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LUCKY STRIKE - PRICE POSITION

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PRICE POSITIONING:

From both short and long term perspectives, LUCKY STRIKE is the Group's best and most promising USIB contender versus Marlboro in the young adult male smoker segment. As the brand grows and is launched in more markets (i.e., becomes established as a truly global brand), key elements of the brand offering are constantly evaluated and improved, including: Product, packaging, style portfolio, creative and pricing.

From an historical perspective, the LUCKY STRIKE price strategy of being "one or two price points below Marlboro" provided a key point of difference for the brand versus Marlboro. The success of the brand at a lower price point in lead markets such as Spain, Singapore and Panama confirmed the validity of this strategy.

At present, pricing across markets is not consistent; it ranges from being at parity price with Marlboro to being below Marlboro price. Relative price versus Marlboro also varies within the markets in every region (a Market Summary is attached).

The purpose of this document is to review current thinking regarding the optimal price position for LUCKY STRIKE vis a vis Marlboro.

CONCLUSIONS:

- In most markets LUCKY STRIKE should be positioned at price parity with Marlboro if it is to achieve its maximum, long term potential as the leading global USIB for young adult male smokers.
- Strategies and timetables for implementing price increases should be developed on a market by market basis due to significant differences between markets in current price positions, franchise and target profiles, stage of brand development and market dynamics.

1991 PRICING STRATEGY:

"Retail price can be one or two price points below Marlboro but is to be in the next significant price category immediately below Marlboro. In cases where low price positioning can have a detrimental effect on the image, parity pricing with Marlboro should be utilized."

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1991 PRICING STRATEGY, cont.:

The 1991 pricing strategy is a modification of the historical price strategy which simply stated:

"Retail price is normally one or two price points below Marlboro."

The 1991 strategy language reflects the Group's directive to bring LUCKY STRIKE's retail price more in line with that of Marlboro, and to position the brand as a major USIB competitor and presence in the global market, i.e., a brand that in all respects is capable of usurping Marlboro's leadership role among young adult male smokers.

In addition, the 1991 language recognizes that in many markets, USIB product price is an imagery element which supports attributes of U.S. origin or U.S. heritage, high product quality and smoker status.

PRICING ANALYSIS FINDINGS:

A comprehensive pricing analysis was conducted in 1990 to determine if a relationship existed between the relative price of LUCKY STRIKE versus Marlboro and the level of brand success in any given market.

The analysis did not identify any generalized formula for optimal price positioning, but it did yield the following general conclusions:

- A LUCKY STRIKE price point lower than that of Marlboro appears to drive SOM growth in markets where:
 - LUCKY STRIKE price is at an index of 80 or less versus Marlboro.
 - Relative consumer income (measured via per capita GDP) is lower.
 - Rate of population growth is higher.
- A LUCKY STRIKE price point lower than that of Marlboro does not appear to significantly drive SOM growth in markets where:
 - LUCKY STRIKE price indexes 93-99 versus Marlboro.
 - Relative consumer income is higher.
 - Rate of population growth is lower.

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SOURCE OF BUSINESS:

The market review that was undertaken in the pricing analysis indicated that the current source of business (as well as target audience) for LUCKY STRIKE appears to vary significantly on a market by market basis.

- Relatively Downscale

Directionally, the current franchise in those low price markets in which the price differential of LUCKY STRIKE versus Marlboro was 20% or greater appears to consist of a smoker group with a lower socio-economic profile (e.g., Panama, Malaysia, Indonesia, Singapore, Israel and Spain).

- LUCKY STRIKE, at a much lower price, provides the lower income consumer with a significant enough savings versus Marlboro to either: Encourage uptrading to LUCKY STRIKE (rather than to Marlboro) from local brands; or, to encourage downtrading to LUCKY STRIKE from Marlboro.
- On judgement, the overall LUCKY STRIKE proposition (USIB, product, packaging and imagery) is attractive and strong enough to allow lower income smokers to trade off the relative status gained from purchasing a premium priced brand (Marlboro) for meaningful price savings.
- Conversely, due to its low price position in these markets, LUCKY STRIKE may not be an attractive alternative to Marlboro among more upscale smokers who are willing to pay premium prices for reasons of status.

- Relatively Upscale

Per capita income levels in Western Europe are much higher than in most other markets. In general, cigarette prices are high, and the absolute difference between price tiers does not permit LUCKY STRIKE to be priced at a level significantly lower than Marlboro. LUCKY STRIKE is priced at parity to Marlboro in two Scandinavian markets.

RSP Index: LS vs Marlboro

- Norway	100	- Germany	95
- Denmark	100	- Belgium	94
- Italy	97	- Switzerland	94
- France	97	- Netherlands	89
-(American Tob.)		-(Based on unit cost of	
		LS 25's vs Marl 20's)	

*i.e. now with
big 10's close
with margin
or discount*

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SOURCE OF BUSINESS, cont.:

- Relatively Upscale

The Western European young adult male smoker target audience is likely to be more affluent and more sophisticated. The success of Marlboro in this region also indicates that a substantial pool of these smokers is willing to pay a premium price for a USIB.

In Japan, LUCKY STRIKE has had success with a price at parity with the leading USIB, Lark, and at a premium (until May, 1991) with Marlboro. It is interesting to note that Marlboro shows signs of growing in Japan, and that JTI has now raised its price from 240 to 250 yen, at parity with LUCKY STRIKE.

On judgement, in markets where the target audience is more upscale; is relatively more sophisticated; and is willing to pay a premium price for a USIB, the marginally lower price of LUCKY STRIKE may be a factor in limiting the brand's growth. This lower price may create a consumer perception that the brand has a lower level of status than Marlboro and is inferior to Marlboro in terms of product quality.

RECOMMENDATION:

If LUCKY STRIKE is to ultimately become the most viable, long term challenger to Marlboro among the largest pool of USIB smokers, i.e., those willing to pay a premium price for a USIB, LUCKY STRIKE price should be brought to parity with that of Marlboro.

Increasing LUCKY STRIKE price to a parity position with Marlboro entails, however, an element of risk; higher in some markets than in others.

- Low Risk Markets

New markets in which the brand is to be launched, such as Denmark, Hong Kong, Guatemala, Venezuela and Saudi.

- On judgement, this approach requires that a longer term perspective be taken in terms of rate of brand growth, investment, etc.
- Since the historical "lower price" point of difference is eliminated, market strategy changes.
 - From: Encouraging up-trading from lower priced local brands.
 - To: Encouraging switching from other premium priced USIB's or high priced local brands.

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RECOMMENDATION, cont.:

- Medium Risk Markets

Markets with the following characteristics:

- The brand is currently small; volume and SOM growth is relatively low or stagnant.
- Current pricing is already close to that of Marlboro. Price differential versus Marlboro is 10% or less; or, the brand is only one significant price point below Marlboro.
 - A simulated test market conducted in 1991 for LUCKY STRIKE 20's by BAT Nederland indicated that the 20's at parity pricing with Marlboro (3.85) had greater potential than did a 20's priced lower than Marlboro (3.50, or, at a 91 index).
- Includes Western European markets (less Spain), Chile, Iceland, Israel.

- High Risk Markets

Markets with the following characteristics:

- The brand, at a lower price point, is well established and/or is growing.
- Current pricing is significantly lower than Marlboro. Price differential versus Marlboro is 15% or more; or, the brand is positioned two significant price points below Marlboro.
- The franchise tends to be composed primarily of people from the lower socio-economic strata.
- Includes Spain, Singapore, China, Malaysia, Panama, Indonesia and Paraguay.

HIGH RISK EXPERIENCE:

Experience in Israel has shown that an increase in price, although having longer term benefits, can have a serious and immediate impact on brand performance.

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HIGH RISK EXPERIENCE. cont.:

Although the change in pricing was not the only factor involved in the decline experienced in Israel, it is, on judgement, the significant factor.

- Prior to the price increase in 1989, the brand was a very low priced product. As such, it was perceived to be a low quality brand that was smoked by people at the lower levels of the socio-economic spectrum.
- Sourcing of the product was changed from Cyprus to Macon to improve the product and the price was raised to improve positioning.

	<u>RSP (NIS)</u>	
	<u>7/89</u>	<u>10/89</u>
- LUCKY STRIKE	1.80	2.50
- Marlboro	2.80	2.90
Index Vs Marlboro	64	86

- Volume decreased from 47.3MM units in 1989 to 0.7MM units in 1990.
- The new price (although still well below Marlboro) placed the brand beyond the means of its traditional franchise, who then defected to other lower price brands. This loss, however, was not offset by inflows from smokers downtrading from higher priced USIB's.

||| What is the long term benefit?

The lesson learned from the Israel price increase is that in established and successful low price markets, both the strategy and timetable for increasing LUCKY STRIKE pricing should be based upon prior consumer research and, where possible, test market experience.

PREMIUM PRICING VERSUS MARLBORO:

Consideration has been given to pricing the brand at a premium to Marlboro. At present, this strategy is not recommended. Once the brand has proven product superiority to Marlboro and SOM levels are significant, this potential approach should be reevaluated.

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LUCKY STRIKE PRICE VERSUS MARLBORO
KEY MARKET SUMMARY

Source: BWIT Region Survey
April, 1991

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BAT Industries document for Province of British Columbia 25 October 1999

LUCKY STRIKE PRICING REVIEW
MARKETS BY ASCENDING PRICE DIFFERENTIAL VERSUS MARLBORO

INDEX RANGE	RETAIL SELLING PRICE		INDEX VS MARL	PRICE POINTS BELOW MARLBORO
	LUCKY STRIKE	MARLBORO		
100 - 100+				
JAPAN	250	250	100	PARITY
HONG KONG	24	24	100	PARITY
MACAU	9.00	9.00	100	PARITY
NORWAY	33.80	33.80	100	PARITY
DENMARK	27.75	27.75	100	PARITY
VENEZUELA*	36	36	100	PARITY
95 - 99				
ITALY	3,250	3,350	97	ONE
FRANCE	10.00	10.30	97	ONE
CHILE	370	380	97	ONE
GERMANY	4.00	4.20	95	ONE
90 - 94				
BELGIUM	74	79	94	ONE
SWITZERLAND	2.90	3.10	94	ONE
85 - 89				
NETHERLANDS**	0.17	0.19	89	ONE
ISRAEL	3.85	4.45	87	ONE
COSTA RICA	100	115	87	ONE
EL SALVADOR*	5.10	5.95	86	ONE
SINGAPORE	3.00	3.50	86	TWO
ICELAND***	179	208	86	ONE
80 - 84				
PRC	4.50	5.40	83	2-3
MALAYSIA	2.30	2.80	82	TWO
PANAMA	0.80	1.00	80	TWO
GREECE	230	270	85	ONE
75 - 79				
INDONESIA	900	1,150	78	TWO
PARAGUAY	800	1,000	80	TWO
BELOW 75				
SPAIN	150	205	73	TWO
LEBANON	299	475	63	TWO
SYRIA	18.00	28.50	63	TWO

* Brand In Development; Not Yet Launched
 ** Unit Price (LS 25's vs Marl 20's)
 *** Marlboro Not In Market; Index Vs Winston & Camel

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