have more training on the job and Production and Leaf more formal training in the initial period), everyone should have a clearly defined personal programme which demonstrated the Group's commitment to training.
19. Appraisal Systems must be linked in with training and development and there should be a further review by Mr. Broughton of the effectiveness of current schemes. It was noted that appraisals of development needs should be distinguished from performance appraisals linked to salary reviews and that appraisals must be realistic and rigorous, especially in cases when performance is unsatisfactory and where this needs to be recorded on a person's employment record.
20. Other points noted were that the appraisal systems should not be unwieldy and that there was a need to train managers in appraisal techniques as part of the overall scheme to be implemented. It was also noted that there would be formal appraisals of the technical competence of participants on the functional courses, which would be reported back to the sponsoring company by the company running the course.

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21. **Communication** : It was agreed that it was necessary to ensure that the new systems of training and management development were communicated positively as an increased commitment to personnel development and that the probable closure of Chelwood should not be seen as a cost-cutting exercise. It was also important to ensure that functions outside Marketing, Production, Leaf and Finance (e.g. Personnel, Planning, Public Relations, I.T., etc.) should also be covered either through participation on functional courses or through their own programmes.
22. **Mr. Broughton** will draft an announcement of the new arrangements for approval by the CPC. This would include plans for a continuing programme of courses at Chelwood during 1993 while alternative proposals for 1994 are considered.

Marketing Issues

23. **November Marketing Seminar** : Arising from reports on impressions gained from the Marketing Seminar, held in Orlando in November, it was noted that although there were mixed views on the value of the sessions on the cost-effectiveness of advertising, there was general agreement on the value of the sessions on brand goodwill, on excise and on competitor analysis.
24. It was agreed that there was a need to improve the techniques of competitor analysis and the Chairman asked that this should be borne in mind when designing the functional training courses.
25. It was agreed that seminars similar to that held in Orlando should be organised only when there was an important issue which it was appropriate to debate. The possibility of organising a further conference on the theme of Sales and Distribution arrangements would be considered in September but it was thought that the conference itself should be delayed until later.
26. **Competitor Analysts** : Considering reports on competitor activity, it was noted that:-
 - (a) More information is required on the pricing policy of Philip Morris and the way in which this is influenced by the need to achieve 20% p.a. earnings growth, despite relatively poor results from Kraft Foods. Also, the role of the share buy-back programme needs further clarification.
 - (b) Trends in RJR may be less favourable than is suggested by their PR which is largely determined by the need to maintain confidence in their equity and loan stock. However, they are not thought likely to want to sell parts of their international business and the evaluation of this has therefore been suspended.
 - (c) There is some uncertainty as to whether Reemstra has the people and financial resources to support their expansion in the East.

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27. It was agreed that Mr. Herter, Mr. Pritchard and Mr. Bramley would meet to determine how a more penetrating analysis of the major competitors could be put together. Before the next meeting, they will agree a structure for a detailed analysis of Philip Morris, RJR (RJP), Rothmans (BDB) and Reemstma (UGVH) to be carried out during the Autumn.
28. **Transdermal Nicotine** : Reviewing the possible implications for B.A.T Industries of the development and sale of Transdermal Nicotine Patches (TNP), it was agreed that the development does not appear to represent a major threat to the cigarette industry. Although TNP is sold largely as a route towards smoking cessation, a parallel development is the potential use of nicotine in countering Alzheimer's disease.
29. It was agreed that it would be inappropriate to B.A.T Industries to become involved in the production or sale of TNPs. However, developments in the field should continue to be monitored by all companies and it was noted, in particular, that Dr. Ray Thornton of BATCo. would be keeping a close watch on developments in the use of nicotine in the treatment of Alzheimer's disease.

New Markets

30. **Exports to Central Europe/CIS** : Mr. Herter reported that exports to the end of April 1992 were 64% ahead of the corresponding period in 1991. Gains in Bulgaria, Czechoslovakia, Poland, Romania and an increase in licensed sales in Yugoslavia, more than compensated for a relatively low figure for the CIS where the comparison had been distorted by a large order in the early part of 1991. However, prospects in the CIS were good and it was hoped that sales for the full year would still show a substantial increase.
31. The Chairman emphasised the need to maintain a clear strategy for sales in Eastern Europe, based on a well defined brand portfolio sourced from high quality production sources and with prices kept within the agreed parameters.
32. Arising from the New Markets meeting held in Budapest on 29th May, it was noted that:-
 - (a) Mr. Herter is proceeding with the team which is to be set up to offer advice to Governments on Excise regimes.
 - (b) A further visit to the Ukraine has been arranged for June.
 - (c) Following a favourable reaction to the initial visit to Belorussia, contact will be maintained.

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- (d) Mr. de Castro has arranged a meeting with Mr. Dunt and Booz Allen to set up a study on the implications of Mercosur. Mr. Dunt is also carrying out a study of the implications of the Andean Pact and other agreements in Latin America and will report on these to the BATCo Board in July.
 - (e) Mr. de Castro will submit an early warning note to the CPC regarding the potential investment in Uruguay.
 - (f) In addition, he will visit Cuba to assess the potential in that country for Brazilian exports and/or investment.
 - (g) Mr. Pritchard will prepare an early warning note for the CPC regarding the potential for an investment in the Philippines.
 - (h) A delegation from Iran is due to visit Hamburg shortly and will also visit Hanoi.
33. Subject to a minor amendment regarding the plans for visiting Albania, the minutes of the meeting held on 20th May were agreed and will be circulated.

The date for the next New Markets meeting has not yet been fixed.

US International Brands

34. Kent : Mr. Pritchard noted that although progress with Kent is generally satisfactory, sales figures for the first quarter had been affected adversely by inventory adjustments by FESU. However, the brand is expected to be on budget for the full year.
35. The strategy for Kent in Europe is still under review and a report on this will be produced at the end of June. Options being considered include packaging in 25s and a super-lights version with a charcoal filter.
36. Lucky Strike continues progressive and although it is not expected to meet its full budget for 1992, it will still show a significant increase over 1991. There are continuing product quality problems in Argentina, Belgium, Indonesia and Malaysia, but there are very good trends in sales in Chile and Switzerland. Distribution in Spain remains a problem but action is in hand on this.
37. Barclay : It was noted that trends in Europe were generally favourable but results from Norway were disappointing. Part of the reason for this was thought to lie with product development but it was also suggested that sales of Barclay may not be sufficiently profitable for the Group's licensee. There may also be a similar problem with Procordia in Sweden.

Mr. Pritchard will review this and will consider options for alternative arrangements which would be more attractive to the local companies, including the supply of cut rag from Finland.

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38. **Viceroy** : Mr. Pritchard reported that an illegal shipment of Viceroy, probably manufactured in Mexico, had been seized by Jordanian customs. It was noted that illegal shipments of Viceroy were still getting through to China. It was asked that anyone with information on this should inform Mr. Pritchard so that he can take counter-action.
39. **Hilton** : It was noted that Hilton continued to make good progress in China and that the full year forecast would be upgraded in line with the increase achieved in the first quarter. The Chairman noted that it was thought that Philip Morris might launch a low price brand, made in the US, to compete directly with Hilton. Mr. Bramley will investigate this and report back to the next meeting.
40. **Tallsman** : Mr. Broughton reported that there had been further negotiations with Gallahers regarding the possible transfer to DAT of the rights to Lucky Strike (and Pall Mall) in France in return for Benson & Hedges in Europe, outside the UK. While there had been a positive response to the principle of the exchange, the two sides still remain some way apart in the relative valuations of the two trademarks. A further complication could be that were agreement to be reached with Gallahers, there might be a need for a further round of negotiations with their parent company, American Brands. Mr. Broughton will report further developments as they occur.

UK International Brands

41. Mr. Rembiszewski outlined the strategies and plans for the promotion of Benson & Hedges, SE555 and Players Gold Leaf.
42. Benson & Hedges was a niche brand in most markets and had been in decline in the few, largely ex-colonial markets in which it had a significant share. The strategy would be to reposition it as a mainstream brand wherever it was possible to do so, focussing on the image of Gold, reflecting quality and an up-market price.
43. SE555 would continue to be promoted as a superior quality 'heritage' brand, selling at a premium price and in some markets above Marlboro.
44. Players Gold Leaf would be moved up-market, priced above local brands, drawing strongly on the imagery of sailors and the sea but promoted with modern yachting images rather than with the traditional bearded sailor. However, the applicability of this campaign to markets such as Pakistan and Nigeria still needs to be confirmed.

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Leaf

45. **Leaf Costs** : Mr. Broughton reported that a comparison of the costing systems used in different companies in the Group had confirmed that these were substantially similar and hence were not the reason for the significant variations in leaf costs between different countries.
46. Mr. Branley and Mr. de Castro were asked to investigate the reasons for the high costs reported by certain countries and to report back with recommendations for reducing these.
47. **Leaf Contracts** : It was noted that a review by Miss Johnson had shown wide variations in the terms of the contracts with dealers to whom the Group supplied Leaf. It was agreed that Mr. Branley should ask RATCo. legal department to draw up guidelines for a model contract which, subject to agreement with Mr. Chalton, would then form the basis for all the Group's contracts with dealers. It was also agreed that all contracts should be approved by Company Boards before being implemented.

Product Development

48. **Y-1 Tobacco** : Mr. Pritchard reported that a programme was in hand in Brazil to overcome the problem of low yield, experienced with Y-1 Tobacco. Y-1 still features in the latest product developments in Brown & Williamson and provided that the Brazilian development is successful, a sustained order will be placed.

Trading Results/Forecasts

49. It was noted that the latest forecast for the full year in 1992 shows volume on budget and trading profits exceeding budget.
50. The main area of uncertainty in the forecasts is the US domestic market where profits have been affected adversely by a switch from higher priced VFM brands (e.g. Viceroy, Doral, Cambridge) to the lowest price categories (Black & White, GPC). Brown & Williamson are reviewing alternative strategies to deal with this situation.

Regulatory Issues

51. **Advertising Bans** : It was noted that the ban on tobacco advertising, passed by the European Parliament, had not been approved by the Council of Ministers at their meeting on 15th May. However, it will be submitted again in the Autumn and it is important, therefore, that companies continue to lobby against it, especially in the UK, Germany and Denmark whose continuing veto is vital in preventing further progress for the ban.

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- 52. Mr. de Castro reported that there had been no significant developments on advertising bans in Brazil and Mr. Pritchard said that Senator Kennedy's bill in the USA would not be presented again until after the US Presidential election.
- 53. In Canada, judgement on the constitutionality of Bill C51 is expected shortly. If this is unfavourable to the industry, there is still the possibility of an appeal to the Supreme Court.
- 54. Environmental Protection Agency : Mr. Pritchard reported that, following challenges by Representative Dingwell, the EPA's work on the Risk Assessment for Environmental Tobacco Smoke and their Workplace Smoking Policy Guide have been further delayed and are unlikely to be published in 1992.
- 55. Firesafe Cigarettes : The Congress team which is trying to develop a satisfactory test for the ignition propensity of cigarettes is experiencing difficulties and is not expected to complete its work for 1-2 years. In the meantime, Brown & Williamson continues to monitor developments and to prepare for the possibility that tests of this type may be introduced.

Any Other Business

- 56. Agreements with Distributors : It was noted that, as in the case of the agreements to supply leaf, there was also a variation in the form of the Group's agreements with agents and licensees for cigarettes. Mr. Bramley agreed to set up a review of current agreements with a view to moving towards a more uniform form of agreement. The Chairman suggested that the new solicitor, who is to join B.A.T Industries as an assistant to Mr. Chalfen, might take a leading role in this work.
- 57. Vienna Exhibition : Mr. Hertz suggested there should be Group representation at the tobacco exhibition due to be held in Vienna. It was agreed that he would organise this

Dates of Future Meetings

- 58. The next meeting is scheduled for Thursday, 3rd September. Dates thereafter are Wednesday, 2nd December 1992; Wednesday, 24th February, Wednesday, 19th May, Wednesday, 19th September and Wednesday, 8th December 1993.

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