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# PHILIP MORRIS USA FIVE YEAR PLAN 1991-1995

PHILIP MORRIS USA
BUSINESS PLAN
1991-1995

EXECUTIVE
SUMMARY

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# EXECUTIVE SUMMARY

During the next five years, PM-USA plans to continue its profit growth, generating operating income increases of 13.2% annually. Domestic cigarettes will contribute a cumulative $17.2 billion to the corporate cash flow over the plan period. Market share will reach 49.6% in 1995, while volume will grow at a compound annual rate of half a percent.

PM-USA's volume growth will occur despite a 2.7% compound annual decline in industry volume. Industry volume will be negatively affected by increasing smoking restrictions, the decreasing social acceptability of smoking and increasing excise taxes. Corporate Affairs will use direct lobbying, the media, and industry allies to minimize state and local tax increases, promote accommodation in public places and preserve the industry's freedom to advertise and promote cigarettes to adult smokers.

Two federal excise tax increases have been legislated for the plan period, with a $2.00 per thousand cigarettes increase in January 1991 and a second $2.00 per thousand increase in January 1993. As a result of these increases, industry volume will decline faster in 1991 and 1993 -- 2.7% and 3.3% respectively -- than in the other years of the Plan when volume declines 2.5%. PM-USA's volume will continue to grow modestly with growth declining to an increase of 0.1% in the final year of the Plan. It is our objective to prevent any further increases in federal excise taxes during the plan period. The 1990-1994 PM-USA Plan assumed no federal excise tax increase.

Within this environment, PM-USA will widen its lead as the number one cigarette manufacturer. PM-USA has scheduled up to 6 full margin line extensions during the plan period. These offerings are expected to add incremental business by appealing to competitive smokers and retaining PM-USA smokers as they age. They will enable PM-USA to increase its presence in industry segments where we are underrepresented, such as menthol and ultra low tar, while building on our leadership in growing demographic segments (25-44). Our brands' marketing mix will continue to include image advertising and retail promotions. However, retail merchandising and in-store promotions will steadily gain in importance, with consumer promotion accounting for 40% of the Company marketing budget in 1995, compared to 23% in 1990.

The 1991-1995 Plan includes broad enough coverage in each of the current price/value categories for PM-USA to be aggressive. New price/value offerings will only be considered as a defensive move. While PM-USA will continue to actively participate in the price/value category, it will not fuel its growth, recognizing the market deterioration and the commodity-like status price/value brings to the industry.

Additional manufacturing capacity will not be required to accommodate projected PM-USA volume growth. However, PM-USA's current capacity of 313 billion units cannot accommodate both our domestic volume and growing export volume. The total is forecasted to exceed installed capacity by 43 billion units by 1995. Consequently, the Plan includes a capital appropriation of $589 million to expand the Cabarrus Manufacturing Center. The project, which would begin early in 1991, consists of expanding the Primary, Make/Pack building and plant infrastructure. Cabarrus' capacity will rise from 78.9 billion in 1990 to 160 billion cigarettes per year in 1995, bringing total PM-USA capacity to the 408 billion unit level by the end of the plan period.

PM-USA entered the decade of the nineties with considerable momentum despite the erosion of the industry. During the plan period, management will exploit PM-USA's major competitive advantage of strong trademark recognition for Marlboro, Merit, B&H and Virginia Slims. Focused line extensions, geographically targeted marketing, and trade class specific promotional programs will be used to capitalize on our trademarks. With an established young adult smoker base, PM-USA will hold smokers as they age. Recognized product quality, strong package sales, and Marlboro full margin strength will continue to deliver competitive advantage over the next five years.

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THE
ENVIRONMENT

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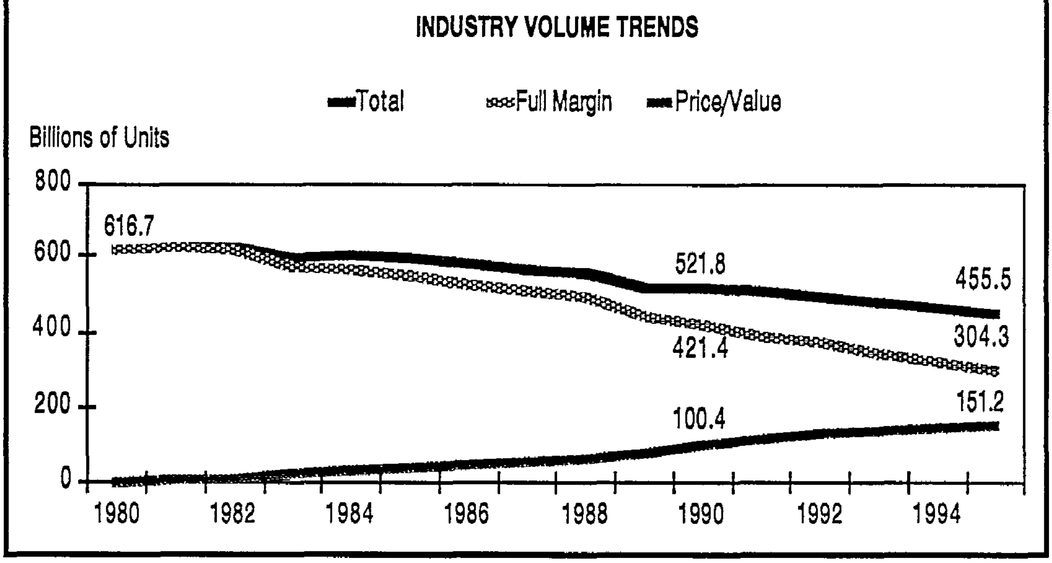
# INDUSTRY OVERVIEW

In 1990, the U.S. cigarette industry achieved record revenues and operating income, totalling an estimated $24 billion and $8.5 billion, respectively. Higher prices and operating efficiencies continued to more than offset unfavorable mix changes and volume declines.

## INDUSTRY VOLUME TRENDS

Industry volume of 521.8 billion in 1990 was down 0.3% versus 1989, continuing a downward trend which began in 1981/1982. However, a two year comparison is more meaningful because of RJR's and Lorillard's decision to "de-load" in 1989. Since 1988, industry volume has declined an average of 3.3% per year, exceeding the industry's decline over the past decade. Since reaching its peak of 626.5 billion units in 1981, U.S. cigarette consumption has declined at a compound annual rate of 2.0%. Factors negatively influencing volume include the health controversy, the declining social acceptability of smoking, more smoking restrictions, and rising excise taxes and prices.

Over the next five years, we expect cigarette consumption to continue declining given the increasingly hostile smoking environment and the effect of two federal excise tax increases. There were no federal excise tax increases during the last five years. Sales of cigarettes in the U.S. are projected to decrease an average of 2.7% per year between 1990 and 1995, reaching 455.5 billion in 1995. This is a slight acceleration of the trend of the last five years when industry volume declined 2.6% per year. Full margin brands will fuel this decline, decreasing an estimated 6.3% per year, while price/value brands will help keep consumers in the marketplace.




| COMPOUNDED ANNUAL VOLUME GROWTH (%) | 1985-1990 | 1990-1995 |
|---|---|---|
| Total Industry | (2.6) | (2.7) |
| Full Margin | (5.2) | (6.3) |
| Price/Value | 18.3 | 8.5 |

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## Price/Value

Price/value will continue to be the most dynamic segment in the tobacco industry, fueled by aggressive full margin pricing, brand/packing proliferation and higher availability at retail.

PRICE/VALUE PROLIFERATION

| | # Brands | # Packings |
|---|---|---|
| 1989 | 25 | 152 |
| 1990 | 30 | 182 |
| 1995 | 34 | 196 |

Over the next five years, price/value's share of the industry is expected to rise approximately 2.8 share points per year, from 19.2% in 1990 to 33.2% in 1995. Over the past five years, the price/value category grew approximately 2.4 share points per year. Price/value volume is expected to grow at an annual rate of 8.5%, reaching 151.2 billion units in 1995 compared to 100.4 billion in 1990. New competitive entries are likely to be introduced to meet the increasing consumer preference for lower priced cigarettes.

MARKET SHARE OF PRICE/VALUE SUBSEGMENTS

| | 1981 | 1985 | 1990 | 1995 | Difference 1990-95 |
|---|---|---|---|---|---|
| Black & Whites | 0.5 | 4.6 | 3.6 | 4.1 | 0.5 |
| Branded Generics | - | 1.4 | 10.4 | 16.0 | 5.6 |
| Value 25's/30's | - | 1.3 | 0.7 | 0.4 | (0.3) |
| Price-off | - | - | 1.0 | 1.4 | 0.4 |
| Sub-generics | - | - | 3.5 | 11.3 | 7.8 |
| Total | 0.5 | 7.3 | 19.2 | 33.2 | 14.0 |

## Assumptions

This industry forecast is based on the following assumptions:

- The **federal excise tax** will rise $2.00/M in January 1991 to $10.00/M and again in January 1993 to $12.00/M, per the budget accord reached in November. There are no further increases in federal excise taxes planned.

- **State excise taxes** will rise approximately 10.0% per year, increasing from almost $0.24 per pack in 1990 to $0.38 per pack in 1995. This represents a slight increase in the trend of the past five years when state excise taxes increased 8.7% annually. The state excise tax increases are higher in the earlier years of the Plan as many states currently have large budget deficits.

- The industry remains relatively price inelastic due partially to the availability of lower priced alternatives, such as Bristol, which had an average retail carton price (85mm) of $8.48 in 1990, compared to $15.27 for a full margin brand. **Elasticity** is assumed to be -.37. This means that for every 10% increase in price, industry volume will decline 3.7%, or approximately 19 billion units (based on 1990 volume).

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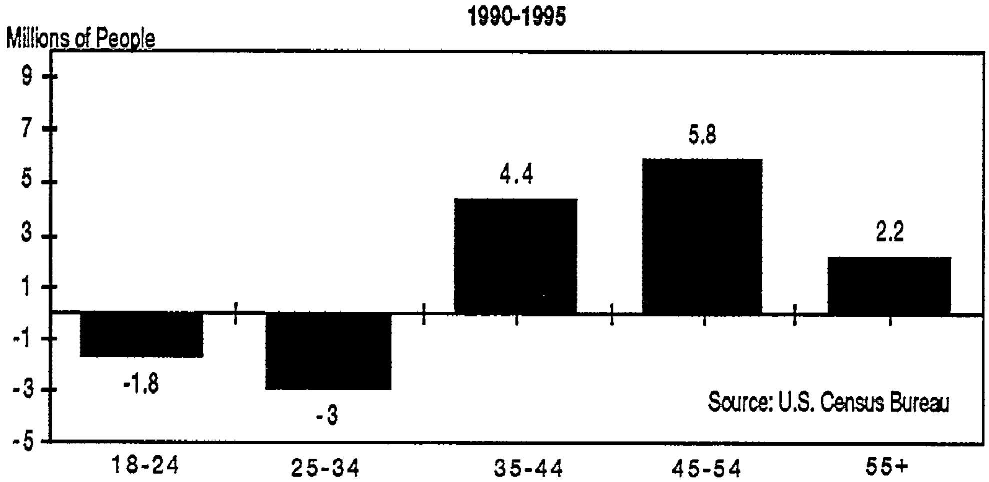
- **Population trends,** while favorable (+7.6 million smoking age people between 1990 and 1995), will not provide as much potential volume as in the past five years when the smoking age population grew 10.6 million. Growth will occur mainly in older age categories where smoking incidence has historically declined, partially offsetting the benefits of population gains. The 35-54 age group will show the largest growth (+16.2%) and will comprise the largest share of the population (21.8%). The over age 55 population will also grow (+4.1%). These trends highlight the desirability of retaining smokers as they age.

ADULT POPULATION GROWTH BY AGE GROUP
1990-1995




Longer term, industry volume will be negatively affected by a decline in the number of potential new smokers, adults under 25 are forecasted to decline 5.5% – while the 25-34 cohort will decline 5.9%. This trend is of particular concern to PM-USA because of our historical strength among these cohorts.

- **Smoking incidence** is forecasted to decline 2.6 share points to 26.5% in 1995. **Average daily consumption** will also decline, although to a lesser extent, averaging 25.4 cigarettes per day in 1995. As shown in the following chart, average daily consumption and smoking incidence are expected to decline the most among 45-54 year olds.

| | Average Daily Consumption(1) | | | Incidence (%) | | |
|---|---|---|---|---|---|---|
| | 1990 | 1995 | Difference | 1990 | 1995 | Difference |
| Under 25 | 23.3 | 22.9 | (0.4) | 31.2% | 28.3% | (2.9) |
| 25-34 | 25.3 | 24.0 | (1.3) | 35.2 | 31.7 | (3.5) |
| 35-44 | 27.5 | 25.3 | (2.2) | 33.4 | 29.5 | (3.9) |
| 45-54 | 27.8 | 25.4 | (2.4) | 30.3 | 24.1 | (6.2) |
| 55-64 | 27.9 | 26.4 | (1.5) | 26.3 | 23.5 | (2.8) |
| 65+ | 25.0 | 23.9 | (1.1) | 14.9 | 11.6 | (3.3) |
| Total | 25.9 | 25.4 | (0.5) | 29.1 | 26.5 | (2.6) |

(1) Roper consumption data has been adjusted to reflect industry volume.
Source: Roper (1990 Incidence) and PM-USA Market Research Demographic Model (1995)

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# PRICING

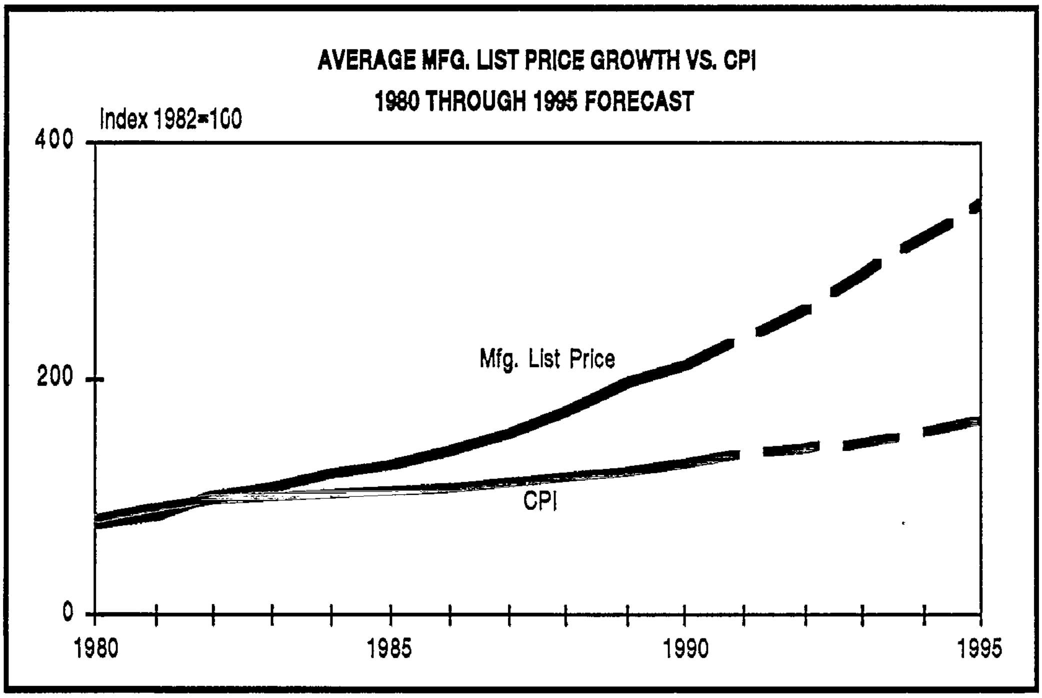
Pricing will continue to be a major contributor to PM-USA's profitability during the plan period. PM-USA is faced with the challenge of balancing operating income growth goals with the objective of unit volume growth. It is critical that PM-USA's pricing strategy, particularly in an environment of high taxation, does not accelerate the decline of industry volume or encourage consumer switching from PM-USA's full margin products to less profitable price/value brands.

PM-USA's pricing strategy for 1991 through 1995 includes the following actions:

- Utilizing price increases to supplement volume increases and productivity gains to achieve operating income growth goals.
- Structuring frequency and amount of price increases to minimize impact on PM-USA full margin brands.
- Reducing net retail price pressure on high margin segment of the business through price increases:
  - Reduce the gap between Bristol and Full Margin prices from 44% in 1990 to 32% in 1995.
  - Reduce the gap between sub-generic and branded generic prices to less than $3.00 per carton and maintain during plan period.
- Maintaining retail price competitiveness using on-carton coupons for branded generic products. Do not lead new discount levels.
- Recognizing that there may be competitive entries introduced at lower price levels during the plan period.

## Manufacturer List Prices

The combination of manufacturers' price increases and rising state excise taxes during the 1980's caused full margin cigarette prices to increase in excess of inflation. The graph below illustrates the rate of growth for cigarette prices (excluding FET) versus the consumer price index for the same period. Manufacturers' list prices increased a compound annual average of 10.9% from 1980 through 1990, while the inflation rate of other goods and services as measured by the CPI increased 4.5%.



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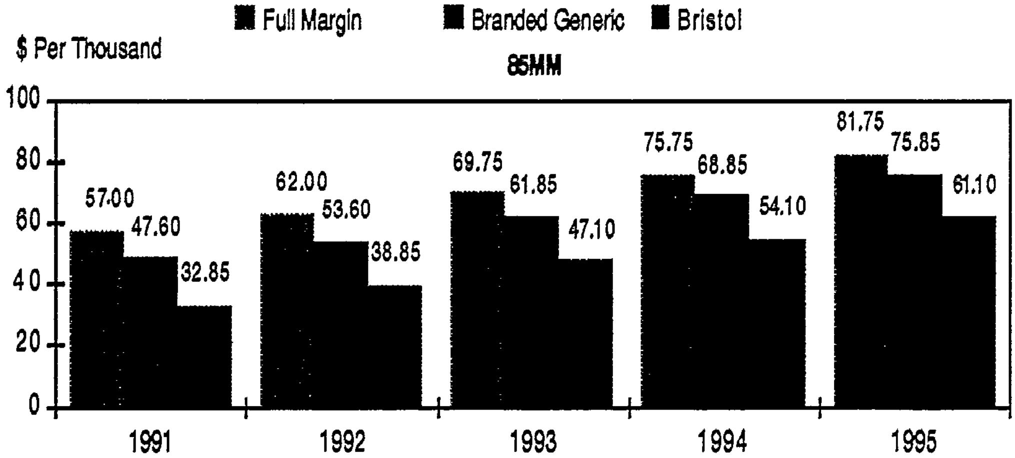
The rapid growth rate for full margin cigarette prices is the driving force behind the emergence and growth of the price/value category. The widening retail price gap between the lowest priced brands (such as Liggett's Pyramid) and full margin brands and the competitive activity it has encouraged has further accelerated the growth of the category. PM-USA's large share of industry full margin unit volume puts the company's profitability at risk if the price/value category continues to grow rapidly.

A new PM-USA pricing strategy is to lead upward pricing pressure in the low price categories, while stabilizing full margin pricing. Our objective is to reduce the price gap between full margin and discount brands. The Plan assumes that the industry practice of semi-annual price increases will be maintained. Annual price increases on full margin brands are projected to be $5.00 in 1991 and 1992, rising to $6.00 in 1993, 1994 and 1995. PM-USA will start by taking an additional $2.50 per thousand increase on branded generics and $3.00 per thousand increase on sub-generics out of cycle in March 1991. In addition, annual price increases on branded generics and sub-generics are projected to be $6.00 in 1991 and 1992, rising to $7.00 in 1993, 1994 and 1995. Pricing actions for FVB will be structured to ensure that the retail price of our black and white/private label products is comparable to the lowest priced branded products in the industry.

PM-USA AVERAGE LIST PRICES
1991-1995




Source: PM-USA Market Research

Our goal is to reduce the retail price gap to the following levels by 1995:

**ESTIMATED RETAIL CARTON PRICE DIFFERENTIAL**
**85mm**

| | 1990 | 1995 |
|---|---|---|
| Full Margin | $15.27 | $24.94 |
| Branded Generics | $10.01 | $18.93 |
| vs. FM | $5.26(34%) | $6.01 (24%) |
| Bristol | $8.48 | $16.84 |
| vs. FM | $6.79 (44%) | $8.10 (32%) |
| vs. BG | $1.53(15%) | $2.09(11%) |

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The accelerated pricing of price/value products will improve the profitability of the category. Projected net margins are forecasted to increase substantially over the plan period.

**PROJECTED NET CONTRIBUTION PER THOUSAND**

| Full Margin | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1990-95 CAG |
|---|---|---|---|---|---|---|---|
| Marlboro | $29.63 | $33.77 | $37.66 | $42.28 | $47.74 | $52.75 | 12.2% |
| B&H | 26.63 | 30.18 | 33.82 | 38.87 | 46.03 | 51.05 | 13.9 |
| Merit | 28.58 | 32.81 | 34.42 | 41.75 | 44.91 | 51.80 | 12.6 |
| VS | 23.90 | 29.43 | 33.87 | 36.58 | 42.38 | 48.20 | 15.1 |
| Parliament | 24.49 | 30.57 | 34.42 | 39.19 | 44.35 | 49.38 | 15.0 |
| **Price/Value** | | | | | | | **1991-95 CAG** |
| Cambridge | $2.63 | $9.19 | $11.00 | $13.77 | $15.66 | $18.60 | 19.3% |
| Alpine | (1.23) | 4.42 | 6.77 | 12.55 | 14.34 | 18.02 | 42.1 |
| Bristol | 1.25 | 10.88 | 10.60 | 13.60 | 16.61 | 19.80 | 16.1 |
| Bucks | (47.00) | 6.06 | 5.58 | 10.06 | 13.87 | 16.83 | 29.1 |

The profitability of the price/value category is ultimately dependent on the level of marketing support. Competitive marketing efforts including escalating coupon rates and values, increased retail promotion and new brand introductions are slowing the increase in net margins for the category. PM-USA must remain competitive in this category and minimize the possibility that competitors will see their volume potential being greater than the risk to their profitability. Competitors who are using full margin brand profits to finance price/value marketing efforts must be pressured into defending their full margin brands or risk accelerated volume decline rates, further impairing their profitability. PM-USA's strategy is to leverage full margin brands to relieve competitive pressure in the price/value category.

Pricing assumptions for the plan period create the possibility of the emergence of a fourth price tier. As price/value margins increase, the opportunity to introduce a marginally profitable product could become appealing to competitors, who are willing to postpone profitability in the hope of gaining volume. PM-USA will defend against new entries of this nature by matching competitive price efforts through couponing and other promotional efforts.

Although this pricing strategy enables PM-USA to meet projected income growth targets, it is possible that other manufacturers will seek to accelerate pricing. While estimates of RJR's forecasted profits indicate that cash flow is more than adequate to cover debt obligations under current pricing assumptions, RJR's parent, KKR, may seek to improve operating income growth performance to improve the market for its high yield debt and recent equity issues. In addition, PM-USA's pricing strategy is forecasted to yield RJR a compound average operating income growth rate of 5.8% (1990-1995), below the pre-KKR average growth rate of 11.9% (1983-1988).

## Retail Pricing

PM-USA price increases over the plan period will increase retail cigarette prices at a higher rate than both the consumer price index and disposable income per capita. In the current recessionary economy, PM-USA must achieve its income goals without increasing prices to a level that leads to the acceleration of industry volume decline.

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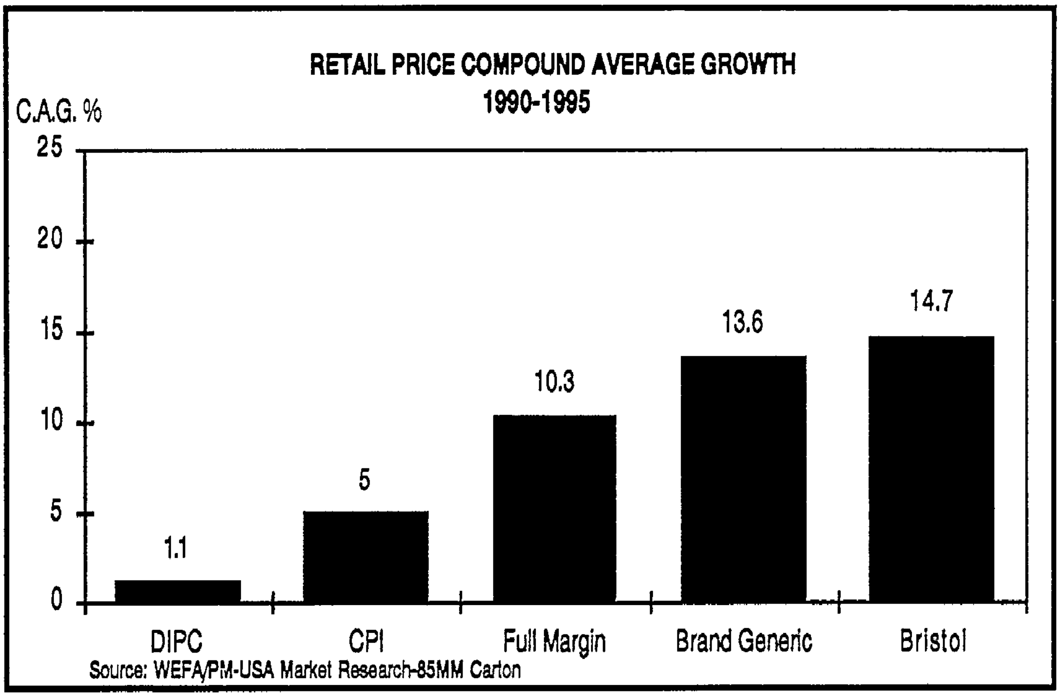
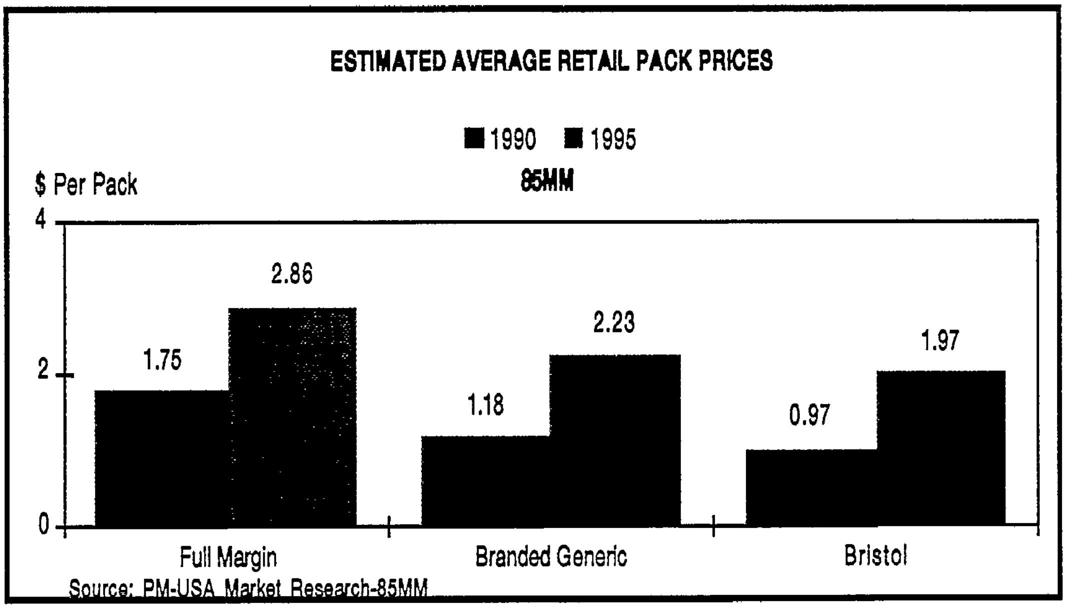



The average retail carton and pack prices for full margin, branded generics and Bristol are forecasted to increase annually an average of 10.3%, 13.6% and 14.7%, respectively. Excluding 1990, Bristol has a compound growth rate of 11.0%. This compares with a 5.0% increase for general inflation and a 1.1% increase in disposable income. Average retail pack prices are projected to near the $3.00 mark by 1995 for full margin.

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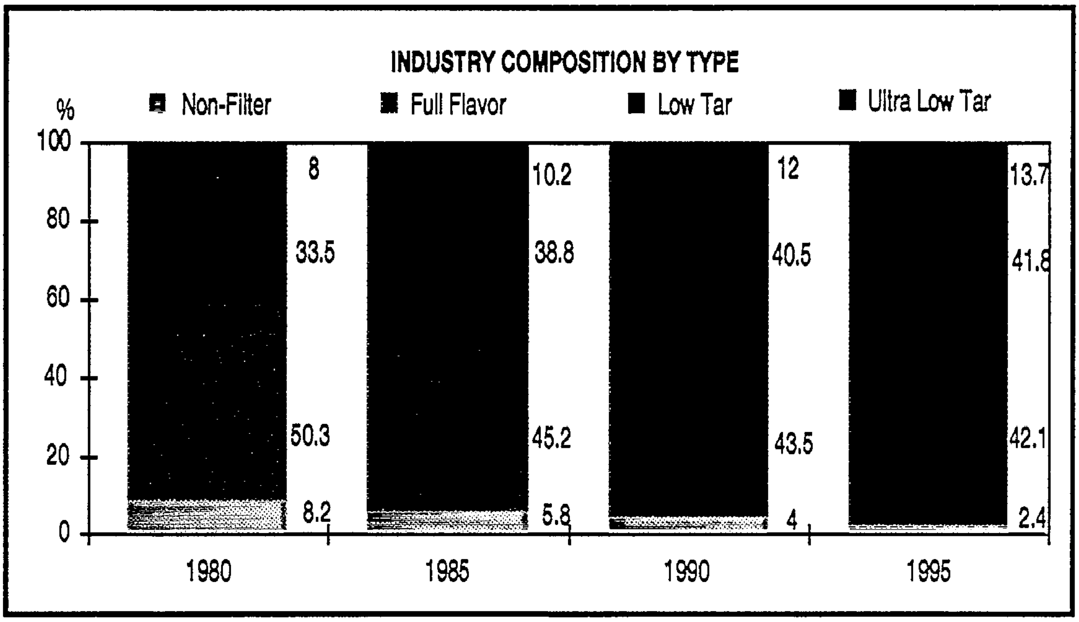
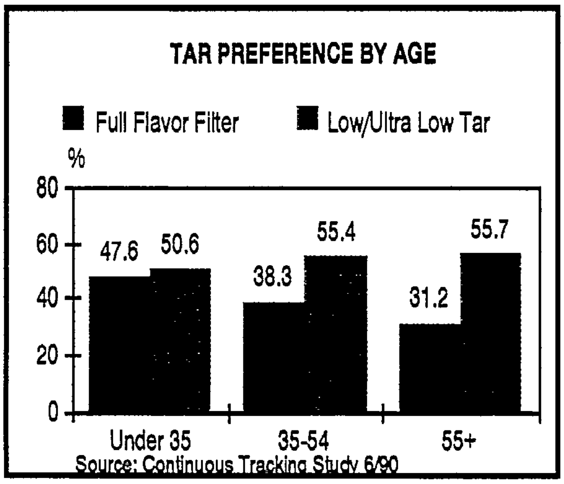
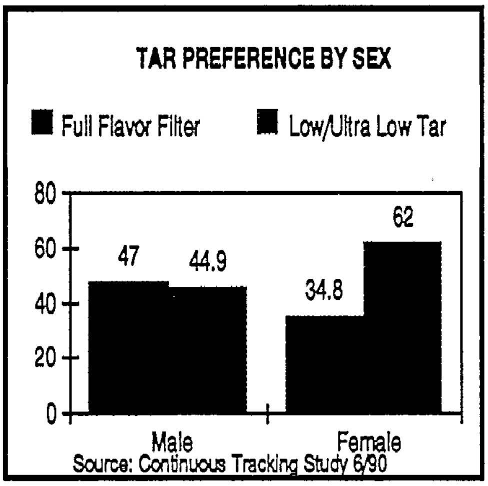
## PRODUCT CATEGORY TRENDS

Aside from price/value, a major growth segment in the industry is low tar. Low/ultra low tar cigarettes, which comprised 52.5% of 1990 industry volume, will continue to grow, although at a slower rate than the past five years. Marketed low tar will grow 1.3 share points to 41.8%, while ultra low tar will grow from 12.0% in 1990 to 13.7% in 1995. Line extensions of existing PM-USA brands, coupled with competitive low tar price/value entries, will contribute to this gain.

Low tar's growth will be aided by the growing percentages of female and older smokers in the smoking population, offset partially by decreasing percentages of better educated and higher income smokers. Increased publicity regarding the alleged health issues associated with smoking and product proliferation within this segment will also fuel the category's growth. Full flavor will decline 1.4 share points, reaching 42.1% in 1995. This marks a slight deceleration in the category's decline; between 1985 and 1990, the category decreased 1.7 share points. In 1975, full flavor accounted for almost 80 percent of industry sales.



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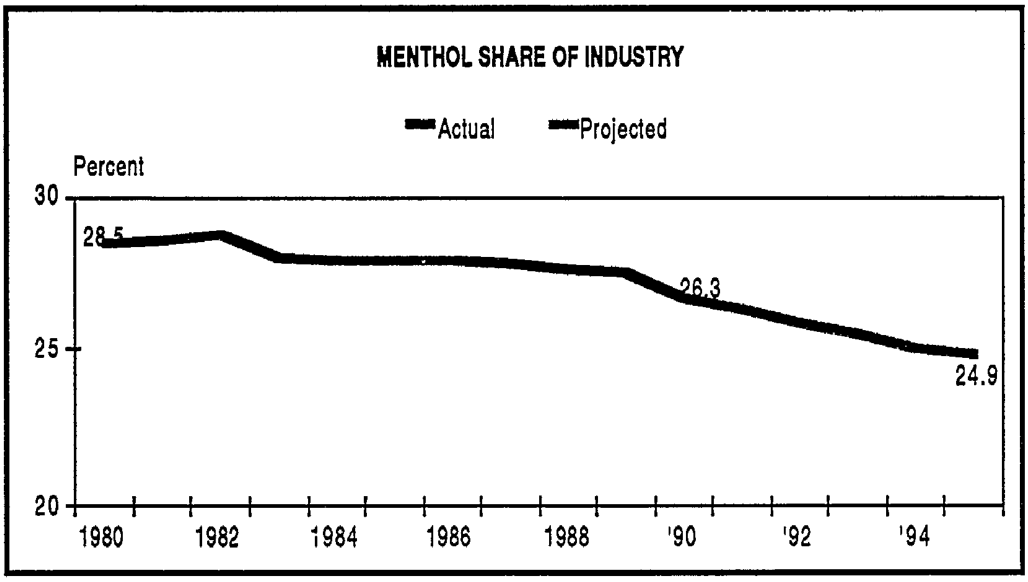
Menthol will continue to decline, mainly as a result of its declining appeal among young adult smokers. In addition, smoking incidence among blacks, who comprise a disproportionately large share of menthol smokers compared to all smokers -- 16% vs. 7%, respectively – is declining faster than among whites. In 1995, menthol is projected to comprise 24.9% of the industry, an annual decline of almost 0.3 share points. PM-USA will not be as adversely affected by this decline because of our lack of a full margin free-standing brand. B&W (Kool), RJR (Salem) and Lorillard (Newport) will be most affected.




In terms of preferences by length and packaging, box will continue to grow at the expense of soft pack. This is largely due to line extensions expected to be introduced during the plan period. The box category will reach 28.3% of the industry in 1995, up from 23.6% in 1990. There will be little shift in preferences by length.

**PROJECTED CATEGORY SHARES**
**(%)**

| | 1985 | 1990 | 1995 | Difference 1990-1995 |
|---|---|---|---|---|
| Box | 17.5 | 23.6 | 28.3 | +4.7 |
| Soft Pack | 76.7 | 72.4 | 69.3 | (3.1) |
| 80/85's | 54.8 | 54.5 | 55.4 | +0.9 |
| 100's | 37.1 | 39.2 | 40.1 | +0.9 |
| 120's | 2.3 | 2.3 | 2.1 | (0.2) |
| Total Filter | 94.2 | 96.0 | 97.6 | +1.6 |



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# COMPETITIVE STRUCTURE

In past years, cigarette manufacturers routinely pursued diversification strategies because of the less favorable long term prospects for the industry. These companies have since spun off many of their non-tobacco units, due to attempted takeovers and decisions to refocus on core businesses, including tobacco. These dynamics have increased competitors' dependence on earnings from tobacco, thereby heightening competition among the firms.

Since 1985, no manufacturer, except PM-USA, achieved either volume or market share growth. While PM-USA's volume grew at a compound annual rate of 0.6%, the rest of the industry declined 4.6% annually. Our market share grew 6.3 share points, paced by price/value, which had the largest gain in the industry. As shown in the following chart, PM-USA's full margin business was the only one in the industry to experience share growth.

**MARKET SHARE PERFORMANCE**
(Share Point Change 1985-1990)

| | Total | Full Margin | Price/Value |
|---|---|---|---|
| PM-USA | 6.3 | 1.5 | 4.8 |
| RJR | (2.0) | (6.0) | 4.0 |
| B&W | (1.6) | (3.8) | 2.2 |
| Lorillard | (0.5) | (0.6) | 0.1 |
| American | (0.7) | (2.6) | 1.9 |
| Liggett | (1.5) | (0.5) | (1.0) |

PM-USA's success has, and will continue to come, primarily at the expense of our competitors' full margin businesses. As shown in the following chart, all competitors are forecasted to continue to lose full margin market share. Winston (-3.6), Salem (-2.2), Kool (-2.0), Kent (-.76) and Pall Mall (-1.1) will continue to pace their respective manufacturers' declines.

All competitors are expected to gain share in the price/value segment, partially offsetting full margin declines. Liggett, the only company which lost price/value share over the past 5 years (-1.0), will show modest growth, as their declining black and white business (-0.1) will be offset by the continued growth of Pyramid (+0.2). Doral will continue to fuel RJR's growth (+1.8), while Magna's share will remain essentially unchanged. American's growth will come mainly from the sub-generic tier, with Montclair gaining 2.1 share points and Misty 1.1 share points. Lucky Strike, as a price-off brand, will remain relatively unchanged. B&W's Raleigh Extra is expected to grow 1.9 share points, while Belair's share will remain fairly stable.

**PROJECTED COMPETITIVE MARKET SHARES**

| | 1990 | | 1995 | | Price/Value's Share of Company Volume | |
|---|---|---|---|---|---|---|
| | Full Margin | Price/ Value | Full Margin | Price/ Value | 1990 | 1995 |
| PM-USA | 37.3% | 5.0% | 38.9% | 10.7% | 11.8% | 21.5% |
| RJR | 23.7 | 5.9 | 15.7 | 8.4 | 20.0 | 34.9 |
| B&W | 6.3 | 4.0 | 3.7 | 5.8 | 38.3 | 60.9 |
| Lorillard | 7.5 | 0.1 | 5.0 | 0.9 | 1.6 | 15.0 |
| American | 5.0 | 1.8 | 2.9 | 4.9 | 27.3 | 63.1 |
| Liggett | 1.0 | 2.4 | 0.6 | 2.5 | 71.0 | 81.3 |

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# R.J. REYNOLDS

## Parent Company Outlook

Kohlberg Kravis Roberts & Company continues to pursue a strategy of reducing and restructuring R.J.Reynolds' debt, while maximizing the Company's equity valuation. In contrast to the distress experienced by many highly leveraged companies, RJR is in excellent financial condition.

- KKR has divested operating units to help reduce debt to $20 billion from $30 billion at the time of the buyout (April 1989).
- KKR provided a $1.7 billion capital infusion to strengthen RJR's financial structure and allow it to restructure its debt at lower interest rates.
- Analysts estimate the Company will have a minimum of $1.5 billion per year in free cash flow over the next several years to further reduce debt.
- RJR Tobacco will focus on growing Doral's volume in price/value, while minimizing its full margin share decline by actively promoting Camel and introducing new products. Increased export volume will be sought to maintain operating efficiency.

## Market Share

RJR's share of 1990 industry **shipments** increased 1.1 share points from the prior year to 29.6%. This comparison is distorted by RJR's reduction of trade inventory programs in 1989, which depressed shipments for that year. Adjusting volume to reflect the trade inventory reduction results in an estimated share loss of between 1 and 1.5 share points. Of the Company's total volume, 80.0% was full margin and 20.0% price/value.

RJR MAJOR BRAND PERFORMANCE*

| Brand | Share 1989 | Share 1990 | Change |
|---|---|---|---|
| Doral | 3.9 | 4.3 | +0.4 |
| Camel | 4.1 | 4.4 | +0.3 |
| Winston | 9.6 | 8.8 | (0.8) |
| Salem | 6.6 | 6.1 | (0.5) |
| Vantage | 2.7 | 2.4 | (0.3) |

*Source: MSA - 1989 adjusted for "de-load"

## New Products/Positioning

RJR continues to introduce new products and reposition existing ones to stabilize volume. In contrast to its competitors, the Company is aggressively developing new full margin brands.

- Camel's repositioning as a brand for young adults smokers has increased its share of adult smokers under 21 years old to 8.2% from 2.8% (1987). RJR will continue to feature Camel as its premier full margin brand rather than Winston. RJR introduced Camel Ultra Lights (11/90) without a test market evaluation.
- RJR has initiated new efforts to attract smokers to Winston and Salem. Winston has switched from Marlboro type imagery to an eagle symbolizing quality, while Salem has added packings designed to appeal to black menthol smokers.
- RJR is testing a scented product, Horizon (4/90), as a full margin brand.
- Dakota (3/90), also being tested in the full margin category, is marketed as an alternative to Marlboro.
- Sterling was reintroduced (9/90) as a price-off brand with continuous $3 coupons and is marketed as an alternative to B&H and other brands.

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## Marketing

RJR Domestic Tobacco's marketing efforts have become increasingly aggressive, following the 1989 appointment of James Johnston to Chairman and CEO. The Company will continue to actively compete for share of young adult smokers by boosting pack promotions for Camel, primarily in the convenience/convenience gas trade class. Camel and Salem will receive a disproportionate share of media support. RJR also appears committed to driving Doral's carton volume with additional couponing.

- V.P. of Marketing Peter Hoult was replaced in September 1990 by James Schroer, a former tobacco, beverage and packaged food consultant at Booz, Allen & Hamilton.
- RJR's estimated media expenditures fell 15% to $186mm in 1990 compared to the prior year.
  - Camel's measured media support increased $21.6mm to $70.6mm; it is the industry's second most advertised brand behind Marlboro. Most of the brand's increase came in outdoor.
  - Spending for Salem declined $5.1mm to $37.4mm, while more substantial decreases were made for Vantage ($25.3 mm to $17.6mm) and Winston ($26.8mm to $21.8mm).
  - Most support for Magna and More was withdrawn.
- In 1990, RJR's percent of supermarket volume sold on coupon rose 6.6 percentage points to 38.5%, increasing sharply in the 3rd quarter, and then topping 50% in the 4th quarter.
  - Camel filter's percent of supermarket volume purchased with coupon decreased from 30.5% to 22.4%. However, coupon activity increased to 40.2% of volume in the 4th quarter.
  - Couponing for Doral increased from 54.4% to 70.9% of supermarket sales; coupon values also climbed, with almost all 4th quarter volume being purchased with a $3 coupon.
- RJR continues its retail fixture dominance of the supermarket trade class, particularly in carton racks where it has a 5:1 advantage over PM-USA. Overall, RJR maintains a 3:1 carton rack advantage over PM.
- RJR has responded vigorously to PM-USA's Plan R pack merchandising program.
  - Stores have been offered a $1,000 bonus payment to add RJR pack displays.
  - These actions reflect RJR's increased emphasis on pack sales to address the increasing consumer preference for packs.

## R&D

KKR has continued to support RJR's investment in research and development. The number of researchers is approximately 650 from a high of 800 prior to the takeover. RJR's development focus is in two areas: a Premier type article and flavor and scent innovations.

- The team that worked on Premier is essentially still intact, and the level of related patent activity remains high.
- RJR has the industry's only captive flavor facility which produces the flavor-release compounds used in the new products, Horizon and Chelsea.

## Operations

- Quality improvements through process innovations have narrowed the quality gap with PM-USA.
- Optical scanners have been developed that reportedly will reduce pack defects by 75%.
- RJR's manufacturing modules operate as mini-factories and consist of Protos 8000 cpm makers, G.D packers, G.D wrapper/boxers and Focke case packers.
- Domestically, RJR has capacity of 225 billion units and output of only 191 billion units (domestic/export - 157/34 billion). To further improve operations, it is essential for RJR to further develop export markets.

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## Competitive Advantages

KKR will continue to maintain a major role in decision making at RJR. The Company will attempt to maintain a balance between the sometimes conflicting goals of generating cash for debt purposes and enhancing equity value. In the near future, RJR will rely on several competitive strengths to try to stabilize full margin share and total volume.

- **Manufacturing Efficiency:** The combination of high speed modular equipment and non-union labor makes RJR the industry's most flexible and efficient manufacturer.
- **Retail Fixtures:** RJR continues to dominate in the number of retail fixtures. This is particularly true in supermarkets, which is a critical outlet for the growing price/value segment.
- **Leaf Cost Advantage:** RJR realizes substantial cost savings by using less expensive off-shore leaf, higher percentages of reconstituted materials and lower rod weights than PM-USA.
- **Single Brand Price/Value Strategy:** This has contributed to Doral's success in becoming the first top ten brand from the price/value segment, with a 4.3 market share and 22% of category volume.
- **Closely Held:** The Company's closely held financial structure will continue to allow aggressive tactics on matters such as advertising content and market segmentation. During the plan period, KKR will reduce its share of RJR's equity, but should retain control of the Company.
- **New Product Aggressiveness:** RJR displays new product aggressiveness in the full margin category, while introductions by competitors have been curbed.

# BROWN & WILLIAMSON

## Parent Company Outlook

Brown & Williamson's parent, BAT, underwent a dramatic restructuring during 1989 and 1990. In response to Sir James Goldsmith's takeover bid, the Company divested its retail, paper and other operating units, narrowing its focus to insurance and tobacco.

- The Company's before tax income for the first nine months of 1990 declined 44% due to investment and underwriting losses in its financial services units. Increases in tobacco profits, primarily due to higher B&W exports to the Far East, have helped to offset these losses.
- B&W contributes 49% of BAT's worldwide tobacco operating income and 17% of BAT's tobacco volume.
- For the future, BAT will continue to rely on B&W to provide cash flow and operating income growth. However, B&W's profitability is being threatened by eroding full margin volume and increasing, but less profitable, price/value volume.

## Market Share

Brown & Williamson's share of 1990 industry **shipments** declined 1.1 share points to 10.3%. B&W's volume is skewed more heavily to price/value than any competitor aside from Liggett -- 38.3% of its volume is price/value. The Company had a 20.5% share of the price/value category in 1990, down 2.7 percentage points versus 1989, ranking the Company third in the segment.

- Kool's share declined 1.0 share point to 4.9% and volume declined 17.5% versus 1989, underscoring B&W's inability to attract young adult smokers to the brand and retain existing older smokers.
- Price/value performance was mixed. New Belair and Raleigh Extra gained volume, while Viceroy, Richland 20's, 25's and GPC Generics declined. In total, 1990 price/value volume was 20.6 billion units, an increase of 2.5 billion or 13.8% over 1989.

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## New Products/Positioning

Brown & Williamson is focusing it efforts on improving its price/value performance and strengthening Kool.

- B&W is testing a Kool Deluxe lights and ultra lights (3/90). The packaging is very similar to Benson & Hedges.
- Belair is pursuing a dual price strategy. It was introduced nationally (3/90) as a branded generic and its full margin packings remain in distribution.
- Raleigh Extra (6/90) was introduced nationally as a sub-generic in six packings and is being aggressively marketed as "the lowest price in the store". Raleigh full margin remains in distribution, with 1990 unit volume declining 32.5%.
- B&W's strategy of maintaining distribution on full margin Raleigh and Belair provides financing for the introduction of price/value entries. Without marketing support and lower price alternatives, Raleigh and Belair full margin volumes have declined at the highest rates in the industry.

## Marketing

Brown & Williamson has reduced support for several of its full margin and price/value brands. This is most likely temporary, connected to the poor performance of BAT's financial units and the need for B&W to boost profitability. Media support for its full margin brands has been reduced and couponing decreased.

- In 1990, estimated media support for B&W brands dropped 53.2%, from $85.4mm to $40mm, the sharpest decline in the industry. Media spending for 1990 versus 1989, dropped from $30.6mm to $16.8mm for Capri, while Kool's spending fell from $28.7mm to $6.4mm. After investing $8mm in 1989 repositioning Viceroy, B&W virtually halted spending for this brand.
- B&W's percent of total supermarket volume purchased with coupon decreased from 30% in 1989 to 24% in 1990, primarily due to reductions in full margin Raleigh and Belair couponing.
- Viceroy's couponing increased from 38.7% to 40.4%, with higher on-carton coupon values to compete with Cambridge and Doral. In the 4th quarter, these averaged $2.79 versus $1.99 same period year ago.

## R&D

B&W relies on its domestic R&D resources and those of other BAT units based in Europe. B&W's staff is estimated at 320 and is divided among blend, cigarette, filter and package R&D. Patents filed during the past year suggest that BAT will concentrate on research for Premier type articles, low sidestream products and packaging innovations.

- Most B&W filings are "concept patents" which grant a proprietary position for an item based on research rather than actual development of that article.
- B&W continues to compete with larger companies by rapidly analyzing new technologies from competitors and changing them sufficiently to establish proprietary patents.

## Operations

B&W's production facilities are relatively modern and rely primarily on Protos 7200 cpm makers and G.D. X-1 and X-2 packers. Making capacity is 94 billion units and domestic demand 56 billion. The Company will increasingly rely on export volume to maintain operating efficiency. Still, B&W has virtually eliminated a wide quality gap with PM-USA by strengthening its process development and engineering.

- B&W accounts for 20% (32.5 billion units) of total U.S. exports. Japan accounts for approximately one-third of total export volume. Leading brands are Kent, Lucky Strike and Barclay.
- Patent activity suggests that BAT will continue to improve quality by developing improved manufacturing equipment, quality assurance inspection devices and process modifications.

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### Competitive Advantages

Brown & Williamson has a number of advantages and disadvantages in relation to its competitors. Its core full margin brand, Kool, is declining 60% faster than the total menthol category, and Viceroy is vulnerable to RJR and PM-USA's growth strategies for Doral and Cambridge. Still, B&W has strengths upon which to build.

- **Size of BAT:** BAT is the world's second largest tobacco concern and provides global resources and management perspective to B&W.
- **Price/Value Share:** B&W has a strong foothold in the category with a 20.5% share distributed among five brands.
- **Experience Marketing Low Cost Products:** BAT's experience selling in third world countries, where margins are extremely low, could help B&W compete in price/value in the U.S.
- **Export Strength:** B&W is skillful at developing export markets and is having success marketing Kent and Lucky Strike in Japan.

## LORILLARD

### Parent Company Outlook

Lorillard's parent, Loews, has continued to live the basic theory of investing, buy low and sell high. The Company's operating units now include tobacco, insurance, hotels, oil, and an equity investment in CBS.

- Lorillard continues to provide over 50 percent of Loews' operating income.
- With insurance anticipating a difficult year in 1991, Loews will increasingly rely on Lorillard to generate income growth. This may explain Lorillard's current plan to strengthen its full margin volume by introducing redesigned advertising and packaging for Kent.

### Market Share

Lorillard's share of 1990 industry **shipments** declined 0.3 share points to 7.6%, reflecting the continued decline of Kent and True. The Company continues to concentrate on the full margin segment which represents 98.4% of its volume. Newport's share was flat in 1990, the first time in 15 years the brand did not grow market share. Newport, Kent and True represent 95% of total volume, with Newport accounting for 61% of Lorillard's business.

### New Products/Positioning

Lorillard is actively trying to develop new brands and packings to maintain volume. The Company's primary opportunity is to grow its share of the price/value category, but is also testing new packings to strengthen its core Newport franchise. Lorillard's price/value test products indicate that it may pursue a segmentation strategy with diverse offerings.

- Heritage Lights were introduced nationally (7/90) as a price-off brand with continuous $4 off-carton and 30¢ off-pack coupons.
- Old Gold is being tested as branded generic in Kentucky.
- Style will be tested in early 1991 as both a price-off (Hartford and north of Hartford) and branded generic (New Orleans) directed at women.
- Testing is continuing for Harley Davidson as both a full margin (Oregon) and price/value product (Arkansas).
- Newport "10-packs" are being tested (4/90) in Mississippi.

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## Marketing

Lorillard continues to devote the bulk of its media budget to Newport. However, the Company recently announced its intention to relaunch Kent with a $10 million advertising campaign, portraying the brand with a "distinct image of classic sophistication". This signifies a major reversal from the minimal support received in most of 1990, when it was speculated that Lorillard would move the brand to price/value.

- Lorillard's estimated media spending in 1990 increased $19.8mm to $108.6mm. In 1990, Newport was the industry's third most advertised brand. It's media spending rose 5% to $64.8mm and accounted for 60 percent of Lorillard's media budget.
- Lorillard's overall percent of supermarket volume purchased with a coupon increased from 21 to 24 percent, despite a slight decrease for Newport. Promotions tied to new brands and the repositioning of Old Gold contributed to this increase.
- Lorillard has increased carton coupon values to support Kent, and it has also raised carton coupon values on Newport while competitive support for Salem and Kool has lagged.

## R&D/Operations

Loews has not shown much commitment to enhancing its competitive position through R&D or upgrading its manufacturing equipment.

- Lorillard's research and development activities are limited and focus primarily to products with "fire safety" attributes and scent applications.
- Since its acquisition by Loews, Lorillard has invested sparingly in manufacturing equipment. It relies primarily on (5000 cpm) MK9's and AMF 379's (175 ppm) for making and packing, respectively.
- With 1990 sales at almost 40 billion units, Lorillard's excess capacity will top 28 billion units.
- Lorillard lacks export volume which would enhance its operating efficiency.

## Competitive Advantage

**The Newport Franchise:** Lorillard will be hard pressed to maintain its share gains against renewed marketing efforts by Kool and Salem and increased menthol price/value offerings. However, Newport's strength with young adult smokers will enhance Lorillard's position and provide trade leverage for its other brands.

- Newport is the second most popular brand among smokers under 25.
- Fifty percent of all menthol smokers under 25 choose Newport, and this age group comprises 33 percent of the total franchise.

# AMERICAN

## Corporate Outlook

Tobacco profits accounted for 65% of American Brands' 1989 income, up from previous years. The Company has divested companies which do not fit into its five core businesses: tobacco, insurance, distilled spirits, office products and hardware. Given the economic climate and the additional weakness in financial services, American will focus on generating earnings from its tobacco units.

- American produces and sells more units in England than in the U.S.. Its British unit ,Gallaher, continues to be the market leader with 45 percent of U.K. sales.
- Within the U.S., American will concentrate on introducing products in the price/value category, while focusing its full margin efforts on Carlton. It will continue to milk its non-filter and charcoal businesses.

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## Market Share

American's share of 1990 industry **shipments** declined 0.2 share points to 6.8%; 72.7% of American's volume is full margin and 27.3% price/value.

- American's decline is due to the performance of its full margin brands, which decreased 1.0 share point. Pall Mall declined 0.4 share points and Lucky Strike 0.1 share points. Carlton's share declined 0.1 share point, the first decline since 1987.
- In contrast, American's price/value brands grew 0.8 share points, due to Montclair (+0.6 share points). Malibu's share declined 0.2 share points to a 0.5 market share.

## New Products/Positioning

American's price/value business continues to be the focal point of its product strategy. American added packings and increased distribution for Montclair and American Lights following their introductions in 1989 and 1988, respectively. In 1990, the Company broadened its price/value offerings by adding a sub-generic, Misty (9/90), its first product directed at women.

- Misty is being directed at Virginia Slims smokers with the slogan "Today's slims. Why pay more?"
- Lucky Strike (2/90) is being test marketed at branded generic prices in several markets. In December 1990, American reclassified Lucky Strike as a price-off brand back to 1987.
- Bull Durham, discontinued in 1986, is now in national distribution as a sub-generic.

## Marketing

American held 1990 media expenditures relatively flat at 68.0mm, while continuing to coupon heavily.

- In 1990, Carlton remained American's most heavily advertised brand, despite decreasing $6.9mm to $27.2mm. Carlton accounted for 40 percent of American's media budget. Remaining support was spread over Malibu, Pall Mall and Montclair.
- The percent of American's supermarket volume sold on coupon continued to exceed the industry average, increasing slightly from 30.5% in 1989 to 31.1% in 1990. Couponing increased on Pall Mall and Malibu, but decreased on Carlton. Malibu continues to account for a disproportionate share of American's couponing.

## R&D/Operations

American lacks the commitment and resources to achieve significant technological advances. The Company's patent activity shows no substantial R&D efforts. American's making capacity is 74 billion units while total output for 1990 fell below 37 billion units.

- American may develop its export business which accounted for only 2 billion units in 1990.
- American relies primarily on Protos 7200 cpm makers, but will be hampered by limited box pack capability.

## Competitive Advantage

American's primary strength lies in its spectrum of well known brands that can be repositioned into the price/value segment.

- **Price/Value Aggressiveness:** The lack of a major full margin franchise frees American to aggressively develop price/value brands without significantly cannibalizing its own full margin volume. American's competitive disadvantages are substantial. The median age of its smokers is 52 years versus 37.2 for the industry and 31% of its volume is sold in the shrinking non-filter segment.



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# BROOKE GROUP (Liggett)

## Parent Company Outlook

In November 1990, Bennett S. LeBow, Brooke's chairman and majority stockholder merged his highly leveraged private investment vehicle Brooke Partners L.P. (which has majority stakes in MAI Four and Western Union) into the Company. LeBow restructured so that pre-tax income can be used to pay the partnership's $45 million annual interest expense. Brooke Group, which formerly had a net worth of $105 million, now has an additional $300 million in long-term debt and negative net worth (-$104). Still, in the present structure, Brooke's tobacco business is not directly tied to the unresolved financial problems at MAI and Western Union.

- In the short term, Mr. LeBow will manage Brooke's tobacco business for cash flow to channel into his other businesses. His actions will probably include reducing debt by buying MAI Four and Western Union's bonds at their current discounted prices.

## Market Share

Liggett's share of 1990 industry **shipments** increased 0.1 share points to 3.4%, due to the growth of Pyramid (+0.4 share points). Of Liggett's total volume, 71.1% is price/value.

## New Products/Positioning

Brooke introduced no new products in 1990, concentrating on Pyramid and maintaining Eve. Through joint ventures and acquisitions, Brooke has expanded its offerings to wholesalers to include confections and trading cards.

- Brooke will continue to seek joint ventures (Fazer Chocolates) and new product lines (CMC-Sports Trading Cards) that complement its existing distribution system.

## Marketing

In 1990, Brooke increased its media spending from $3.6mm to $6.1mm, while maintaining the lowest coupon levels in the industry at 14.3% of supermarket volume.

- Mr. LeBow will continue to minimize investments in marketing to allow Brooke to generate more short term free cash flow.

## R&D/Operations

- Brooke lacks the resources to pursue aggressive research and development. Mr. LeBow's short term investment horizon for the business will continue to limit these activities.
- Brooke has 31 billion in capacity and domestic shipments of below 18 billion.
- Brooke has relatively modern Protos 7200 cpm making equipment, but continues to rely on aging AMF-379 175 ppm packers with no box capability.

## Competitive Advantage

Brooke's limited resources and aging full margin brand franchises have limited it to pursuing low price strategies. In the future, this strategy will continue to dominate the Company's business options.

- **Pricing Flexibility:** Brooke lacks any major stake in the industry's existing price structure and thus will be unrestrained to initiate new price tiers to achieve volume gains.

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## NEW COMPETITOR

For the plan period, Japan Tobacco Inc. (JTI) has the potential to be a significant competitor. JTI manufactures and markets the world's second leading brand and the best selling brand in Japan (Mild Seven). JTI has a strong background (90 years) in tobacco manufacturing and machinery technology. Despite its dominant 85.3% share of Japan's cigarette market, JTI's volume is stagnant. In response, the Company is seeking to grow its export sales. In 1990, JTI's exports increased 68%, to 7.2 billion units. The Company is believed to be developing a blend of Mild Seven for the U.S. Given the competitiveness for acquiring retail space and wholesale distribution, JTI may seek a partnership or licensing arrangement with a U.S. firm.

## Alternative Products

Nicorette is a nicotine chewing gum/smoking alternative produced and marketed by A.B. Leo Pharmacia (Sweden). Annual U.S. sales of Nicorette are valued at $88mm. Pharmacia had 1989 net sales of $431mm, with 76% of revenue generated outside of Sweden. Pharmacia plans to launch three new products directed at smokers: a skin patch (plaster which allows nicotine to be absorbed through the skin), a nasal spray and a device resembling a cigarette which will allow the user to inhale nicotine through the mouth. The three products are due to be launched in 1992 and 1993.



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# MARKET

## WHOLESALE COMMUNITY

Consolidation remains the operating principal in the distribution community. Looking back ten years to PM-USA's top 100 accounts, 71% still remain direct, 20% were acquired or merged, and 9% went out of business.

- Since 1984, the number of wholesale tobacco distributors has decreased 16% to 1,280. Wholesale grocers have also declined 18% to 540. Combined, they represented 78% of direct sales in 1989.

- Direct retailers, representing 19% of direct sales, have increased in number 41% from 1984 to a current total of 495 accounts. This has been fueled in part by the recent popularity of wholesale clubs.

The impact of these consolidations can be measured by the amount of business concentrated in the largest accounts. In 1990, 54% of industry volume was sold to the top 75 accounts versus 48% in 1984. Consolidation in the industry is projected to continue as the financial investment required to operate efficiently and remain competitive becomes prohibitively high.

Some of the more notable consolidations in the distribution community in 1989/1990 included Golden Distributors acquisition of Capital Distributors, Metropolitan Distributors, C.G. Inc., Nu Service Tobacco, and Alpert Brothers. These acquisitions increased Golden's average weekly sales by approximately 92 million units. Golden subsequently filed for Chapter 11 under the bankruptcy code, as have other smaller tobacco distributors.

As the wholesale community moves into the 1990's, it is facing growing financial liability. Traditionally dependent on bank financing to respond to industry inventory programs, distributors will be squeezed as the slowdown in the economy causes greater conservatism in commercial banking. The banking industry has been re-evaluating their credit positions as a result of bad real estate investments and large loan exposure in international markets and has, in turn, reduced the credit available to the tobacco industry.

## THE RETAIL UNIVERSE IN THE 1990'S - TRADE CLASS MANAGEMENT

The changing retail environment and the unique characteristics of cigarette purchasing have resulted in a disperse pattern of sales over many trade classes. Over the past five years, there have been gradual shifts in both the type of outlet used to sell cigarettes and the form in which they are sold -- single pack versus carton. In addition to this, the increasing number of cigarette packings, along with the growing number of consumer products in general, creates intense competition for limited retail space.

In the current business environment, it will be increasingly necessary to focus on groups with similar merchandising characteristics, operating policies and customer bases as each provides a unique opportunity to tailor programs offering a competitive advantage. Seeing such an opportunity in the 1960's and 1970's, R.J. Reynolds established its now long standing position as the principal fixture supplier in supermarkets. Over the years, this has given their brands/products an advantage in terms of inventory and in-store presence.



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The convenience and gas trade class has increased its representation of industry sales from 28% in 1985 to 36% in 1990. There has been a corresponding decline in small grocery, drug and vending. PM-USA has established a superior position in convenience and gas stores and this strength is expected to continue as the convenience and gas contribution to industry volume increases during the Plan period. It is projected to reach 38% of industry volume by 1995.

PERCENT OF INDUSTRY VOLUME

| | 1985 % of Volume | 1990 % of Volume | 1995 % of Volume |
|---|---|---|---|
| Supermarket | 26 | 24 | 23 |
| **Convenience & Gas** | **28** | **36** | **38** |
| Grocery | 11 | 10 | 9 |
| Drug | 9 | 7 | 7 |
| Mass Merchandiser | 5 | 5 | 5 |
| Liquor | 5 | 5 | 5 |
| Vending | 5 | 3 | 2 |
| Other | 11 | 10 | 11 |

Source: Sales Planning

PERCENT OF STORES

| | 1985 % of Stores | 1990 % of Stores | 1995 % of Stores |
|---|---|---|---|
| Supermarket | 12 | 12 | 12 |
| **Convenience & Gas** | **42** | **50** | **48** |
| Grocery | 20 | 14 | 12 |
| Drug | 10 | 9 | 10 |
| Mass Merchandiser | 3 | 3 | 4 |
| Liquor | 7 | 7 | 7 |
| Other | 6 | 5 | 7 |

Source: Sales Planning

Associated with the growth in the convenience store trade class has been a shift in consumer purchase patterns toward packs. Since 1984, pack purchases have increased from 46% to 57% of total industry volume in 1990. Pack purchases are projected to reach over 60% of industry volume in 1995. Dividing trade classes into pack and carton outlets by purchasing patterns yields the following:

1990 VOLUME BREAKOUT BY CARTON AND PACK

| Carton Outlets | Pack | Carton | Pack Outlets | Pack | Carton |
|---|---|---|---|---|---|
| Supermarkets | 30% | 70% | Convenience/CG | 85% | 15% |
| Mass Merchandisers | 15% | 85% | Grocery | 60% | 40% |
| | | | Drug Stores | 60% | 40% |

Source: Market Research

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## Carton Outlets

*Supermarkets*

In 1989, cigarettes were the 5th largest selling product group in supermarkets representing $8.2 billion, or 3.2%, of total supermarket sales. Supermarket cigarette volume declined 7% in 1989; in 1990, volume continued to decline for a decrease of 5%. The shopper demographics of this trade class mirror RJR's smoker profile (age 35+) and are characterized as predominantly carton purchasers. However, in recent years the emphasis in supermarkets has been switching to the front-end as pack sales comprise a larger portion of volume (30% in 1990 versus 24% in 1985). Presence at the front-end offers an advantage in terms of impulse buying, new product introductions, availability of packings, and strong point-of-sale visibility. For the retailer, pack sales are more profitable on a per unit basis than carton sales with an average margin of 32% compared to 14% for cartons.

| % Share 1990 | PM-USA | RJR | B&W | Lor | Amer | Liggett |
|---|---|---|---|---|---|---|
| Chain | 37.2 | 33.2 | 8.4 | 7.1 | 8.4 | 5.8 |
| Change vs. 1989 | 1.2 | (0.6) | (0.2) | (0.3) | (0.2) | 0.1 |
| Independent | 34.9 | 31.6 | 9.7 | 6.8 | 9.9 | 7.1 |
| Change vs. 1989 | 1.5 | (2.1) | (0.2) | (0.2) | 0.5 | 0.6 |

Source: New Nielsen December 1990

| National Supermarkets % Contribution to Total Company Volume | PM-USA | RJR | B&W | Lor | Amer | Liggett |
|---|---|---|---|---|---|---|
| | 21.1 | 27.0 | 21.1 | 22.4 | 32.0 | 45.0 |

Source: New Nielsen, MSA, SPACE

Total merchandising spending for the industry in supermarkets has increased 23% annually since 1984. Pack spending has taken on significance representing 18% of total payments.

MERCHANDISING SPENDING
SUPERMARKET TRADE CLASS
(In Millions)

| 1984 | PM-USA | RJR | B&W | Lor | Amer | Liggett | Total |
|---|---|---|---|---|---|---|---|
| Carton | $21.7 | $22.2 | $15.3 | $9.2 | $7.0 | $3.4 | $78.8 |
| Pack | - | - | - | - | - | - | - |
| Total | $21.7 | $22.2 | $15.3 | $9.2 | $7.0 | $3.4 | $78.8 |
| **1990** | | | | | | | |
| Carton | $64.2 | $64.0 | $25.7 | $12.8 | $11.8 | $5.0 | $183.5 |
| Pack | 27.0 | 13.9 | 0.3 | 0.1 | - | - | 41.3 |
| Total | $91.2 | $77.9 | $26.0 | $12.9 | $11.8 | $5.0 | $224.8 |

* 3rd Revised for PM-USA, 2nd Revised for all others
Source: Sales Planning

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## Pack Outlets

*Convenience & Gas*

Convenience and gas stores represent the largest single trade class in terms of unit volume. Volume increased 2% in 1990. Changing consumer lifestyles have favored the growth of this trade class. The shopper demographics of this trade class are typified by young adult male blue collar consumers. Retail emphasis in this trade class has focused on the development of unique package merchandising concepts to gain counter and visibility positions.

Convenience and gas outlets operate in a volatile environment. Over the last five years, the total number of stores has grown 26% to 83,000, a 12% annual growth rate for gas stores and 2% for food stores. However, in 1989, traditional operators such as Circle K and 7-11 (both filing Chapter 11) declined by 200 outlets due to financial difficulties. In contrast, oil marketers expanded by 700 stores. Oil operators now account for half of the top 20 convenience operators.

| % Share 1990 | *PM-USA* | *RJR* | *B&W* | *Lor* | *Amer* | *Liggett* |
|---|---|---|---|---|---|---|
| *Convenience/Gas* | 46.2 | 29.6 | 8.8 | 6.9 | 5.2 | 3.3 |

Source: New Nielsen December 1990

| National Convenience & Gas % Contribution to Total Company Volume | *PM-USA* | *RJR* | *B&W* | *Lor* | *Amer* | *Liggett* |
|---|---|---|---|---|---|---|
| | 33.8 | 30.9 | 26.5 | 27.8 | 23.4 | 30.4 |

Source: New Nielsen, MSA, SPACE

Spending in the convenience and gas trade class has increased over 21% annually since 1984. Pack spending represented 66% of total spending for 1990 compared to 60% in 1984. PM-USA accounts for almost 45% of total merchandising spending in this trade class.

MERCHANDISING SPENDING
CONVENIENCE AND GAS TRADE CLASS
(In Millions)

| 1984 | *PM-USA* | *RJR* | *B&W* | *Lor* | *Amer* | *Liggett* | *Total* |
|---|---|---|---|---|---|---|---|
| Carton | $9.0 | $7.6 | $5.8 | $1.3 | $1.7 | $0.4 | $25.8 |
| Pack | 12.7 | 12.2 | 6.6 | 5.1 | 1.7 | 0.1 | 38.4 |
| Total | $21.7 | $19.8 | $12.4 | $6.4 | $3.4 | $0.5 | $64.2 |
| **1990*** | | | | | | | |
| Carton | $28.3 | $20.6 | $12.5 | $2.2 | $5.0 | $1.1 | $69.7 |
| Pack | 63.8 | 45.5 | 14.7 | 9.9 | 2.0 | - | 135.9 |
| Total | $92.1 | $66.1 | $27.2 | $12.1 | $7.0 | $1.1 | $205.6 |

* 3rd Revised for PM-USA, 2nd Revised for all others
Source: Sales Planning

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## MARKETING MIX

Industry marketing spending increased an average of almost 10% per year between 1985 and 1990, reaching approximately $4.6 billion in 1990. There has been a shift in spending, however. Estimated industry measured media expenditures decreased 14.7%, from $834.9 million in 1985 to $712.7 million in 1990, while non-media spending for merchandising, couponing, sales force and promotional expense almost doubled to approximately $3.8 billion in 1990. As a result, advertising expenditures (excluding production costs) as a percent of industry marketing spending have declined -- from 29% in 1985 to 16% in 1990. This trend is expected to continue through the plan period.

INDUSTRY MARKETING EXPENDITURES

| | 1985 | Per M | 1990 Est. | Per M | 5 Year CAG |
|---|---|---|---|---|---|
| PM-USA | $837 | $3.92 | $1,854 | $8.41 | 17.2% |
| RJR | $1,120 | 5.95 | $1,532 | 9.92 | 6.5% |
| B&W | $350 | 4.94 | $ 425 | 7.91 | 3.9% |
| Lorillard | $275 | 5.71 | $ 345 | 8.68 | 4.6% |
| American | $180 | 3.98 | $ 320 | 9.00 | 12.2% |
| Liggett | $ 81* | 2.78 | $ 87 | 4.92 | 1.4% |
| Total Industry | $2,843 | $4.78 | $4,563 | $8.74 | 9.9% |

* Excludes Generic Incentives

In 1990, industry media expenditures totaled $712.7 million, a further decline of 9.7%. Excluding PM-USA, the industry's measured media expenditures decreased approximately 24% since 1985. In contrast, PM-USA's expenditures increased 2.6% during the same time period, primarily reflecting increased expenditures for Virginia Slims and the launch of Cambridge, Alpine, and Bucks offset by decreased expenditures for Marlboro, B&H, Merit and Players. On a per thousand basis in 1990, PM-USA's expenditures were slightly above the industry. While Lorillard and American outspent the industry average.

MEASURED MEDIA EXPENDITURES

| | Total Expenditures (MM) | | Annual % | Per M | |
|---|---|---|---|---|---|
| | 1985 | 1990 E | Change | 1985 | 1990 |
| PM-USA | $296.7 | $304.2 | 0.5% | $1.39 | $1.38 |
| RJR | 321.9 | 185.9 | (10.4) | 1.71 | 1.20 |
| B&W | 76.8 | 39.9 | (12.2) | 1.09 | 0.74 |
| Lorillard | 84.6 | 108.6 | 5.1 | 1.76 | 2.73 |
| American | 40.3 | 68.0 | 11.0 | 0.90 | 1.91 |
| Liggett | 15.6 | 6.1 | (17.2) | 0.53 | 0.34 |
| Total | $835.9 | $712.7 | (3.1%) | 1.41 | 1.37 |

Source: Lynch Transcript Service and Media Planning

There has been a gradual shift in the types of measured media utilized for message delivery over the past ten years. Magazines and outdoor spending each represent 44% of spending. Newspaper expenditures have declined to a little over 4% of total industry expenditures.

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## TYPES OF MEDIA

| | 1980 | 1985 | 1990 |
|---|---|---|---|
| *Magazines* | *39%* | *44%* | *44%* |
| Newspapers | 26 | 13 | 4 |
| *Outdoor* | *22* | *28* | *44* |
| Other | 13 | 15 | 8 |

Source: Leo Burnett

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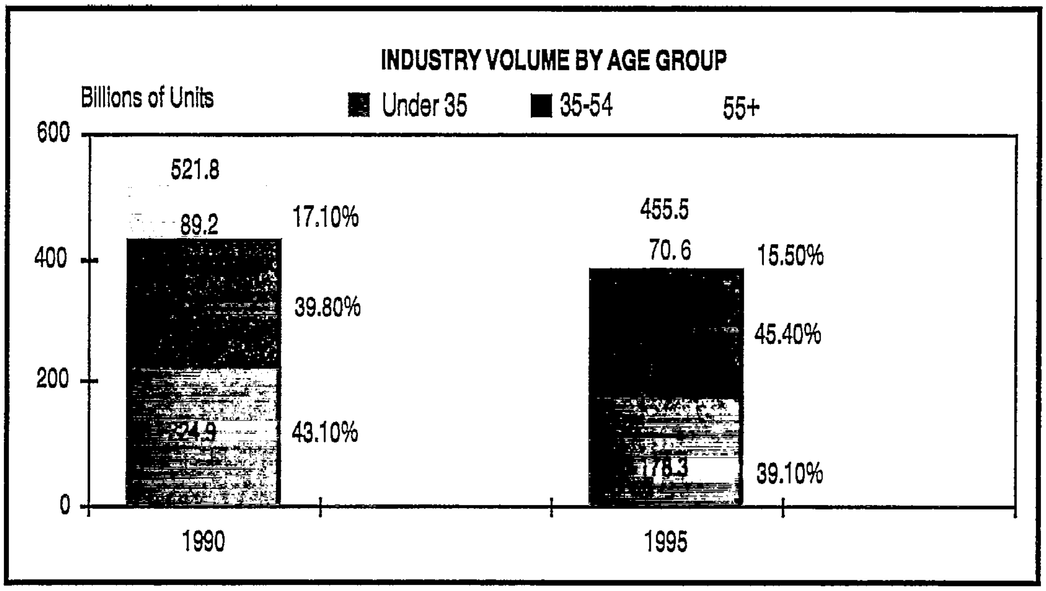
# CONSUMER

Over the next five years, the percentages of females, over 35's, and blue collar workers are expected to increase within the smoking population. Occupational and educational breakouts discussed below indicate that smoking incidence has declined at a slower rate among females than among males, and has actually increased among females who have not graduated from high school.

## AGE

The aging population, combined with consumption patterns, will affect the age composition of industry volume. The largest share of volume will come from smokers aged 35-54 as baby boomers age into these cohorts. Volume contribution by adult smokers under age 35, previously the highest volume contributors, will decrease to 39.1% in 1995, as population within this segment declines.




## OCCUPATION

Blue collar workers will comprise a larger share of smokers in 1995. Since 1970, smoking among white collar workers has declined more than among blue collar workers, widening the gap of smoking prevalence between the two groups. Differences between male and female smoking prevalence by occupation are as follows:

- In white collar occupations, males and females smoke at similar levels.
- Among blue collar occupations, the percent of males who smoke exceeds that of females by a large margin.
- Smoking prevalence has decreased among all occupations for males. Among females, decreases were generally smaller and smoking incidence actually increased among female service workers.

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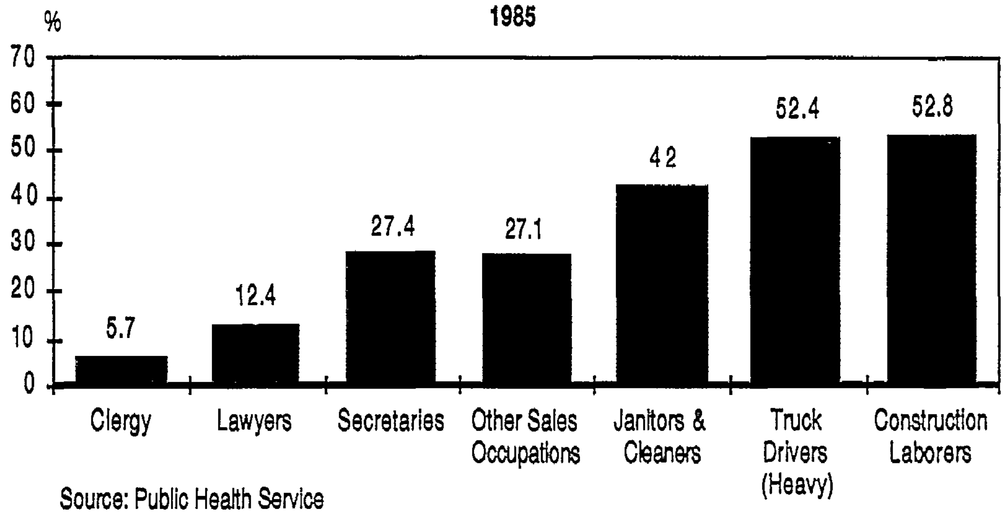
**SMOKING PREVALENCE BY OCCUPATION**
**(%)**

| | Males | | | Females | | |
|---|---|---|---|---|---|---|
| | 1970 | 1985 | Chg | 1970 | 1985 | Chg |
| Professional, Technical | 33.2 | 19.9 | (13.3) | 27.3 | 20.8 | (6.5) |
| Managerial, Official | 38.8 | 27.9 | (10.9) | 40.7 | 27.9 | (12.8) |
| Clerical and Sales | 43.7 | 31.7 | (12.0) | 41.9 | 31.2 | (10.7) |
| Service | 49.5 | 39.2 | (10.3) | 35.5 | 36.6 | 1.1 |
| Blue Collar | 51.1 | 43.0 | (8.1) | 40.8 | 35.6 | (5.2) |

Source: Public Health Service

Occupational groups with the largest proportion of current smokers are transportation workers, handlers, equipment cleaners, helpers and laborers, such as truck drivers and construction laborers. The lowest proportion of current smokers is among the professional specialty occupations, including clergymen and lawyers.

SMOKING STATUS BY OCCUPATION
1985




Source: Public Health Service

## EDUCATION

Smoking will continue to be skewed more heavily toward the less educated. Only one-third of smokers (age 25-54) had any college compared to approximately 50% of non-smokers. Conversely, almost 25% of smokers did <u>not</u> graduate from high school compared to 12% of non-smokers.

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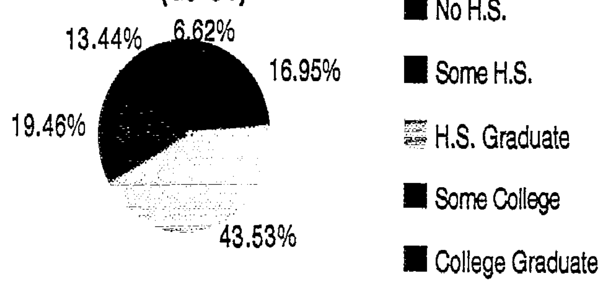
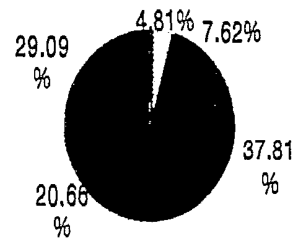
**SMOKERS EDUCATIONAL ATTAINMENT**
**(25-54)**




Source: Public Health Service

**NON-SMOKERS**
**EDUCATIONAL ATTAINMENT**
**(25-54)**




As with occupation, these general trends mask important sex differences.

- Smoking among males has declined at all education levels.
- In contrast, smoking among females has increased among those who have not graduated from high school and remained about the same among high school graduates. As with males, it has declined sharply among females who have been to college.

**SMOKING PREVALENCE BY EDUCATIONAL ATTAINMENT**
**(%)**

| | Males | | | Females | | |
|---|---|---|---|---|---|---|
| | 1970 | 1985 | Chg | 1970 | 1985 | Chg |
| Grade School | 39.2 | 33.4 | (5.8) | 19.7 | 22.1 | **2.4** |
| Some High School | 51.0 | 46.0 | (5.0) | 34.4 | 38.8 | **4.4** |
| H.S. Graduate | 47.7 | 36.6 | (11.1) | 32.2 | 31.1 | (1.1) |
| Some College | 37.3 | 29.9 | (7.4) | 36.6 | 25.0 | (11.6) |
| College Graduate | 30.6 | 20.1 | (10.5) | 26.0 | 16.1 | (9.9) |

Source: Public Health Service

These changing profiles, coupled with an aging population, may have particular impact on PM-USA, whose demographic profile is skewed to younger, better educated and higher income smokers. These trends also point to the further growth of the price/value category, whose smokers tend to be skewed toward older, female, less educated and lower income smokers.

**COMPARISON OF DEMOGRAPHIC PROFILES**
**(%)**

| | Full Margin | Price/Value |
|---|---|---|
| Men | 91 | 9 |
| Women | 89 | 11 |
| Under 25 | 96 | 4 |
| 25-34 | 92 | 8 |
| 35-44 | 88 | 12 |
| 45-54 | 87 | 13 |
| 55-64 | 86 | 14 |
| 65+ | 85 | 15 |
| Under $30,000 | 85 | 13 |
| $30,000+ | 91 | 7 |
| No College | 60 | 25 |
| Some College | 68 | 21 |

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# PRODUCT

## New Product Categories

In 1990, there were no major new product developments by industry firms. Reduced tar cigarettes continue to dominate the new product segment as approximately two-thirds of the new packings introduced in 1990 were low tar. Reduced tar packings now account for 68% of all industry packings. Other concept products under development include:

- Reduced Nicotine: Recent tests by PM-USA for de-nicotined cigarettes reveal some consumer interest, but frequent dissatisfaction with the product's taste. A reduced nicotine cigarette (half-nic) rather than a de-nicotined product might be successfully marketed in the low tar segment.

- Reduced Visible Smoke: This product is intended to produce less visible smoke from the lit end. Products tested by RJR and PM-USA have relied on advanced paper technology and reductions in tobacco content to achieve the desired performance. The concept's ultimate success will depend on the ability of the product to deliver satisfying taste, and for its manufacturer to communicate its advantages to the smoker.

- Light/Scented Smoke Aroma: The concept of a scented cigarette is to minimize or eliminate the discomfort of smoking to others, and thus make the product more socially acceptable. RJR continues to test Horizon in this category. Horizon Lts 100's registered 0.5 share in Atlanta test market during the fifth month of shipments, with regular slightly out-performing the menthol.

- Flavored Cigarettes: Menthol's appeal among young adult smokers has been declining in recent years. A flavored cigarette may attract smokers that want additional flavor but find menthol blends too harsh.

- All Natural: While an all natural cigarette could accommodate possible ingredient disclosure laws, it has low potential as smokers do not consider this an important issue.

- No Ashtray Odor: In the 1987 Concept Study, this was ranked first by smokers because it would eliminate ashtray odor which they find unpleasant. It would also be amenable to non-smokers. The scented cigarette could successfully fill this niche.

- New Devices: Since Premier's introduction and subsequent withdrawal, no new smokeless devices have been introduced. Still, development activity continues by PM-USA, BAT, and RJR. Other companies such as Sweden's Pharmacia will reportedly introduce nicotine products such as gum, compresses, and articles that mimic cigarettes which will be marketed to both smokers choosing to quit and those unable to smoke because of smoking restricted areas.

## Packaging

- Due to the sharp increase in cigarette prices and the proliferation of price/value products, companies will consider new packings alternatives for full margin products. Half carton, "10-pack" and twin-pack configurations may be introduced to hit more attractive pricepoints and slow the defection from full margin to price/value. Currently, Newport 10-pack and Cartier 10-pack are being test marketed. Current retail audit share (9/90) in Los Angeles stores carrying Cartier 10's regular and menthol is 0.2.

- Environmental concerns will lead manufacturers and suppliers to develop packaging and cigarette filters that are biodegradable. Board manufacturers will develop recycled board with 35% recycled filter. Reduced weight packaging will be evaluated for consumer acceptability and quality assurance.



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# SOCIETY

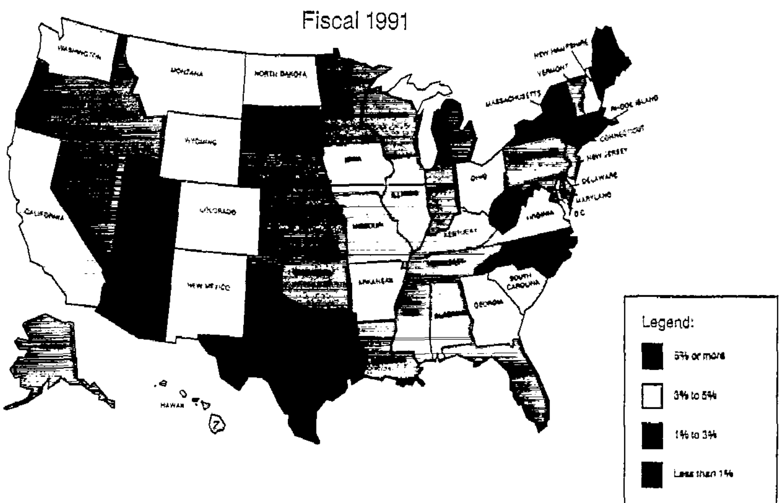
## TAXATION

State excise taxes will continue to increase during the plan period, due to two factors:

- First, the organized anti-smoking movement has made higher cigarette excise taxes an important part of their legislative agenda, saying that smokers should pay for the alleged "social costs" imposed on the economy. Cigarette smoking has been inappropriately associated with productivity losses, job absenteeism, rising health care costs and increases in various types of insurance. Anti-smoking forces also believe that rising retail prices will contribute to smoking quit rates.

- Second, the poor fiscal health of many populous states. A forecast from the National Association of State Budget Officers indicates that 50 percent of the states face potentially serious revenue shortfalls, raising the probability of tax increases. States anticipated to be hardest hit economically for fiscal year 1991 and the rest of the 1990's are in the Northeast, including New York, Connecticut and Massachusetts. The map below highlights 25 states that are forecasted to have fund balances (projected revenues less fixed and mandated expenditures) below 3% of total expenditures, with 12 states at less than 1%. Three percent is considered the minimum acceptable balance for prudent budget management.

A Measure of Financial Stress:
Year-end Balances as a Percent of Expenditures




Source: National Association of State Budget Officers.

In 1990, excise tax increases were proposed in 35 states, of which 8 passed. The 1990 weighted average state excise tax was 23.8 cents per pack, a 1.9 cents increase versus 1989, slightly higher than the average annual increase between 1985 and 1989. The combined taxes (Federal, State and Local) on an average carton increased 2.7% in 1990 to $4.92.

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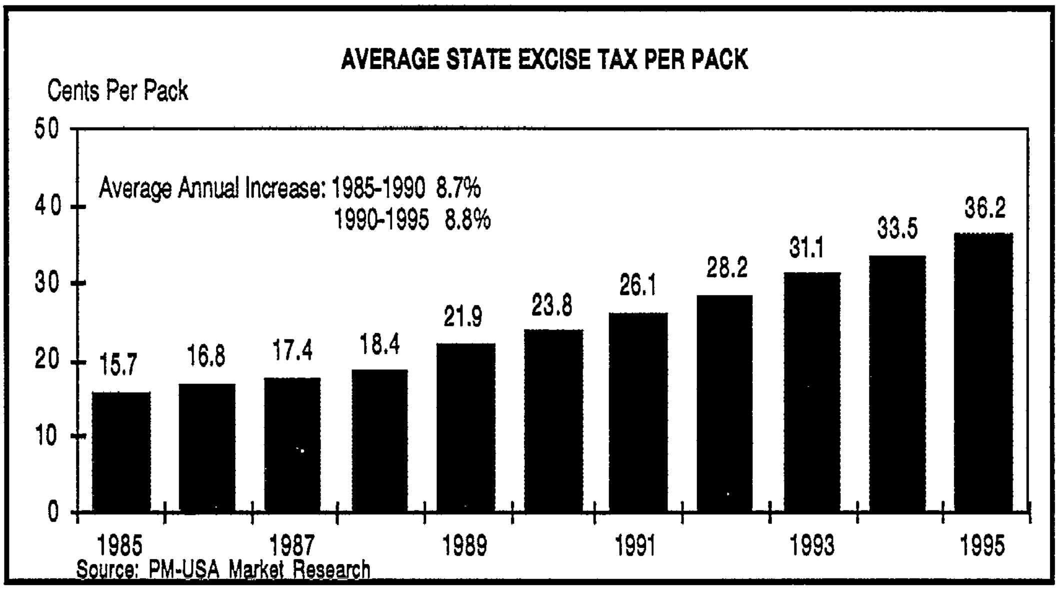


## STATE EXCISE TAX INCREASES

| 1990 | | | | 1991 (Most Likely) | | | |
|---|---|---|---|---|---|---|---|
| State | $ 1990 Increase | % Change | % PM-USA Volume | State | $ 1991 Increase | % Change | % PM-USA Volume |
| AZ (15) | $.03 | 20% | 1.4% | CO (20) | $.15 | 75% | 2.0% |
| DE (14) | .05 | 36 | 0.2 | CT (40) | .10 | 25 | 1.1 |
| FL (24) | .099 | 41 | 5.9 | DE (19) | .05 | 26 | 0.2 |
| LA (16) | .04 | 25 | 1.6 | IA (31) | .03 | 10 | 1.6 |
| NH (21) | .04 | 19 | 0.5 | ME (31) | .06 | 19 | 0.6 |
| NJ (27) | .13 | 48 | 3.1 | MA (26) | .04 | 15 | 2.9 |
| NY (33) | .06 | 18 | 7.7 | MN (38) | .10 | 26 | 1.5 |
| TX (26) | .15 | 58 | 7.2 | MS (18) | .05 | 28 | 1.1 |
| | | | | MO (13) | .05 | 38 | 2.1 |
| | | | | NM (15) | .25 | 60 | 0.2 |
| | | | | NC (2) | .20 | 10 | 2.9 |
| | | | | ND (30) | .10 | 33 | 0.2 |
| | | | | OK (23) | .05 | 22 | 1.2 |
| | | | | PA (18) | .10 | 56 | 4.8 |
| | | | | WI (30) | .10 | 33 | 1.9 |

( ) = Excise Tax Per Pack Prior To Increase

Source: PM-USA Corporate Affairs/Market Research

Proposals that earmark existing or new tobacco tax revenues for specific state expenditures, such as education and health services, were introduced in 29 states, of which 2 ( AZ, FL) passed in 1990. This passage rate of 6.9% is less than half the 1989 level: 7 passed/38 proposed (18.4%).

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# MARKETING RESTRICTIONS

During the plan period, anti-smoking forces will intensify legislative efforts to restrict or ban the sale and marketing of tobacco products. Proposals will continue to focus on banning or restricting outdoor and point of sale advertising, prohibiting sampling and severely restricting cigarette vending machine sales. Proponents of these restrictions use the youth and smoking issue to advance their legislative agenda.

## Advertising

- 18 bills defeated in 1990.
- Outdoor bans repealed in Iowa and Boston, MA.
- One state (Utah) prohibits outdoor advertising.
- 29 bills are pending in states and municipalities.
- 11 Municipalities restrict outdoor advertising.

## Sampling

- 17 bills to ban or restrict sampling were defeated in 1990.
- 21 bills are pending in municipalities.
- 29 municipalities ban or severely restrict sampling.
- 4 states (CA, MN, NE, UT) ban or severely restrict sampling.
- The Waxman Omnibus Tobacco Bill passed out of subcommittee in September 1990.

## Sales/Vending

- 18 municipalities (MN) ban vending sales completely.
- 5 states restrict vending sales to offices or adult locations.
- 11 municipalities require locking devices or adult supervision.
- 44 states impose a minimum age, from 16 to 19 for the sale of cigarettes. 6 states have no minimum age requirement.

There has been a substantial increase in the introduction of state and local legislation to restrict or ban sales through vending machines in the late 1980's. However, contrary to the argument that vending machines allow easy access to cigarettes for minors, recent surveys compiled by the vending industry indicate that 80% of all cigarette vending machines are located in places not frequented by minors. Nevertheless, Health and Human Services Secretary, Dr. Louis Sullivan, proposed model state legislation to ban tobacco vending machines, impose licenses on all tobacco retailers and raise the minimum age for sale of tobacco products to 19 years in May.

In 1990, 24 states and the District of Columbia considered vending legislation in 1990, of which 16 were defeated. Five states and D.C. have legislation pending. Three states passed sales restriction bills:

**Alaska-** Retailer license agreement.
**Minnesota-** Allows machines in workplaces, liquor establishments, clubs or with locking devices; retail licensing defeated.
**Indiana-** Allows vending only in workplaces, bars, or in machines with locking devices.

Local ordinance proposals appear to be a serious threat for the future. Restrictions on the sale of tobacco products, primarily vending related, were proposed in 133 localities in 1990. Measures were adopted in 56 cities. Most notable are New York City, Westchester County, Pittsburgh, Houston and Sacramento. Legislation is still pending in 62 localities including Chicago, Minneapolis, Buffalo, Philadelphia and Seattle.

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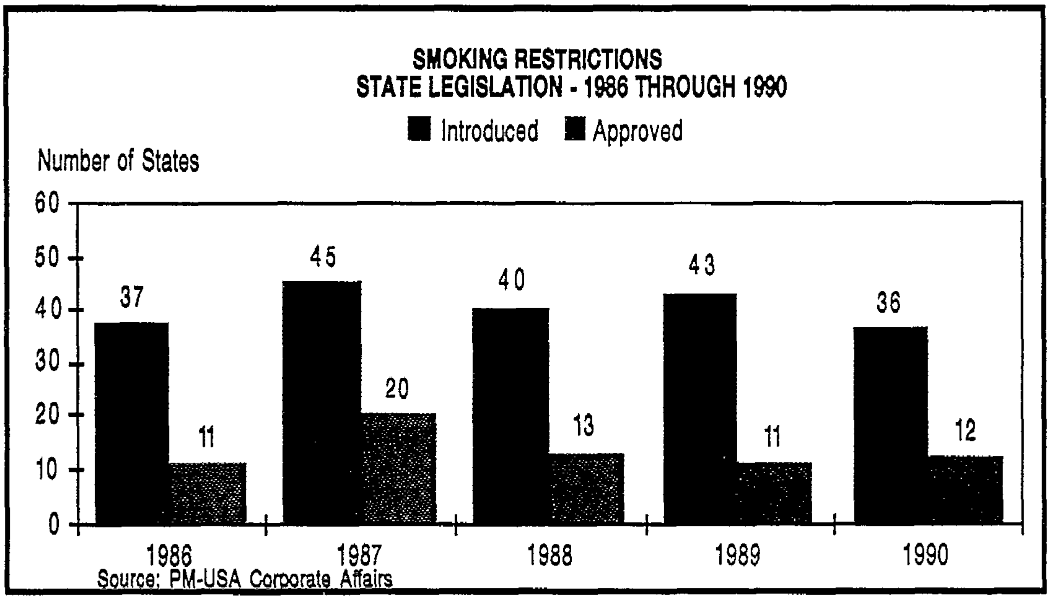
# SMOKING RESTRICTIONS

The environmental tobacco smoke controversy continues to be the primary argument for anti-smoking forces, public health officials and employers seeking to restrict a person's right to smoke. The scope of these restrictions broadened significantly in the late 1980's and is forecasted to continue during the plan period. States and an increasing number of localities are moving from simply regulating smoking in public conveyances and other common areas to restricting smoking in the private workplace and restaurants, to outright bans on smoking.




- Currently, 26 states and more than 300 localities have enacted laws to restrict smoking in restaurants. This has occurred despite public opinion survey data that indicate for a majority of people, smoking is not of primary importance when dining out.

- 28 states and approximately 300 localities have enacted laws governing smoking in the workplace.

- 60% of all U.S. companies now restrict smoking, up from 16% in 1980. One quarter of 283 companies surveyed in 1989 by the Administrative Management Society were smoke free, up from 14% in 1988.

The tobacco industry, led by PM-USA and the Tobacco Institute, is taking a pro-active approach and is proposing legislation to reduce or repeal smoking restrictions:

- **Preemption of local smoking ordinances** - 7 states have proposed bills to preempt local governments from adopting smoking restrictions more stringent than state law; 2 states (IA, VA) have preempted local smoking regulation.

- **Guarantee smoking accommodation** - 12 states have proposed bills to require that smoking may not be banned in workplaces. 3 states (SC, TN, VA) have passed measures.

- **Modify/roll back smoking restrictions** - 3 states have proposed legislation to reduce or repeal restrictions on smoking. 1 state (ME) measure has passed.

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# DISCRIMINATION IN THE WORKPLACE

Employers are infringing on personal lifestyle decisions. Legal, off the job activities such as smoking, are being used as criteria for employment related decisions including hiring, promotions and dismissal. In a majority of instances, employers are using the cost savings argument, citing various studies purporting to link smoking to poor health, absenteeism, accidents and lost productivity.

Only 3 states have adopted laws permitting government employers to discriminate against smokers in hiring: Massachusetts (public safety personnel), North Dakota (hiring preference for Department of Health job applicants) and Florida (firefighters). Legislation concerning police and firefighters in Kansas was repealed in 1990. In contrast, 5 states enacted employment protection for smokers in 1990, bringing the total to 7. Legislation to prohibit employment discrimination of smokers was proposed in 21 states in 1990, up from 12 states in 1989.

Discriminatory hiring practices are in opposition to a majority of American's opinions. According to a national poll released in January, 1990 by the National Consumers League, an overwhelming majority of adults surveyed felt employers had no right to ask about the private lives of its job applicants, to base hiring and firing on what employees do on their own time, or to attempt to change employee lifestyles.

- 74% said an employer has no right to ask employees if they smoke off the job.
- 76% felt the employer has no right to refuse to hire a smoker.
- 74% felt the employer has no right to require an employee or job applicant to quit smoking.

# ENVIRONMENTAL TOBACCO SMOKE

## Risk Assessment By The EPA

The Environmental Protection Agency (EPA) recently convened a Scientific Advisory Board to review evidence on the alleged health effects of environmental tobacco smoke (ETS). A draft report released by the EPA in June 1990 concluded that second hand cigarette smoke should be designated a cause of lung cancer and the agency has named a 16 member panel to review its report for accuracy.

Many flaws have been pointed out during the review period and several key issues demonstrate the lack of scientific justification to support the determination that ETS is a cause of lung cancer in non-smokers:

- Of the 24 published studies on spousal smoking and non-smoker lung cancer, the majority (19) have reported no statistically significant elevated risk associated with ETS exposure.
- The few studies that report a statistically significant association are considered weak and difficult to interpret because of design.
- Of nine U.S. Studies, none -- not even the largest case-control study ever conducted in the U.S. -- has reported a statistically significant association between spousal smoking and lung cancer.

In spite of these findings, the panel's Chairman, Dr. Morton Lippman, stated that there was a consensus among the review panel that involuntary exposure to tobacco smoke causes lung cancer in non-smokers and increases risk of respiratory illness in children. He also stated that ETS should be classified as a known human carcinogen and that workplace smoking policies should reflect the hazard.

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The review process has not concluded and there are several steps remaining before the EPA's report is finalized. The study must be reworked in light of the Scientific Advisory Board's findings and then submitted for an EPA "ETS" administrative review. The final step in the process is for the EPA Administrator William Reilly to give his approval.

The conclusion has serious implications for the tobacco industry as the Labor Department's Occupational Safety and Health Administration, which has agreed in a court suit to consider regulating ETS in the workplace and is awaiting the EPA's verdict. The final EPA report is scheduled to be released in Spring 1991.

## PRESSURE ON SMOKERS

A smoker segmentation study suggests that smokers' attitudes are heavily influenced by non-smokers' opinions and actions, which are becoming less favorable toward the industry. Among non-smokers the percent of anti-smoking "Zealots" has been increasing while the percent of "Supporters" has decreased.

Of particular concern to PM-USA and the industry is the increasing number of anti-smoking "Zealots". Zealots, who represented 17% of the non-smoker population in 1990 compared to 14% in 1988, would like to see smoking abolished and are extremely intolerant of smokers. Although they are a small minority, the demographic profile of this group -- older, upscale and from the Northeast -- indicates that they are opinion leaders in society. At the opposite end of the spectrum are "Supporters" (14% of non-smokers in 1990, down from 17% in 1988). Supporters like smokers and support smokers' rights. However, this group tends to be downscale and less involved politically.

### Behavior Towards Smokers

Non-smoker behavior towards smokers differs greatly by non-smoker segment, especially in terms of their willingness to confront smokers. It is encouraging that, on an overall basis, smoking appears to be a minor issue for a majority of non-smokers.

% Completely agree:

| | Total Non-Smokers | Zealots | Supporters |
|---|---|---|---|
| More willing to ask people not to smoke | 17% | 58% | 4% |
| Becoming less tolerant of smokers | 22% | 66% | 3% |
| Should be more pressure on smokers to quit | 17% | 55% | 2% |

Almost one third of non-smokers consider smoking to be unacceptable for anyone. However, when compared to other controversial behaviors, smoking is only moderately unacceptable.

Believe smoking is unacceptable behavior:

| Total Non-Smokers | Zealots | Supporters |
|---|---|---|
| 30% | 68% | 4% |

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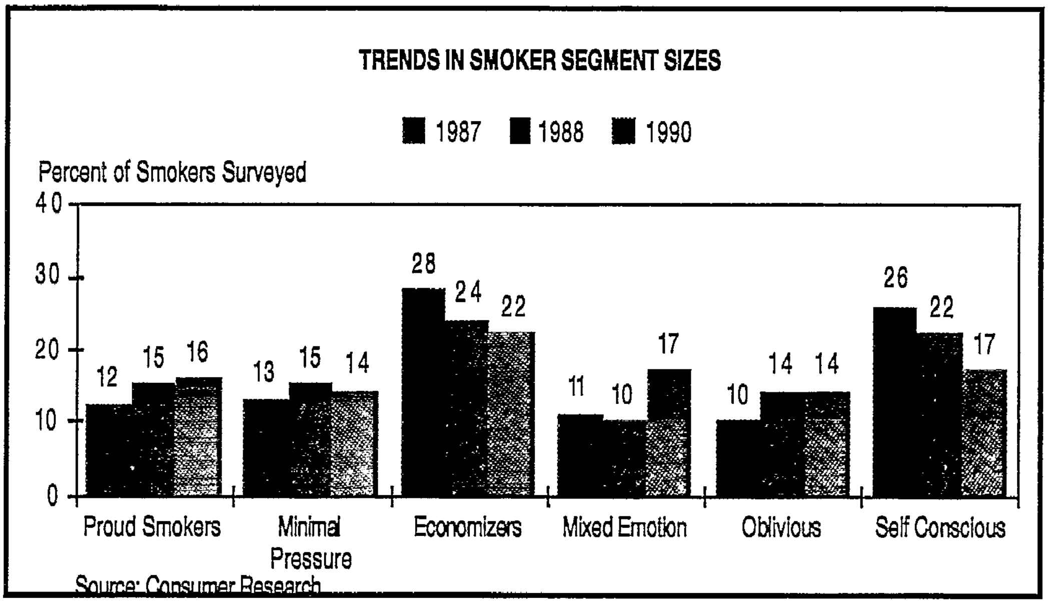
## Smokers' Attitudes

In terms of smokers, the following graph indicates that the percent of people who identified themselves as "proud smokers" actually increased, while "self conscious" smokers decreased. This suggests an increase in committed smokers that choose not to quit despite continued social pressure. Those classified as "mixed emotions" also increased, indicating that many smokers are becoming ambivalent and more sensitive to anti-smoking efforts.




These findings will have implications for the tobacco industry in terms of potential new product categories. Cigarettes which meet the desires of smokers, while accommodating non-smokers, could provide potential volume gains, although to date products with such attributes have been generally unsuccessful.

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THE COMPANY
PLAN

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# THE PHILIP MORRIS USA MISSION STATEMENT

## ONLY BEING BETTER WILL KEEP US FIRST

The mission of Philip Morris U.S.A. is continued growth in volume, market share and income. To succeed we must have the best brands and marketing programs, the best people, quality products, and efficient, low cost production. We must encourage an approach to business where risk-taking, innovation and quick response are combined with financial discipline. Central to this mission is the defense of our right to market our products and of the adult consumer's right to enjoy them.

**To fulfill this mission, we are committed to the following goals:**

- Build volume, market share and profitability.
- Preserve and enhance the competitive spirit and commitment which make us the number one tobacco company in the USA.
- Employ superior people and provide a challenging work place that encourages, recognizes and rewards personal initiative.
- Earn the trust, respect and loyalty of our consumers, customers and employees.
- Create strategically sound long term plans and be committed to effectively implementing them.
- Develop technologically advanced facilities and products that service consumer desires and therefore meet customer needs.
- Manufacture the best cigarettes in the world and through marketing, let the world know we do.
- Fight for a social environment in which the adult choice to smoke is respected and our right to market is preserved.
- Be cost conscious and efficient in all aspects of business.
- Maintain the highest legal, moral and ethical standards in everything we do.

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# BUSINESS OBJECTIVES

## I. GROW INCOME AND CASH FLOW — Weighting 50%

$ Billions

| | 1989 Actual | 1990 Actual | 1991 | 1992 | 1993 | 1994 | 1995 | CAG 90-95 |
|---|---|---|---|---|---|---|---|---|
| Operating Income | 3.6 | **4.2** | 4.8 | 5.4 | 6.0 | 6.9 | **7.8** | 13.2% |
| After tax Cash Flow | 2.1 | **2.5** | 2.9 | 3.3 | 3.7 | 4.2 | **4.7** | 13.5% |

## II. ACHIEVE AGGRESSIVE SHARE TARGETS — Weighting 30%

| | 1990 | 1995 |
|---|---|---|
| Total PM-USA Share | 42.3% | 49.6% |
| Total PM-USA Share of Full Margin Category | 46.2% | 58.3% |
| Total Marlboro Brand Share | 26.0% | 29.1% |
| Total PM-USA Share of Price/Value Category | 25.9% | 32.1% |
| Total PM-USA Share of Price/Value by Segment | | |

| | 1990 | 1995 |
|---|---|---|
| Branded Generics | 32.1 | 38.1 |
| Sub-generics | 24.9 | 31.1 |
| Black & White | 18.3 | 23.7 |
| PV 25's | 17.4 | 20.0 |

## III. INCREASE UNIT VOLUME — Weighting 20%

Units in Billions

| | 1989 Actual | 1990 Actual | 1991 | 1992 | 1993 | 1994 | 1995 | CAG 90-95 |
|---|---|---|---|---|---|---|---|---|
| Industry | 523.6 | **521.8** | 507.9 | 495.3 | 479.0 | 467.1 | **455.5** | (2.7%) |
| PM-USA | 219.5 | **220.5** | 221.3 | 224.0 | 225.0 | 225.7 | **226.0** | 0.5% |

**Total Weighting 100%**

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It is PM-USA's Plan to attain objectives I though III while maintaining the competitive advantage of the Company's full margin trademarks. This will be accomplished by reversing the industry practice of relying almost exclusively on declining full margin brands for profitability to fund aggressive competition for volume growth from price/value offerings.

- Use promotions and new line extensions to attack competitive full margin brands, forcing competition to spend aggressively to defend their largest source of profits.
- Accelerate price/value pricing to narrow the list price gap between full margin and discount brand list prices.
- Lower our marketing investment in the price/value category providing competitors the opportunity to do likewise.

As a result, price/value promotional levels will grow more slowly thereby improving price/value margins, competitors will have room to meet volume and profit goals primarily through growth in their price/value offerings, and PM-USA will accelerate its share of full margin while slowing the decline of this price category.

# INCOME STRATEGIES

## Pricing Increases

The tobacco industry has traditionally implemented semi-annual price increases, one at mid-year and one at the end of the year. Average revenue per thousand increased 8.8% annually during the period 1985-1990. The plan for 1991-1995 assumes that this pricing practice will continue on full margin brands. Annual full margin price increases are projected to be $5.00 in 1991 and 1992, rising to $6.00 in 1993, 1994, and 1995. A new PM-USA pricing strategy is to lead upward pricing pressure in the low price categories, while stabilizing full margin pricing. The plan is to reduce the price gap between full margin and discount brands. PM-USA will start by taking an additional $2.50 per thousand increase on branded generics and $3.00 per thousand on sub-generics out of cycle in March 1991. In addition, annual price increases on branded generics and sub-generics are projected to be $6.00 in 1991 and 1992, rising to $7.00 in 1993, 1994 and 1995. Pricing actions for FVB will be structured to ensure that the retail price of our black and white/private label products is comparable to the lowest priced branded products in the industry. With this pricing, the average revenue per thousand will increase 10.2% annually during 1990-1995.

## Cost Efficiencies

PM-USA plans to become the most efficient, highest performance manufacturer in the tobacco industry during the next five years. This will be done with better production planning, increased production speeds, reduced labor, lower conversion costs and wrapping material economies. Other efficiencies will be realized throughout operations as a result of the implementation of the supply chain initiative to integrate business systems. Synergies within Philip Morris Companies Inc. will be aggressively sought through Purchasing Council participation to realize savings in materials procurement.

## Overhead Control

During the plan period, overhead costs will be carefully monitored and controlled. Adjustments will be made to the organizational structure and related head count to suit changes in the way the business is managed. Major gains will be made in productivity savings through factory consolidation and modernization. A new fixed cost philosophy will be adopted that emphasizes the need to be competitive in overhead cost management. A functional analysis will be done in 1991. Efforts will be made to flatten selected departmental organizations where current vertical structures impede decision making and program execution. Resource management will be a top priority, with a focus on productivity and management information systems to upgrade performance without increasing overhead. In addition, export related fixed costs will at least be held to inflation.



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# SHARE STRATEGIES

## Marlboro

The number one cigarette brand, Marlboro, will improve upon its leadership position during the plan period, reaching a market share of 29.1%. Existing Marlboro business will be maintained through strong image reinforcement and value added promotional programs. A marked increase in promotional activity will be used to both offensively and defensively support the brand. A special effort will be made to attract young adult smokers through a Marlboro medium line extension and a more contemporary look for Marlboro imagery. A second line extension, along with continued growth of Marlboro Lights, will contribute new business among older smokers at the expense of the competition. The Marlboro brand family will receive increased marketing support, with particular emphasis on value-added retail promotions. Both trade class and regional focusing will be employed to maximize Marlboro's competitive advantage.

## Other Full Margin

The market share declines of our other full margin brands are expected to continue. However, every effort will be made to minimize the decline and revitalize these franchises. Regional marketing approaches will be implemented to promote each brand family in their strongest geographic areas. Media, promotions, and merchandising will be designed to attract adult smokers under age 35 and minimize outswitching to price/value brands. In addition, each of the these brands will launch line extensions to capitalize on their trademark equity. Benson and Hedges will introduce a king size version in 1992 to appeal to young adult males and ethnic smokers who are seeking a sophisticated, upscale cigarette. Merit will extend its offerings in the ultra low tar segment with Merit Ultima in 1992 and Merit Ultima Menthol in 1994, "best of the lowest." Virginia Slims will also line extend with a luxury length product in 1993, which may be a value product.

## Price/Value

The price/value category will continue to grow during the next five years. Price is expected to remain the major competitive advantage relative to full margin offerings; however, within the category, image and retail positioning will help differentiate our brands from those of the competition. PM-USA's share of the category will come from building four distinct price/value positionings: Cambridge - flavorful branded generic of choice; Bristol - the best of the lowest priced brands; Bucks - full flavor branded generic for young adult smokers; and Alpine - the leading branded generic menthol. Our products will be priced competitively, but will not alleviate price competition in the category.

# VOLUME STRATEGIES

Unit volume growth will be achieved through full margin line extensions and continued price/value growth. Each of the major PM-USA full margin brands will introduce at least one new line extension over the next five years, with two line extensions planned for Marlboro. A key element of the volume strategy is to avoid the typical U.S. cigarette industry "old brand" annual decline rate of 10%. PM-USA's focus on the strength of our full margin trademarks through both line extensions and strong promotional programs is designed to rejuvenate our "older brands." A major new product development or a technological breakthrough might create additional unit volume during the plan period. However, this volume would be incremental to the Five Year Plan forecast.

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# MACRO ISSUES

A series of key issues transcend individual, departmental functions within PM-USA and set the stage for the future of the domestic cigarette industry in general and PM-USA in particular. These issues emanate from changes that have occurred internally and externally to PM-USA during the past decade and are expected to continue to affect the business during the plan period. The purpose of this broad based issues review is to provide the context within which the Five Year Plan has been conceived.

## INDUSTRY

The tobacco industry is characterized as mature and declining, yet with relatively high margins for a low cost consumer product. Entry and exit barriers are considered to be high. The outcome of a decision by one firm is affected by the reaction of its competitors. The ability of the industry to enjoy its financial success may be affected by a singular strategic move by one member which seizes competitive advantage away from another.

During the 1980's, two firms made such moves. First, Liggett established the black and white segment in 1980, creating a non-branded low price category in an industry of brands and consistent pricing. Then in 1984, R.J. Reynolds made a another price move with Doral, introducing a discount product with marketing support and a dependency on trademark recognition. These competitive moves radically changed industry pricing and related profitability, creating a permanent discount cigarette segment with lower margins known as price/value that threatens to turn cigarettes into a commodity with little differentiation.

Another major industry change has been in company structure. While the companies were originally founded and established as tobacco firms manufacturing cigarettes, today not one company is solely dependent upon its tobacco business. The industry conglomerates of today are subjected to non-tobacco influences and all the implications of owners and directors who have multi-dimensional business interests. While domestic tobacco continues to provide strong cash flow for each firm, it is not viewed as the only long term business interest of any of the six companies.

The future of the tobacco industry is viewed more positively in the international arena, particularly by Philip Morris Companies Inc. and BAT. Both the growth of the export cigarette business and the opening of new markets in Eastern Europe, Russia, and Asia support International cigarette industry expansion. There are also two other international influences that will impact the domestic business during the plan period -- JTI and Pharmacia. JTI has been marketing its Mild Seven brand to Asians in major urban areas in the United States, while Pharmacia has been selling nicorette gum and patches as cigarette equivalents in all domestic markets. Both firms were not considered to be part of the domestic industry in the 1980's, but they are expected to play a role in the 1990's.

## SOCIETY

Cigarette smoking is no longer viewed as the pleasurable, sophisticated adult custom it was considered in the 1950's and 60's. Smoking has evolved from a majority adult habit to a minority act, enjoyed by a weakened social constituency. In contrast to the white adult middle and upper class male smoker who typified the consumer thirty and forty years ago, the smoker of today is likely to be an uneducated blue collar worker, an elderly lifetime smoker, a foreigner, a woman, or a minority. Consequently, the political and social base of the smoker has eroded and opinion leaders have begun turning against the industry, supporting legislation, litigation, and non-profit anti-smoking groups that seek to restrict when and where a consumer can enjoy a cigarette.



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The social pressure on smokers is expected to continue during the next five years. Product innovation responsive to social concerns of the alleged health effects of cigarettes on smokers' and non-smokers' health could help deter further anti-smoking laws and restrictions. R.J. Reynolds and PM-USA are actively working on alternative smoking devices that provide pleasurable smoking experiences, address consumer concerns about health risks and social acceptability, and are profitable business ventures. One of these products may be commercialized in the final years of the plan period.

## PM-USA

PM-USA reached industry leadership in 1983 and has maintained the number one position ever since. PM-USA has continued to widen the gap with its nearest competitor, RJR. This PM-USA momentum is expected to continue during the plan period, reaching a 50% PM-USA share target by 1995. The implications of a large industry share in a declining market are many, including industry consolidation, severe price competition, possible margin reduction and excess capacity. The nature of the product demand by 1995 will play a key role in determining the profitability and the future viability of the business. Ideally, as industry volume declines, and PM-USA seizes a larger share, consumer demand will be concentrated in the full margin segment.

The future success of the PM-USA full margin franchises, particularly Marlboro, will help determine long term company strength. The near term management of the Company's participation in the price/value category in a way that does not accelerate consumer acceptance of discount product is key to maintaining the volume viability of the full margin segment. In addition, PM-USA could extend the life cycle of the cigarette business by developing and successfully introducing a technologically advanced smoking device that is difficult and costly to imitate.

## PRICING

Price increases continue to provide a major source of income growth for the cigarette industry. Prior to 1982, the industry enjoyed modest price increases with cigarette prices growing at a rate below or equal to the CPI. Beginning with the June 1986 price increase, an acceleration in price was initiated by competitors in response to declining unit volume and a changing sales mix favoring price/value.

The magnitude of future price increases must be viewed within the context of the potential impact on demand. While historically cigarette sales have been relatively immune to economic influences, the rapid acceleration of the price/value category suggests that a segment of the smoking population is driven by price considerations.

Recognizing that the price/value category has had an adverse impact on financial performance by shrinking the full margin category, PM-USA will implement a strategy to reduce the incentive for consumers to trade down to lower priced cigarettes. This will be achieved through leading upward price pressure in the low priced categories, while stabilizing full margin pricing. The gap between the lowest and highest priced products will be reduced from 44% in 1990 to 32% in 1995.

It is important to recognize the impact of strategic actions which these increases make available to competitors. First, competitors with lower income growth targets will gain increased financial flexibility which potentially could be used for additional marketing expenditures. Second, accelerated price increases may result in the initiation of a new price tier. As profit margins have become high, it has been profitable for some manufacturers, whose sales are declining, to market cigarettes at a discount. A manufacturer with excess capacity incurs little expense in running extra production. In addition, a manufacturer that comes to market early with a new low price gains a competitive advantage over other manufacturers that are not ready with a competitive response.

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# MARKET

The domestic cigarette market will become increasingly fragmented. It has evolved from a national orientation of major leading brands to one of regional and local sectors. At the same time, packs have proliferated, and multiple price points have been established. Consequently, the industry marketing approach has changed from one based primarily on media imagery to one focused on product promotion and in-store merchandising.

At the same time, the distribution community has shrunk to a smaller number of distributors who carry more and varied stock keeping units. Distribution consolidation is expected to continue in the future. On the one hand, consolidation yields fewer accounts to deal with, but greater numbers of SKU's makes cigarettes only one of a number of distributor product offerings. Direct retail accounts are also increasing, providing more efficient distribution from cigarette manufacturer to retailer.

At retail, there is a changing universe with new types of outlets gaining in importance: super stores, convenience stores and hostile stores. The super stores grew up on the West Coast and are making their way East. These stores stress volume buying, particularly by the carton. The convenience stores, on the other hand, find their greatest strength in PM-USA's forte -- sales by the pack, or a greater number of smaller size transactions. Both super stores and convenience stores generally appreciate the solid income they receive from cigarette sales. But, at the other extreme is the growing phenomenon of the hostile outlet. These are retail establishments that reluctantly carry cigarettes. They have been unduly influenced by the anti-smoking movement.

Anti-smokers continue to advocate a smoke-free society. One of their strategies is legislative restriction directed at the tobacco industry's ability to market its products. The industry in general and PM-USA in particular will continue to actively work to minimize government interference in our business and marketing strategies throughout the plan period.

# CONSUMER

The cigarette consumer is changing. The smoker is characterized by new demographics in terms of age, sex, race, and income and educational levels. The typical smoker during the plan period will be an aging "baby boomer" that is accustomed to brand proliferation and varied pricing levels. He or she is no longer chiefly concerned about the risks associated with smoking. However, these same smokers have developed a sensitivity toward non-smokers and anti-smokers. They have internalized the anti-smoking climate and no longer expect to enjoy smoking everywhere they go.

During the last decade, the consumer abandoned the tar dynamic for the price dynamic. However, as smokers age, they often do move down the tar spectrum. The move tends to be a studied one as the consumer reluctantly embraces the sensory sacrifice that has traditionally characterized lower tar cigarettes. It is a question of balancing the sensory costs with perceived health benefits.

The smoker of today is generally accustomed to lighter tasting products. The fact that they started smoking with filter cigarettes gives them a milder base or frame of reference than their parents. Consequently, there is a good possibility that they will embrace an ultra low tar as a viable choice by 1995, causing this relatively new and non-dynamic category to experience faster growth in the late 1990's.

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## PRODUCT

The first machine made cigarette was a non-filter Camel made by RJR in 1913. The product stayed virtually the same until the 1950's with the advent of the filter. That was the last major product change in the industry. Numerous attempts have been made to introduce other new products with unique features in the last 40 years. Many of the most recent modifications have been influenced by environmental and social concerns. Concepts like Premier, low smoke, and low or no odor intuitively seem like good new product ideas, but none of them have met with commercial success. The consumer has expressed an interest in tar and nicotine reductions, but these are viewed as minor adjustments to existing brand families -- not real product differentiation.

During the plan period, there is a possibility that a new smoking article will be introduced into the market. It would provide smoking pleasure, but offer product benefits above conventional cigarettes. Both the product and its packaging would address environmental and social concerns, but in a revolutionary way. The product would be preemptive and address competitive product attributes, those of non-cigarette products like chewing tobacco, chewing gum, nicorette gum, coffee/cola and alcohol providing a simple low cost pleasure, but without the alleged health risks to smokers and non-smokers of today's cigarette.

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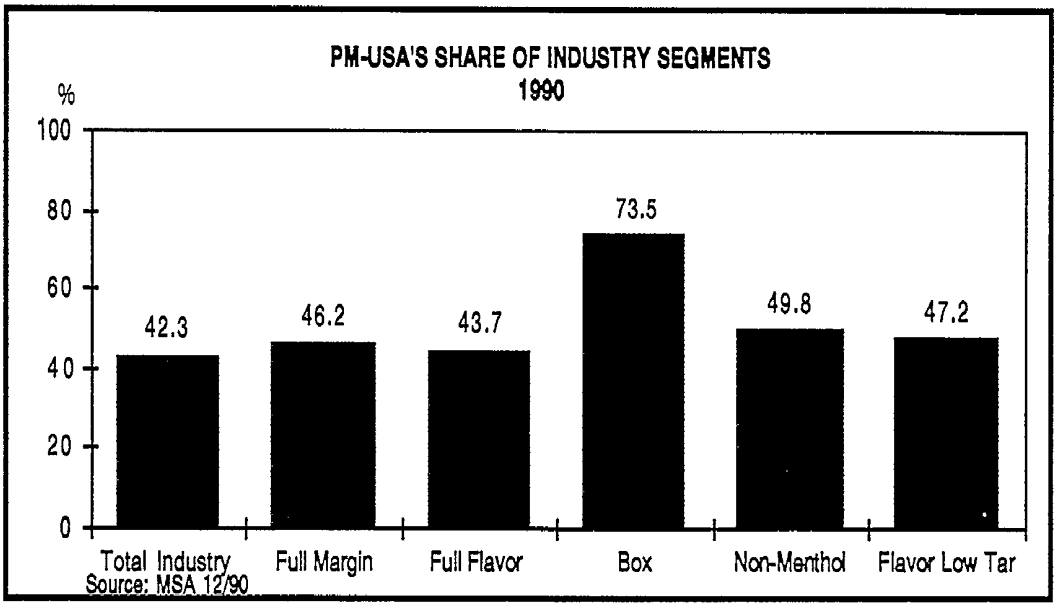
# PM-USA

PM-USA has been the number one cigarette manufacturer in the U.S. since 1983 when it surpassed RJR. In 1990, with a market share of 42.3%, PM-USA accounted for 43% of estimated industry revenues and almost half of estimated industry operating income. The Company's operating margin of 40.6% was the highest in the industry due to a favorable volume mix and marketing and operating efficiencies.

## REPRESENTATION IN KEY INDUSTRY SEGMENTS

PM-USA produces four of the top ten brands in the U.S. cigarette industry. Marlboro continues as the number one selling cigarette brand, while Benson & Hedges, Merit and Virginia Slims are currently numbers 8, 9 and 10, respectively. In addition, the Company has the leading share of several key industry segments, including full margin, full flavor, box, non-menthol and marketed low tar. PM-USA's demographic profile is also the strongest in the industry, with a 57.1% share of adult smokers under age 35, primarily due to Marlboro (43.6%). In contrast, RJR's strength is among smokers over age 45. PM-USA continues to improve its performance among older age cohorts and, in 1990, its share among 35-44 year olds exceeded RJR's for the first time.

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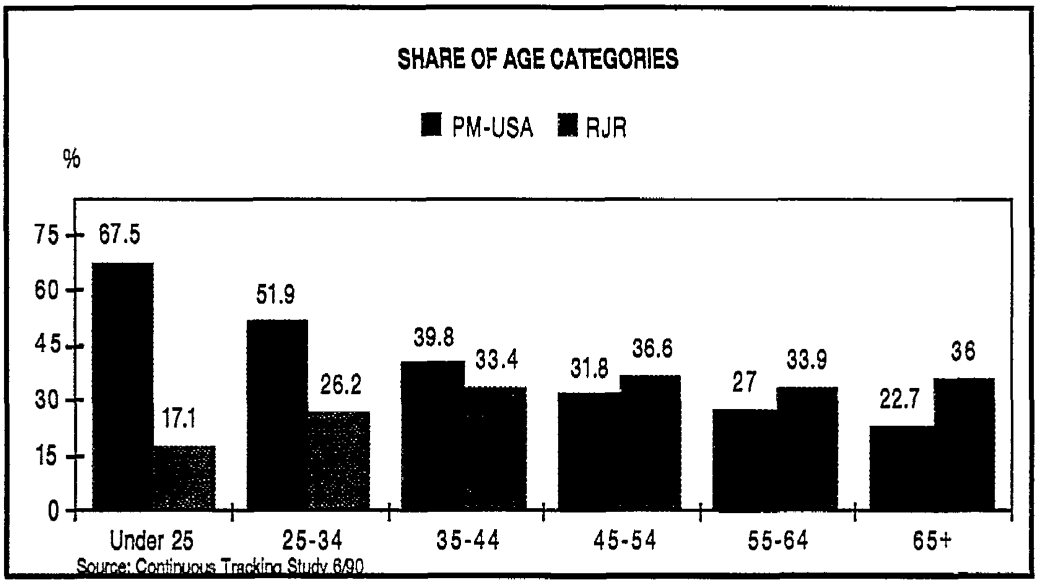
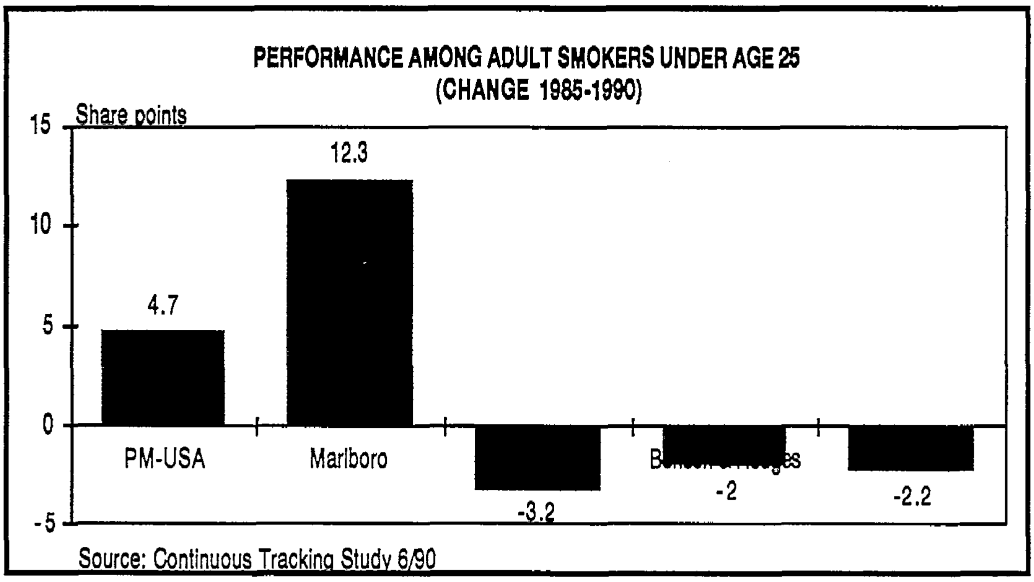


Source: Continuous Tracking Study 6/90

A major area of concern for PM-USA is that, aside from Marlboro, its brands' appeal among young adult smokers has been declining. B&H's, Merit's and Virginia Slims' older demographic profiles make them particularly vulnerable to price/value inroads. During the plan period, line extensions and marketing strategies will be developed to address these weaknesses and improve PM-USA's position in industry and demographic segments where it is currently underrepresented. The Company plans to improve its performance in the menthol category, especially menthol 85's, the ultra low tar category and the price/value segment as shown in the graph on top of the next page.



Source: Continuous Tracking Study 6/90

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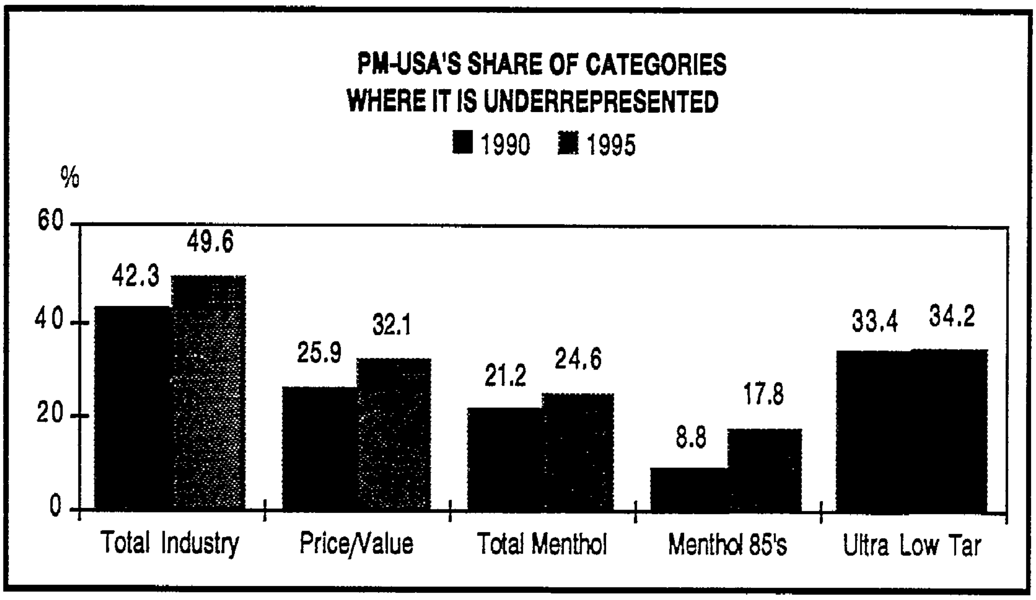


During the plan period, PM-USA will place considerable emphasis on the more profitable full margin segment, where the Company is already well represented with a 46.2% share. Our share of this category is projected to grow 12.1 share points, reaching 58.3% in 1995. PM-USA's full margin performance is forecasted to outpace the industry's, with volume declining an average of 1.8% annually compared to 6.3% for the industry. Marlboro's volume is forecasted to decline only 0.4% annually, mainly as a result of two line extensions – one scheduled for June 1991 and the second for June 1993. All other PM-USA full margin brands are expected to decline at rates lower than the industry during the plan period.

**PM-USA SHARE OF CATEGORY**

| | Full Margin | Price/ Value | Total Industry |
|---|---|---|---|
| 1990 | 46.2% | 25.9% | 42.3% |
| 1991 | 47.9 | 29.0 | 43.6 |
| 1992 | 50.6 | 29.3 | 45.2 |
| 1993 | 53.6 | 30.1 | 47.0 |
| 1994 | 55.9 | 31.1 | 48.3 |
| 1995 | 58.3 | 32.1 | 49.6 |
| Diff. 1990-95 | +12.1 | +6.2 | +7.3 |

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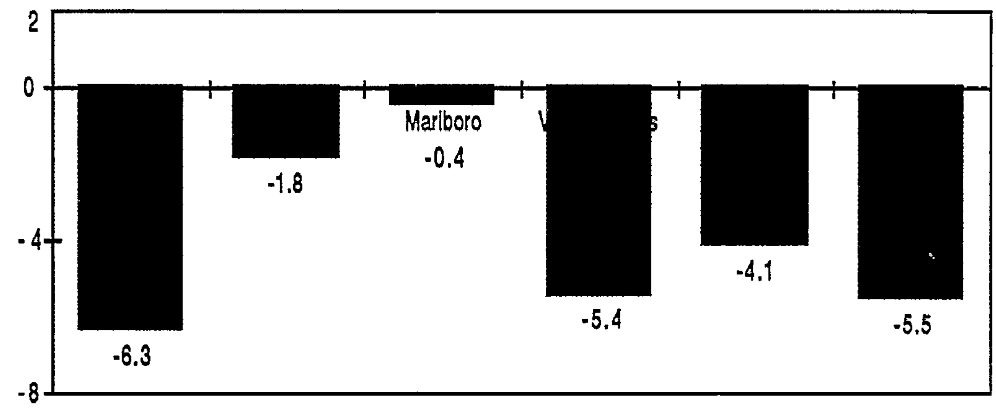
**PROJECTED FULL MARGIN VOLUME PERFORMANCE**
**(1990-95 C.A.G. %)**




In the price/value segment, PM-USA will also outperform the industry, with volume growing 13.3% per year versus 8.5% for the industry. PM-USA's branded generics will increase from 17.4 billion units in 1990 to 27.8 billion in 1995, while our sub-generic volume is projected to more than triple, reaching 16.1 billion units in 1995. Projected shares of the various price/value subsegments are outlined below. We do not plan to participate in the price-off subsegment.

**PROJECTED PM-USA SHARE OF PRICE/VALUE SUBSEGMENTS**
**(%)**

| | 1990 | 1995 | Difference 1990-95 |
|---|---|---|---|
| Black & Whites | 18.3 | 23.7 | +5.4 |
| Branded Generics | 32.1 | 38.1 | +6.0 |
| Value 25's | 17.4 | 20.0 | +2.6 |
| Price-off | 0 | 0 | NC |
| Sub-generics | 24.9 | 31.1 | +6.2 |
| Total P/V | 25.9 | 32.1 | +6.2 |

## PM-USA'S ROLE IN THE CORPORATION

PM-USA plays a unique role within Philip Morris Companies Inc. as the major income and cash generator. This role is significant as it enables the Corporation to retire debt from past food company acquisitions and to pay for future acquisitions. PM-USA must, therefore, assure that its income stream is maximized during the plan period and beyond to meet the cash requirements of the Corporation.

The recession resistant character of the cigarette business has helped provide a stable cash flow. PM-USA cigarettes have broad based appeal, leading the domestic cigarette industry in volume and share. In addition, Marlboro continues as the number one selling cigarette brand both here and abroad. It is a full priced, high margin brand, contributing 65.9% of PM-USA's 1990 marginal contribution.

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Besides providing income and cash flow to the Corporation, PM-USA offers production and purchasing synergies to other operating companies. Philip Morris International enjoys income growth from expanding exports of American made cigarettes produced for PMI by PM-USA. Domestic research and development support, as well as technological advances are also shared with PMI. Miller Brewing and Kraft General Foods derive benefit from the materials purchasing of PM-USA.

## LONG-TERM ENERGY REQUIREMENTS

PM-USA, like every other manufacturing facility, requires access to steady, reliable sources of energy in order to operate. A company-wide Energy Task Force was established "to assist...in obtaining a reliable source of energy at a competitive price for consumption in an efficient manner." Much of the work of the Task Force during the next five years will focus on cost savings through corporate synergy.

PM-USA is an energy conscious company that consistently seeks ways to realize energy conservation and the related cost savings. In all of the manufacturing facilities, except the blended leaf plant, PM-USA has dual fuel capacity. This flexibility allows the Company to adjust to supply changes and related price fluctuations.

The preferred manufacturing energy sources are natural gas and coal. Both of these are readily available most of the time. The one exception is 30 to 60 days in the winter when temperatures drop below 30 degrees Fahrenheit and the local natural gas utilities in Richmond and Louisville are unable to meet the priority demand of homeowners. During such times, Philip Morris switches over to a fuel oil alternative. The one facility, the BL plant, that is natural gas dependent runs 50 weeks/year and is guaranteed an uninterruptable supply.

The one area where PM-USA has some exposure is electricity. This is the life line of the business and the most costly of the energy sources. All three states where we operate have an excess of installed capacity and do not currently experience brownouts. However, during the plan period, with increasing demands made on the utilities, electricity supply and cost could become an issue.

**1990 ENERGY SOURCE MIX AND RELATIVE COST**

| Energy Source | BTU's | $ |
|---|---|---|
| Coal | 54% | 20% |
| Electricity | 28% | 68% |
| Natural Gas | 11% | 8% |
| Oil | 7% | 4% |
| | 100% | 100% |

When the cost of manufacture, administration, and warehousing energy supplies are considered, PM-USA spends 12 cents/thousand cigarettes on the mix of energy sources. In 1991, a $5.00 increase in the price of a barrel of oil will cost Philip Morris $21.3 million.

In the future, PM-USA hopes to minimize its dependency on fuel supplies by considering co-generation. Park 500 is one location where internal generation is already possible. It was done for this particular operation because it runs 24 hours a day, 328 days per year, and has a high steam demand. But, PM-USA is continually looking at co-generation opportunities.

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Energy source availability and related price fluctuations also impact merchandising materials, transportation, and leaf processing. The Persian Gulf crisis of 1990 has caused crude oil prices to fluctuate wildly, rising to record highs on price speculation. This, in turn, has increased the prices charged for gasoline and related petroleum products for plastics and the like. However, the world supply is not totally dependent upon the Persian Gulf, especially Kuwait, having viable alternatives to develop and utilize in the future.

Consequently, given the relatively minor usage of oil for cigarette production and the availability of alternative energy supplies, energy sources will not have a material impact on PM-USA.

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DEPARTMENTAL
PLANS

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OPERATIONS

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# OPERATIONS

PM-USA production requirements will surpass installed factory capacities, due to the significant growth projected for our export markets. In 1995 export demand will reach 40% of total PM-USA production. In addition to the projected volume increase, the number of brands for domestic and export markets will also increase presenting significant challenges to Operations.

Last year's plan focused on the modernization of existing facilities to achieve productivity gains, as capacity was in balance with demand. This plan, which continues to realize productivity gains through performance improvements and distinct operations initiatives, will have as its primary focus the expansion of capacity to meet the export demand.

R&D will continue to dedicate considerable effort towards maintaining our world-class product base and providing the steady stream of new products necessary to meet changing consumer needs. Additionally, R&D will develop new technologies in the areas of expanded tobacco and sheet processes to address capacity shortfalls and improvement of subjective criteria.

PM-USA's quality level is considered the industry standard; however, this competitive advantage is threatened, and we will remain vigilant to guarantee leadership by initiating multiple programs.

Besides quality, costs are an important factor in the competitive environment. The 1991-1995 Plan includes a cost saving program of $517.6 million, which reflects contributions from every area of Operations.

Key issues to be addressed during the plan period are:

### Capacity

- Sales projections, based on the forecasts for domestic and export, will exceed installed cigarette manufacturing capacity by 43 billion cigarettes by 1995. The Cabarrus plant, originally constructed to accommodate expansion and having PM-USA's highest quality and lowest manufacturing cost, has been chosen for expansion to address this shortfall.

- Sheet capacity is insufficient for U.S. sourced cigarette production and increasing exports to Europe. A PM-USA/Europe task force will determine short-term alternatives, while a new cast leaf process is developed and tested. Europe is considered the most logical location for construction of cast leaf capacity.

- Expanded tobacco (ET) capacity is also strained by demand, and an additional line will have to be installed. New ET technologies will be added to this installation, time permitting.

- Shortfalls in each of these areas can and will be met in the short term by scheduling overtime and initiating aggressive productivity programs.

### Quality

In recent years, competitors have narrowed PM-USA's long standing advantage in quality, particularly in cigarette defects. PM's pack quality remains ahead of the competition. Our primary focus will be on improving cigarette defect levels by 50% to regain a clear quality advantage.

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## Cost/Productivity

Cost reductions of $517.6 million have been identified. Of this, $187.7 million will be contributed by improvement of manufacturing performance driven in particular by utilization gains of 1.7% per year and reduced reject rates of .3% per year. $211.4 million will be saved through implementation of a productivity initiative which focuses on streamlining the supply chain and consolidation of product specification. Capital programs reducing headcount and the factory expansion of Cabarrus will further reduce manufacturing costs by $79.2 million. Savings in fixed costs and reduction in production overtime, compared to 1990, will total $39.3 million.

## Safety

Providing a safe working environment continues to be a top priority. During the plan period goals have been established to measurably reduce the number of incidents and lost workdays for accidents. Specific action programs will be dedicated to improving our safety performance.

## Training

The aggressive goals in quality and productivity demand a greater emphasis on training than ever before. OSHA and EPA standards will require an increased level of compliance training. The currently scheduled 1.7% of manhours available for training will be increased to 3.5% to meet requirements and achieve performance objectives.

## Environmental Protection

Stringent Federal and State guidelines for pollution control require PM-USA to increase efforts in preventing, controlling and treating air and water discharges. Over the next five years, we expect to see these trends intensify, with a renewed emphasis on enforcing existing regulations and an increased emphasis on reducing emissions not previously regulated.

## Product Development

To support our leadership position, Research and Development will continue to develop new products incorporating benefits which satisfy changing consumer preferences and demographics, as well as implement programs to meet governmental regulations.

## Leaf Supply

Securing an adequate and reliable supply of leaf will continue to be a major issue, as the demand for American-blended cigarettes continues to increase around the world. The situation is particularly critical for burley tobacco, as present U.S. grown quantities are not sufficient to meet projected demands and surplus inventories do not exist. Offshore burley tobacco, as well as oriental tobacco, production also have to be increased.



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## Capacity - Cigarette Manufacturing

The 1990-1994 Five-Year Capacity Plan was based on reaching 334 billion units by 1994, which is the maximum practical capacity of our existing facilities: 140 billion at the MC, 85 billion at Cabarrus, 75 billion at Louisville and 34 billion at Stockton Street.

<u>1990-1994 Five-Year Plan</u>
(Capacity in Billion Cigarettes)

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Total PM-USA | 313.0 | 321.0 | 325.0 | 328.0 | 334.0 |

In 1990, volume growth increased sharply due to strong performance in Asia and the opening of Eastern Europe to imports. As a result, export volume significantly exceeded the forecast, reaching a level of 106.6 billion cigarettes, and driving total production demand to 336 billion units in 1990. This growth exceeded the capacity development program, which was limited to 313 billion units, requiring record levels of overtime. Accordingly, the program had to be advanced to reach the maximum capacity of 334 billion units by 1992, the earliest possible date.

The domestic forecast projects continued share gains despite an industry decline. Moderate volume growth will be achieved through line extensions for full margin brands and continued growth in the price/value segment.

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Domestic Sales (B) | 221.3 | 224.0 | 225.0 | 225.7 | 226.0 |
| Military Sales (B) | 1.8 | 1.6 | 1.5 | 1.5 | 1.5 |

For exports, base and upside scenarios have been developed on a country-by-country basis, taking political and economic conditions into consideration to project each market's growth potential.

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Export Sales (B) | | | | | |
| Base | 120.0 | 132.5 | 138.6 | 144.8 | 150.0 |
| Upside | 124.8 | 144.2 | 157.0 | 168.0 | 180.7 |
| Total Sales (B) | | | | | |
| Base | 343.1 | 358.1 | 365.1 | 372.0 | 377.5 |
| Upside | 347.9 | 369.8 | 383.5 | 395.2 | 408.2 |
| Capacity (B) | 323.3 | 334.0 | 334.0 | 334.0 | 334.0 |
| Capacity Shortfall (B) | | | | | |
| Base | 19.8 | 24.1 | 31.1 | 38.0 | 43.5 |
| Upside | 24.6 | 35.8 | 49.5 | 61.2 | 74.2 |

The shortages dictate an expansion strategy that accommodates the base forecast of over 40 billion incremental cigarettes by 1995 and also provides for the potential of reaching 75 billion units in the upside scenario. Should the upside scenario fail to materialize, 75 billion cigarettes will still be required to meet the base forecast in the year 2000.

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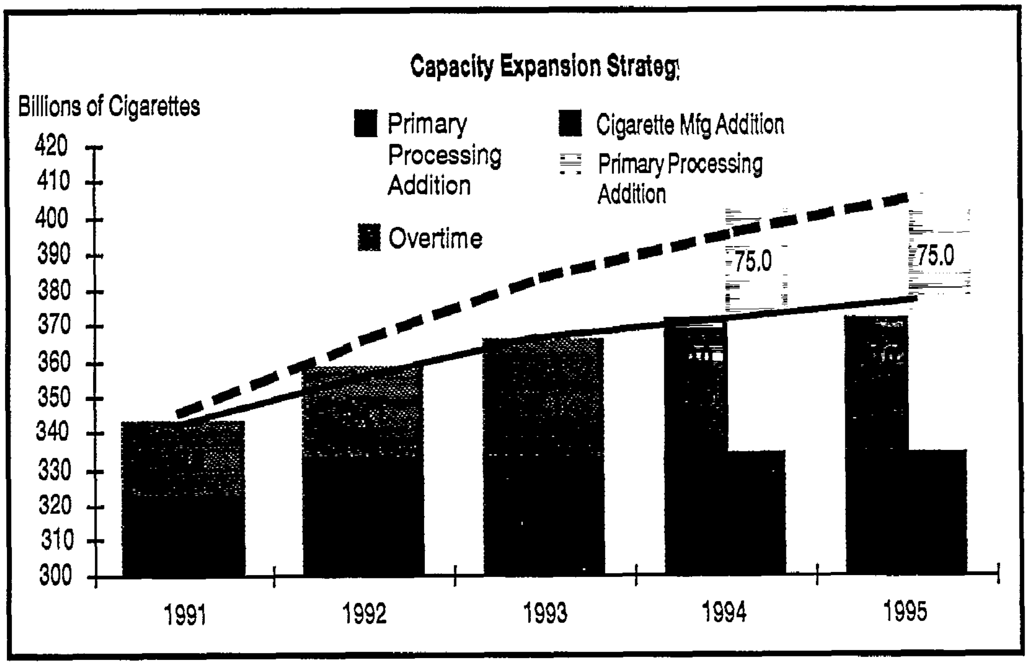
**Issue:**

CURRENT MANUFACTURING CAPACITY IS INSUFFICIENT TO MEET FORECASTED EXPORT REQUIREMENTS.

**Strategy:**

- Accelerate existing renovation and upgrade programs to ensure maximum capacity is increased from 313 billion in 1990 to 334 billion in 1992 instead of 1994. The capacity shortfall in the early years of the Plan will be made up by running selective overtime at all manufacturing facilities.

- In the long term expand the Cabarrus Manufacturing Center. Additional cigarette manufacturing capacity will be installed for 40 billion cigarettes, expandable to 75 billion. This expansion approach provides enough export capacity to meet the base five year plan needs of Philip Morris International. It also provides expansion capabilities to 75 billion incremental units by 1995, which will enable us to meet either future growth or the upside forecast.




| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Base Forecast | 343.1 | 358.1 | 365.1 | 372.0 | 377.5 |
| Upside Forecast | 347.9 | 369.8 | 383.5 | 395.2 | 408.2 |

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Action Plan:

1991-1992

- Free up primary capacity at MC by relocating export cut filler from MC to Stockton Street. (Mid-1991)
- Install high-speed equipment at MC Bay 1 by July 1991 to assure 140 billion make/pack capacity by 1992.
- Complete the installation of G.D. X-2 NV box packers at Cabarrus to balance box and soft pack production needs. (1992)
- Rebuild Cabarrus equipment to reach 85 billion cigarette capacity by 1992.
- Maintain optimal brand allocation to minimize production disruption. (1991-1995)
- Complete MC primary upgrade to meet cut filler capacity of 140 billion units. Until this production level is reached, the primary will implement overtime to guarantee 140 billion in cigarette manufacturing. (Mid-1993)

1993-1995

- Expand infrastructure and primary processing capacity at Cabarrus from 85 billion to 160 billion units. (Mid-1994)
- Expand cigarette manufacturing capacity at Cabarrus from 85 billion to 125 billion units. (Mid-1994)
- Add additional manufacturing equipment as required up to 160 billion units. (1995)

2048360330

**Capacity - Sheet Products**

A Reconstituted Leaf (RL)/Blended Leaf (BL) blend is an integral part of our product in the U.S. as well as in Europe. Presently, Europe receives 25% of PM-USA's output of sheet. The projected demand for sheet, driven by growth of PM-USA export production and higher cigarette production in our European factories, will exceed capacity both for RL and BL.

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**Issue:**

EXISTING CAPACITIES OF RL AND BL ARE INSUFFICIENT TO MEET DEMANDS.

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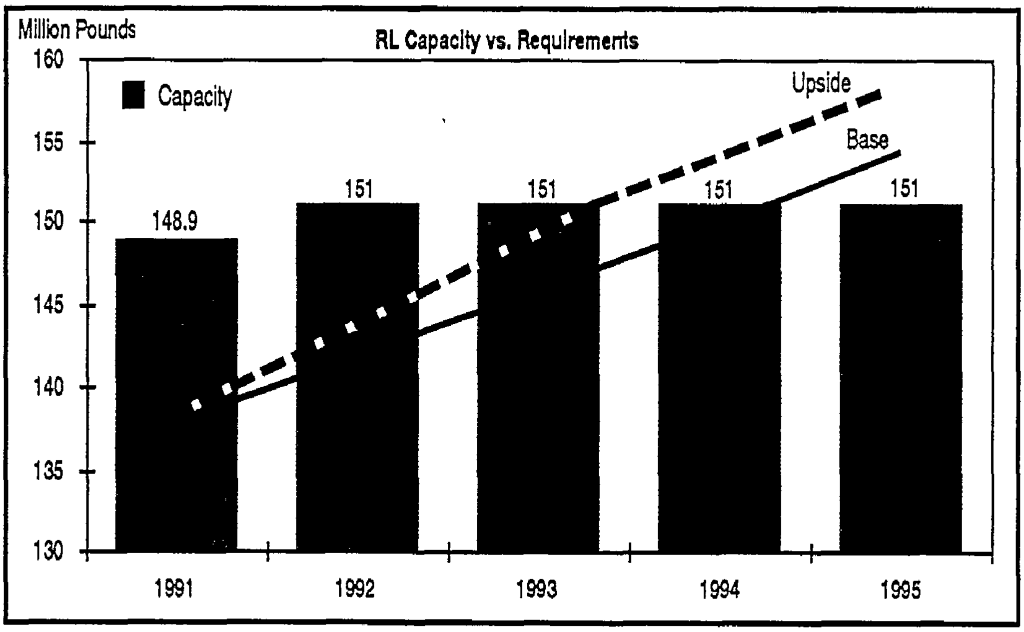
**Strategy:**

RL: Accelerate capital programs to achieve maximum capacity and limit shipments to Europe to 34.5 million pounds per year in order to delay a capacity shortfall to **1995**.




| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Upside | 139.4 | 144.5 | 149.2 | 153.8 | 158.6 |
| Base | 138.1 | 141.6 | 145.7 | 150.2 | 153.2 |
| Europe Export | 38.2 | 34.5 | 34.5 | 34.5 | 34.5 |

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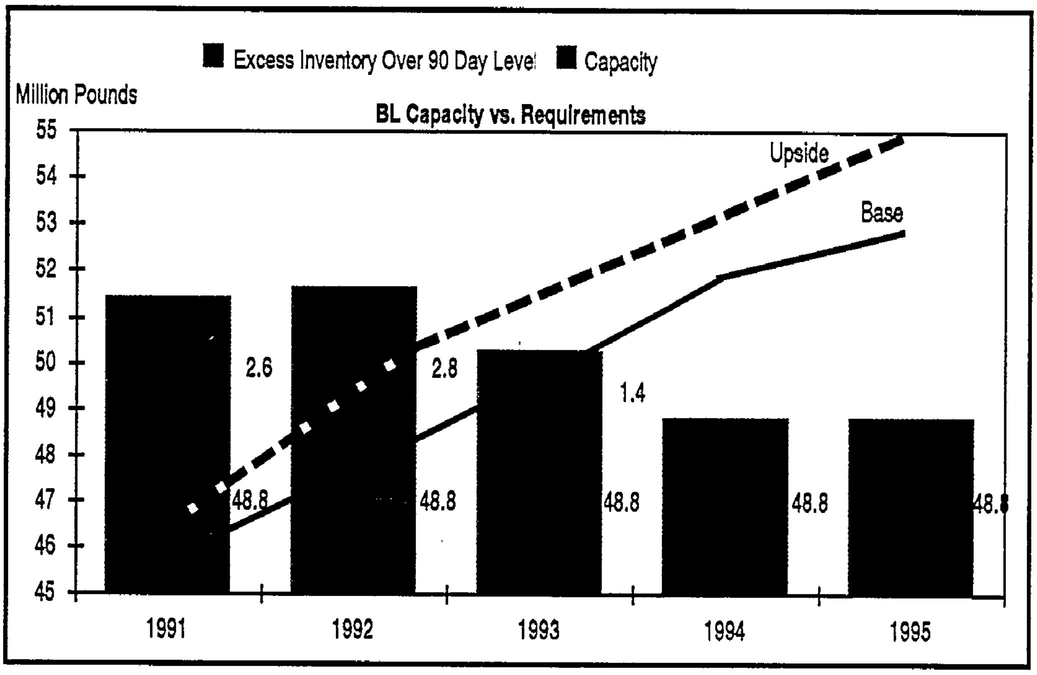
BL: The Richmond plant is our only source for BL production in the USA, where third party BL capacity does not exist. Inventories will be managed to delay the capacity shortfall until **1994.** The BL plant will run at full capacity in 1991 and 1992 in order to build up inventories.




| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Upside | 46.9 | 49.6 | 51.4 | 53.2 | 54.9 |
| Base | 46.4 | 48.4 | 50.0 | 51.9 | 53.3 |
| Europe Export | 5.4 | 5.6 | 5.8 | 6.0 | 6.0 |

RL/BL: Address sheet shortage with a USA/Europe task force, which will:

- Conduct a worldwide by-products availability analysis.
- Formulate an optimum sheet sourcing plan which will include the utilization of PM's BL plant in Venezuela and third-party RL capability.
- Assist third parties to match product subjectives with PM standards.
- Expedite development of an alternate, similar product, Cast Leaf.

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## Action Plan:

**1991-1992**

- Limit RL export to Europe to 34.5 million pounds, and have PMI contract the shortfall. (1991)
- Accelerate capital program ($30.7 million) at RL plant to achieve maximum capacity of 151 million pounds by 1992.
- USA/Europe task force to establish comprehensive plan for sheet sourcing. (1991)
- Manage BL inventories to gain time for CL development. (1991-1992)
- Develop CL process based on pilot plant test. (1991-1992)

**1993-1995**

- Construct CL plant in Europe. (1993-1994)



2048360333

**Capacity - Expanded Tobacco (ET)**

Two locations, Cabarrus and Richmond MC, produce all ET requirements. In 1990, the Richmond MC relied on 24 days of overtime and Cabarrus 21 days to meet requirements. Without expansion, the projected growth in requirements will result in 110 overtime days in both locations by 1995, which is not feasible.

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**Issue:**

EXISTING ET CAPACITY IS INSUFFICIENT TO MEET DEMAND.

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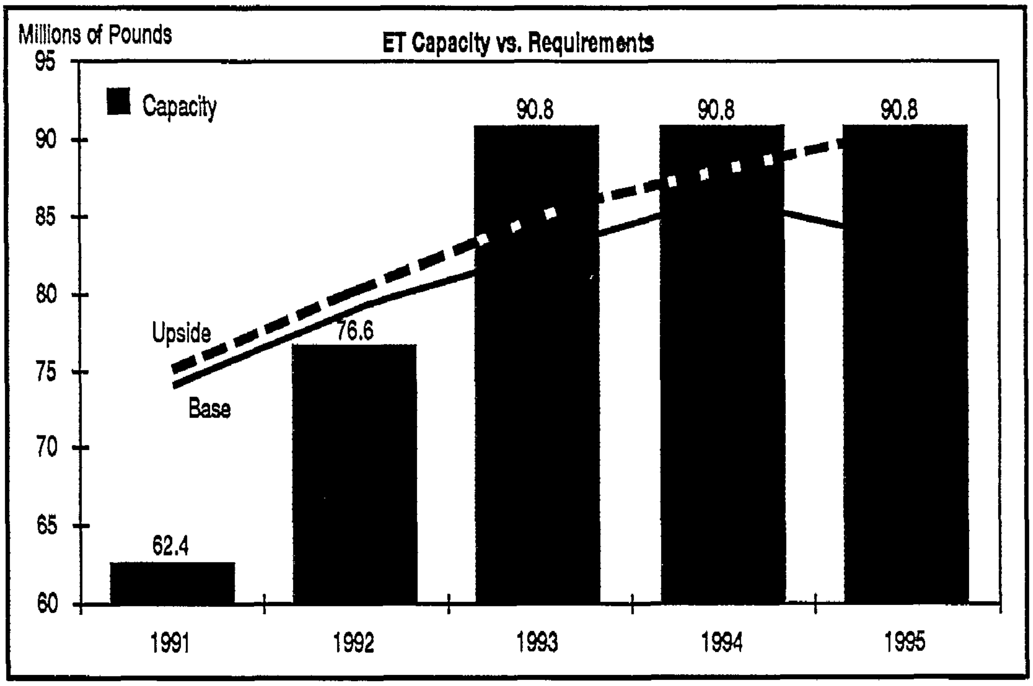
**Strategy:**

Install a second ET line in Cabarrus as space is available.




| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Upside | 75.6 | 81.4 | 84.7 | 87.6 | 90.9 |
| Base | 74.6 | 79.1 | 82.4 | 85.8 | 84.1 |
| Excess/Shortfall | (12.2) | (2.5) | 8.4 | 5.0 | 6.7 |

Base requirements for ET decrease in 1995 due to Europe exporting ET to Turkey.

---

**Action Plan:**

**1991-1992**

- Complete construction of a second ET line at Cabarrus. (Mid-1992)

**1991-1992**

- Continue overtime at MC and Cabarrus to meet requirements. (1991-1992)



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**Capacity - Export Cut Filler and Blended Strips**

Cut filler and blended strip blends are exported to affiliates and licensees overseas. Over the plan period, requirements for both products will double, with the main growth coming from exports to Turkey. As of 1992, the Turkish factory will be supplied cut filler over a three year start-up period, with a phase-in of blended strips thereafter. Sufficient blended strip capacity exists between a one-shift operation at 20th Street and contract manufacturing for the balance with Universal Leaf.

---

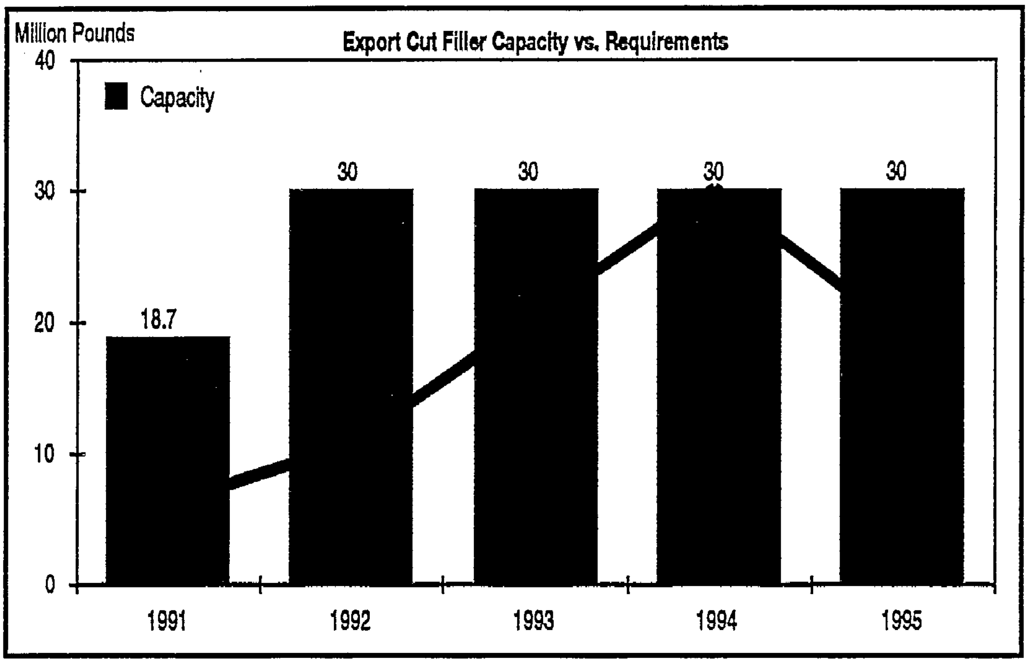
**Issue: Export Cut Filler**

CURRENT EXPORT CUT FILLER CAPACITY IS INSUFFICIENT TO MEET FORECASTED REQUIREMENTS.

---

**Strategy:**

Transfer export cut filler production from the MC to Stockton Street. This will allow the upgraded Primary at the MC to produce at its maximum capacity of 140 billion cigarettes. It will take full advantage of the idle third shift Primary at Stockton Street, where two Primary shifts produce sufficient cut filler for a full three shift cigarette manufacturing operation. Additional make pack capacity at Stockton Street is not possible due to lack of space and infrastructure.




| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Requirements | 7.5 | 11.3 | 21.9 | 31.6 | 17.9 |



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**Action Plan:**

**1991-1992**

- Complete installation of bagging and boxing operations at the Westab Annex of Stockton Street. (1991)

**1991-1992**

- Transfer cut filler production from MC to Stockton Street. (Mid-1991)

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**Issue: Export Blended Strips**

EXPORT BLENDED STRIPS WILL CONTINUE TO BE PRODUCED IN THE MOST ECONOMICAL MODE.

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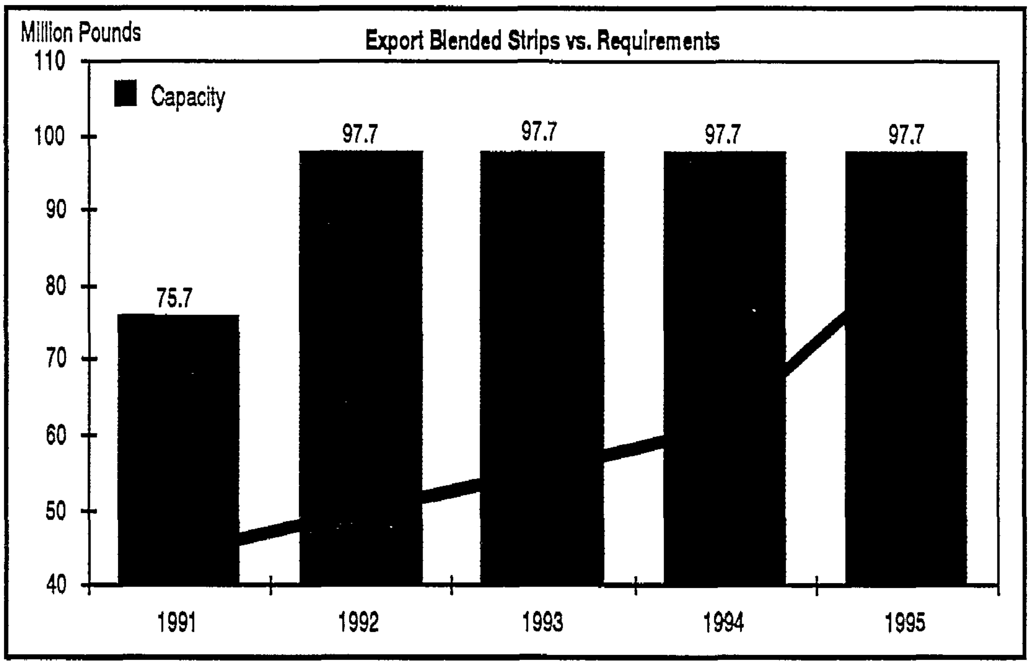
**Strategy:**

Keep one shift at 20th Street and contract balance to ULT facilities.




| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Requirements | 44.4 | 49.8 | 54.3 | 61.3 | 82.8 |

---

**Action Plan:**

**1991-1995**

- Run a one-shift operation at 20th Street as long as it is the most economical option for the company. (1991-1995)

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## Capacity - Other Processes

Expanded Stem/Improved Stem

With the installation of the new rotary Legg dryer (IS) at the end of 1990 in Louisville, IS (as well as ES) capacities are sufficient to meet requirements throughout the plan period.

Flavor Center

In order to meet projected requirements, the Flavor Center will install an additional 10,000 liter processing tank in 1991, increasing annual capacity from 4,700 million liters to 6,000 million liters. Dry flavor production will be relocated to the Flavor Center in 1991.

Louisville Materials Conversion Plant (LMCP)

The first prototype alternate path perforator will be installed in 1992 and will increase capacity beyond requirements. In 1991, the minor capacity shortfall will be met by overtime.

Bermuda Hundred

Production requirements for Bermuda Hundred could vary over the next five years until (or beyond) full capacity of 19.9 million pounds annually is reached. Contingency plans are being prepared to cover different operating scenarios, including budget and manning requirements.

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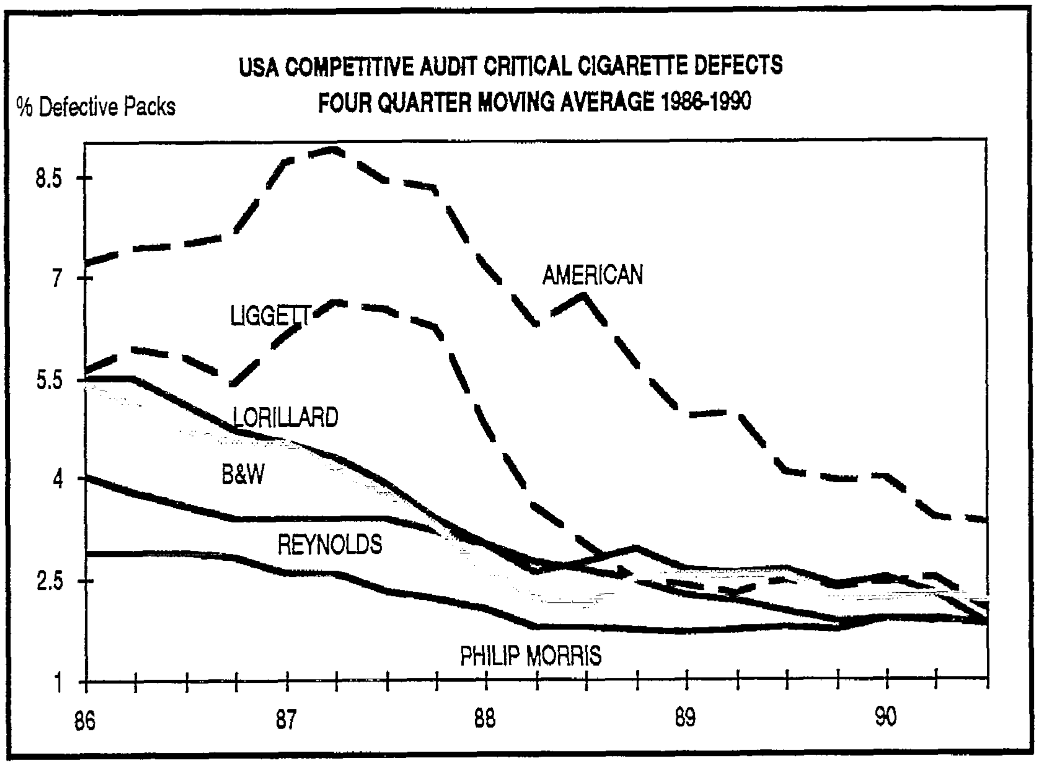
## Quality

The quality of our products has been, and must remain, a distinct, competitive advantage. Quality performance levels are measured in cigarette (product function) and pack defects.

Since 1988, PM-USA's quality position on cigarettes has plateaued, while competitors have significantly improved to match our quality performance.




The emphasis will be to reduce the cigarette defect level by 50% with particular focus on functional defects (void ends, torn rod, open seam, etc.) which are a major cause of consumer complaints.

Leadership has been maintained in the pack area, and we plan to strengthen it.



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**Issue:**

ALTHOUGH PM-USA'S QUALITY LEVEL IS THE INDUSTRY STANDARD, OUR COMPETITIVE ADVANTAGE HAS BEEN THREATENED AND MUST BE MAINTAINED.

**Strategy:**

- Realize the following aggressive Quality objectives:

  During the plan period, defect levels will be reduced as follows.

  - the critical cigarette defect level from 1.92% in 1990 to .98% in 1995.*
  - the critical soft pack defect level from 1.48% to .43%.*
  - the critical hard pack defect level from 1.41% to .54%.*

  *A critical cigarette or packaging defect affects the appearance and/or impedes the function of the product to an extent which is likely to be noticed by the consumer.

- The objectives will be achieved by implementing the following strategies:

  - Ensure consistent manufacturing practices throughout Operations.
  - Intensify training of the labor force and all levels of management.
  - Implement automated process controls to reduce functional defects.
  - Develop multiple quality tolerance levels to ensure appropriate quality levels for all market segments we compete in.

**Action Plan:**

**1991-1992**

- Consolidate materials and product specifications to reduce diversity. (1991-1995)
- Implement "Good Manufacturing Practices" in all cigarette factories and processing plants. (1991-1992)
- Develop an improved overall PM-USA maintenance program for cigarette and filter manufacturing equipment. (1991)
- Determine performance advantages of different quality standards for second and third price tier brands. (1991)
- Replace old generation equipment where target quality parameters are difficult to maintain (MC, Stockton Street). (1991-1992)
- Continue joint Sales/Operations efforts to improve handling and storage practices at wholesale and retail. (1991-1992)
- Certify "direct materials" suppliers and establish partnership programs. (1992)
- Increase quality awareness of supervisory and technical personnel through training on critical cigarette parameters. (1991-1992)

**1991-1992**

- Continue total quality program at Park 500 , extend approach to other Processing Plants, and evaluate applicability for Primaries. (1991-1995)
- Implement statistical process control (SPC) training as part of total quality programs. (1991-1995)
- Adapt offset printing capabilities to our products without any negative subjective impact. (1992)

**1993-1995**

- Complete Quality Assurance Standardization Program in all factories. (1993)
- Install vision systems (cigarette scanners and pack inspections) in all factories. (1991-1994)
- Conduct training programs tailored to the use of process control and vision systems. (1991-1994)
- Develop specifications for currently used adhesives. Modify adhesives to improve performance of high-speed equipment. (1993)



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## Cost/Productivity

Manufacturing cost per thousand has been steadily reduced in recent years on a constant dollar basis by factory consolidations and ongoing modernization programs. This trend will continue during the plan period with cost reduction programs designed to achieve savings of $517.6 million by 1995.

### Cumulative Productivity Savings 1991-1995

| | Savings in 1990 $ Million | |
|---|---|---|
| **Manufacturing Performance** | | |
| - Cigarette Manufacturing | 146.2 | |
| - Processing Plants | 41.5 | |
| | | 187.7 |
| **Productivity Initiative** | | |
| - Supply Chain | 139.2 | |
| - Cambridge Blend Change | 38.6 | |
| - 1991 Material Price Reduction | 26.0 | |
| - Specification Consolidations | 7.6 | |
| | | 211.4 |
| **Capital Programs** | | |
| - Headcount Reduction | 40.2 | |
| - Cabarrus Expansion | 39.0 | |
| | | 79.2 |
| **Variable Cost Savings*** | | 478.3 |
| **Fixed Cost Savings*** | | 20.3 |
| **Subtotal** | | 498.6 |
| **Production Overtime** (Fixed and Variable) | | 19.0 |
| **Total Savings** | | 517.6 |

* Excluding Overtime

The 1991-1995 cost reduction program reflects contributions from every area of Operations. It focuses on changing established practices to provide opportunities for cost savings. Excluding overtime, variable costs per thousand, on 1990 dollar basis, will decrease by $ 0.29 or 3.8%. Fixed costs per thousand will slightly improve over 1990 as most of the volume effect is offset by incremental fixed costs, particularly in the area of expenses associated with increased capacity (depreciation, utilities, equipment rebuild and Cabarrus project expenses). Compared to 1990, the cumulative costs for overtime will decrease, because overtime will be eliminated starting in 1994, upon completion of the Cabarrus expansion.

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## Cost/Productivity - Manufacturing Performance

### Issue:

PURSUE OPPORTUNITIES IN EVERY AREA OF OPERATIONS TO REDUCE MANUFACTURING COSTS.

### Strategy:

Realize aggressive objectives to improve factory utilization by 13% and to reduce rejects by 28%, driving cigarettes per labor hour up from 19.3 in 1990 to 21.2 thousand cigarettes in 1995. Focused training of the workforce, improvement of maintenance, and negotiation of flexible labor practices will be key to accomplishing these goals.

Composite goals to be realized are:

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Factory Utilization (%) | 67.4 | 69.4 | 71.4 | 73.2 | 75.1 |
| Rejects (%) | 4.2 | 4.0 | 3.8 | 3.5 | 3.1 |
| CPLH (000 cigs/man hour) | 20.0 | 20.3 | 20.5 | 20.9 | 21.2 |
| Direct Materials Waste (%) | 5.9 | 5.8 | 5.7 | 5.6 | 5.5 |
| Leaf Yield (%) | 100.1 | 100.3 | 100.4 | 100.5 | 100.5 |

### Action Plan:

**1991-1992**

- Establish overall PM-USA training plan. (1991) The plan will identify workforce skill deficiencies and critical job skills. All existing programs will be reviewed, adapted or replaced. Specific steps in 1991 will be:
  - Conduct needs analysis.
  - Review existing programs.
  - Establish baseline skills requirements.
  - Identify/develop assessment and selection criteria.
  - Develop an improved training program.
  - Identify and resolve labor issues.
- Review current maintenance practices and develop maintenance models for all factories. (1991) Specific steps in 1991 will be:
  - Meet with representatives from each cigarette factory and York Engineering to identify the "as is" maintenance situation.

**1991-1992**

- Develop "to be" maintenance model including approach to:
  - Machine cleaning
  - Preventative maintenance
  - Modifying machine to a standard (on and off floor)
  - Overhaul
  - Training
  - Documentation
- Conduct a test-case implementation of "to be" maintenance model to validate productivity improvements.

- Determine items impacting labor productivity. Main areas are job consolidation, competency-based training and subcontracting. Define Company positions and negotiation strategies for 1991-1992 labor contract negotiations. (1991)



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**1991-1992**

- Continue existing factory programs such as "Investment in Excellence" and "Continuous Improvement Model" to build a highly involved and business-oriented organization.
  - Periodically evaluate the factory programs to ensure effectiveness and consistency in direction. (1991-1995)
  - Implement group and individual productivity incentive systems to increase accountability. (1991-1995)
  - Initiate training for management of a diverse work force. (1991-1995)

**1993-1995**

- Implement PM-USA training plan throughout Operations. (1992-1995)
- Introduce final maintenance model to all factories. (1992-1994)
- Implement negotiated flexibility in labor practices. (1993-1995)

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## Cost/Productivity - Productivity Initiative

### Issue:

PURSUE OPPORTUNITIES IN EVERY AREA OF OPERATIONS TO REDUCE MANUFACTURING COSTS.

### Strategy:

Increase utilization of existing resources by restructuring the business systems comprising the Company's supply chain and consolidating product specifications.

The business environment in which we operate has changed significantly in the last five years. The supply chain, which covers order entry through delivery of product to the customer, has adapted to the changing needs in a vertical, non-integrated fashion.

PM-USA will restructure the business and information systems that comprise the supply chain in order to reduce cost and improve operations flexibility. Order consolidation of direct materials and inventory decreases in direct materials and finished goods will result in reductions in purchase pricing and transportation costs. Variable savings of $139.1 million are targeted over the plan period.

Other significant contributions to savings can be achieved through consolidation of product specifications. Where there are similarities, consolidation will be implemented. Particular candidates for consolidation have been identified and those with the highest potential will be changed in the first two years of the plan.

Additional programs are also being initiated to further reduce manufacturing costs.

### Action Plan:

**1991-1992**

*Supply Chain*

- Implement master production planning and improved factory scheduling. (1991)
- Streamline direct materials flow, certify suppliers and start partnership programs. (1992)
- Implement integrated bill of materials/ product specification systems. (1992)

**1993-1995**

*Supply Chain*

- Optimize finished goods management. (1993)

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### 1991-1992

*Specification Consolidation*

- Implement 20 identified projects to consolidate product specifications. (1991-1992)
- Extend project of specification consolidation to our direct materials vendors. (1992)

### 1991-1995

*Additional Programs*

- A PM USA-wide approach is being developed to reduce equipment changeover time by 75%. (1991-1994)
- A tobacco material balance method has been formulated which includes all steps in tobacco processing from purchase at auction through fabrication. The major areas of improvement in tobacco utilization are OTM waste in the Stemmery, Park 500 and Primaries. We will upgrade processes and develop new technologies to improve leaf yields. (1991-1995)
- Elimination of liquid adhesives for soft pack labels through the use of pre-applied heat seal:
  - Conduct machine tests. (3Q/91)
  - Set performance standards. (3Q/91)
  - Evaluate cost. (4Q/91)
  - Implement factory testing. (2Q/92)
  - Complete the program by extending it to closures, cartons, FTB blanks, etc. (1991-1993)
- Purchasing synergy programs, which will yield lower prices and improve quality, are being developed with PM Europe. Programs to combine tow purchases are nearing completion. Greater participation with KGF, particularly in the areas of folding cartons, adhesives and MRO purchases are being pursued. (1991-1995)

### 1991-1993

*Specification Consolidation*

- Pursue specifications consolidation opportunities on an ongoing basis. (1991-1993)



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## Cost/Productivity - Capital Investments

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### Issue:

PURSUE OPPORTUNITIES IN EVERY AREA OF OPERATIONS TO REDUCE MANUFACTURING COSTS.

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### Strategy:

Implement capital investment and modernization programs to improve PM-USA's cost structure.

Capital investments will be directed to attain headcount reductions of 300 employees, with the greatest savings coming from the Louisville Modernization Program (201 employees). In addition, composite manufacturing costs will decrease after the factory expansion in 1994 in Cabarrus, which is PM-USA's lowest cost producer.

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### Action Plan:

**1991-1992**

- Replace Mark-8's and AMF's with MK-9's and G.D. X's in Stockton Street. (1991-1992)
- Relocate Merit plug making from 20th Street to Cabarrus. (1991)

**1993-1995**

- Automate cigarette handling, case packing, and cigarette by-product collection in Louisville. (1991-1994)
- Install automated overwrap and case packing equipment at MC Bays 3, 4, 5. (1991-1993)
- Expand Cabarrus by 1994.

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## Safety

The prevention of injuries in our manufacturing facilities is a top priority. Longer working hours, necessitated by increased production demands, increase the risk of accidents. Job consolidations require employees to learn new duties. In addition, the increasing regulatory focus on safety in the workplace makes this area more visible to government representatives and union officials.

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### Issue:

PROVIDING A SAFE WORK ENVIRONMENT IS ONE OF THE HIGHEST PRIORITIES THROUGHOUT THE COMPANY. PM-USA WILL SUPPORT THIS COMMITMENT TO SAFETY BY DEVELOPING NEW PROGRAMS AND EXPANDING EXISTING ONES.

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### Strategy:

During the plan period, safety performance improvements of 25% for cigarette plants and 40% for processing plants will be achieved by implementing these strategies:

- Upgrade training in support of safety objectives, focusing on supervisors' skills.
- Design programs that raise employee awareness and integrate safety into all areas of the organization.
- Implement workplace and equipment improvements.

---

### Action Plan:

**1991-1992**

- Train management in hazardous waste operations and emergency response. (1991)
- Educate all employees on new OSHA lock-out procedures. (1991-1992)
- Train supervisors to implement safe work practices, identify high-risk employees and use disciplinary action when appropriate. (1991-1992)
- Increase safety audits at all levels, including hourly employees. (1991)
- Define the extent to which employee injuries or illnesses are related to poor workplace design. (1991)
- Examine the impact work force demographics and job consolidations have on sprain/ strain occurrences (40% of incident occurrences). (1991)

**1991-1992**

- Establish ergonomic plan to address work-place design, job design, and criteria for equipment specifications. (1991-1992)
- Track physician services and cost and select physicians for referral based on PM-USA expectations. (1991)
- Determine the necessity of on-site physician coverage. (1991)
- Review and adjust panel of physicians quarterly. (1991/ongoing)
- Track and enforce employee adherence to PM policies. (1991/ongoing)

**1993-1995**

- Implement ergonomic plan and incorporate workplace design improvements in the following major projects:
  - Primary renovation at MC (1993)
  - Louisville Productivity Program (1994)
  - Cabarrus expansion (1994)



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## Environmental Protection

Pollution prevention best describes the environmental challenge that we, along with all of industry, face for the 1990's. During the previous decades, industry emphasized controlling and treating emissions and discharges, whether it was to the air, water, or land. In many cases, control and treatment will continue as viable options. However, the focus is shifting to preventing the generation of pollutants at the source. As environmental regulations become more stringent there is great advantage to reducing emissions to a level that eliminates the need for environmental permits. Permits, particularly for air emissions, may seriously impair manufacturing flexibility as the lead times for permits increase.

Over the next five years, we expect to see these trends intensify, with a renewed emphasis on enforcing existing regulations and an increased emphasis on reducing emissions not previously regulated. In 1990, Congress passed the Amended Clean Air Act, which will cost industry and the taxpayer about $21 billion. Hazardous and solid waste disposal will continue as a high priority as landfills are filling up and the cost for disposal escalates. Most states are legislating recycling to meet the national goal for reducing landfill disposal by 25% in 1992.

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### Issue:

ENVIRONMENTAL PROTECTION IS A MAJOR NATIONAL PRIORITY. IT MUST BE MANAGED AS AN INTEGRAL PART OF OUR BUSINESS STRATEGY IF WE ARE TO MEET OUR BUSINESS OBJECTIVES.

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### Strategy:

- Implement a comprehensive plan focused on reducing or preventing the generation of pollutants to meet new and anticipated regulations for water pollution and air emissions.
- Implement a program to minimize solid waste and hazardous waste. Focus on recycling and source reduction to approach, over the Plan period, PM's recycle potential of 65% for mixed waste and 50% for process waste. Currently, 16% and 3% is recycled, respectively.
- Develop programs with major suppliers to introduce environmentally friendly packaging and encourage recycling programs.

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### Action Plan:

**1991-1992**

*Water*

- Begin self-monitoring programs at Richmond plants. (1991-1992)
- Install a biological nitrogen removal plant at Park 500. (1991)

**1991-1992**

*Water*

- Upgrade Park 500's wastewater treatment plant to reduce phosphorous discharges. (1991-1994)
- Evaluate alternative water treatment systems for BL Plant and Park 500. (1991-1995)

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1991-1992

*Air*

- Conduct stack tests at all facilities to obtain statistically reliable data on toxic emissions (phosphine, nicotine, ammonia) and volatile organic emissions (VOC's, ethanol, propylene, etc.). (1991)

- Install controls for ethanol emission reductions at Richmond facilities and exhaust and incineration systems at Colonial Heights to satisfy consent agreement with Virginia Air Board. (1991-1992)

- Install pilot plant for new expanded tobacco process which will reduce $CO_2$ emissions. (1991) Incorporate improvements in Cabarrus second expanded tobacco line. (1992)

- Evaluate opportunities to control and reduce sulfur dioxide and nitrogen oxides emissions:

  - Equipping most existing and all new boilers for natural gas, if uninterruptable supply is available, or obtaining very low sulfur oil and coal. (1991)
  - Purchase of steam from a co-generation facility. (1991-1995)
  - Equipping existing boilers with $SO_2$ scrubbers and low NOX burners. (1991-1995)

1993-1995

*Air*

- Evaluate process modifications of existing Philip Morris expanded tobacco plants, based on the new expanded tobacco process. (1994-1995)

- Reduce phosphine fumigation by application of KABAT. (1993)

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**1991-1992**

*Solid Waste/Hazardous Materials*

- Implement employee awareness programs to support the materials recycling concept. (1991)
- Contract with solid waste recycling companies to remove waste where appropriate. (1991)
- Install a tracking system for all waste streams and hazardous waste disposal sites. (1992)
- Manage potential liabilities by controlling contractors and regularly auditing disposal sites. (1991-1992)
- Extend the chemical hygiene plan for R&D and quality assurance labs. (1991)
- Implement a pre-treatment system to dispose of process waste at Bermuda Hundred. (1992)

**1993-1995**

*Solid Waste/Hazardous Materials*

- Implement the R&D hazardous waste control program in our laboratories. (1993)
- Evaluate non-hazardous materials for use in laboratory testing. (1993)
- Develop method for disposal of Park 500 sludge. (1993)
- Remove sand from tobacco prior to processing at LPF. (1993)

**1991-1995**

*Packaging*

- Reconvert foil packaging for B & H Deluxe Ultra Lights to standard. (1991)
- Find consistent, non-contaminated, recycled substrates. (1991-1993)
- Evaluate the feasibility of reduced weight for packaging materials. (1992-1993)
- Review all new and existing packaging materials on any environmentally detrimental compounds. (Ongoing)



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## Product Development

R&D will focus on five main priorities during this planning period:

- the support of PM USA's existing product line, with particular emphasis on full margin line extensions;
- growing the business in the short term by developing new, optimized products and processes;
- continuing the exploration of new product concepts which satisfy unfulfilled consumer needs such as low tar/high flavor, reduced nicotine, low sidestream smoke and other socially acceptable product attributes;
- monitoring government regulations which would affect our products and processes and implement changes while protecting our business and the strength of our trademarks;
- continuing to pursue the development of radically new smoking articles.

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### Issue:

TO SUPPORT OUR LEADERSHIP POSITION, PM-USA NEEDS TO DEVELOP NEW PRODUCTS INCORPORATING BENEFITS WHICH SATISFY CHANGING CONSUMER PREFERENCES, AS WELL AS IMPLEMENT PROGRAMS TO MEET GOVERNMENTAL REGULATIONS.

---

### Strategy:

Develop products of high value to consumers, which address their needs in the areas of health perceptions and social issues related to smoking. Continue to pursue breakthrough product technologies, while also supporting existing product lines and responding to situations which impact product quality.

Monitor government regulations which would affect our products and processes, and implement changes while protecting our business and the strength of our trademarks.

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### Action Plan:

**1991-1992**

- Continue with high priority the development of filter technology aimed at developing filters with increased subjective response and high filtration values for low delivery numbers. (1991-1992)
- Continue the development of paper technology programs, aimed at reducing ignition propensity with minimum subjective cost. The paper technology program is also key in the development of cigarettes designed to add aroma or produce odorless sidestream. (1991-1992)

**1991-1992**

- Continue to evaluate strategies for the optimal application of De-Nic technology. This PM technological advantage is unique in the industry. In addition, continue Tar/ Nicotine interaction studies to determine the threshold of subjective cost/benefit of reduced nicotine and the creation of new flavors to enhance impact. (1991-1992)



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**1991-1995**

- Implement the new products and line extensions, as per the PM-USA Five Year Market Introduction Plan. (1991-1995)
- Develop products that enhance the Company's appeal to smokers in specific segments including ultra low tar, reduced nicotine, and menthol. (1991-1995)
- Develop products with attributes that increase their social acceptability such as low sidestream smoke, scented smoke, reduced odor, and reduced ignition propensity. (1991-1995)
- Monitor US legislation and continue with the ingredients reduction program, to address the pending Whittaker/Waxman and Kennedy bills which include regulations on ingredients, labelling, and advertising restrictions. (1991-1995)

**1991-1995**

- Monitor international regulations on tar, nicotine and CO content and develop appropriate test methods and reposition packings to meet regulations. In addition, specific programs to be undertaken include ingredients adjustments to meet strictest international regulations; the flavor specification program; the development of alternative flavor systems; Project BOLD (low tar/high flavor); and the inclusion of de-nic tobacco to adjust nicotine deliveries. (1991-1995)
- Continue development of new smoking devices which deliver taste close to conventional cigarettes and employ state-of-the-art technology. Project Sigma product specifications are complete, and process and chemical testing is scheduled. Project Beta has Phase I prototypes on hand for subjective optimization, and several options for heater/tobacco cartridge design are under evaluation. (1991-1995)



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## Leaf Supply

In terms of leaf supply, we face challenges on three fronts: domestic burley production, importation of off-shore flue-cured and burley tobaccos, and supply of oriental tobacco.

### Issue: (Domestic Burley Production)

THE DOMESTIC BURLEY PRODUCTION IS NOT SUFFICIENT TO MEET PROJECTED REQUIREMENTS. THE EXISTING LEGISLATION WHICH REGULATES BURLEY PRODUCTION IN THE U.S. DOES NOT ALLOW FOR PRODUCTION QUOTAS TO BE MOVED INTO THE HANDS OF THOSE FARMERS WHO WISH TO GROW BURLEY TOBACCO. AS A RESULT, ONLY 75 TO 79% OF EFFECTIVE QUOTA HAS BEEN GROWN IN THE US DURING RECENT YEARS.

### Strategy:

Needed changes to the burley legislation took place late in 1990. These changes will:

- Permit the sale of burley quotas within counties with certain limits.
- Increase lease limitations within the county per farm to 30,000 pounds.
- Require that farmers grow or lease their quota two out of every three years.
- Prevent quotas from being divided in increments less than 1,000 pounds.
- Allow growers in Tennessee to engage in cross-county leasing.

These changes should allow for the gradual movement of quotas into the hands of farmers who want to grow the tobacco. Our strategy is to monitor and support the execution of these changes in the field, and in addition, encourage further legislative changes in the federal tobacco program, including the increase of the reserve supply level (pool), so that a buffer tobacco inventory is available to the industry.

### Action Plan:

**1991-1992**

- Push for enactment/execution of the recently passed legislation, in time to influence the 1992 burley crop. (1991)
- Support Tennessee growers, so that the leasing of quota across county lines can be implemented, quotas can be consolidated, and the percentage of effective quota grown increased. (1991)

**1991-1992**

- Support universities and farm organization programs to increase mechanization on the farm, to minimize the problem of shortage of farm labor, improve labor productivity and facilitate the consolidation of quotas. (1991-1992)
- Encourage additional changes in the burley legislation, such as an increase in the reserve supply. (1991-1992)

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## Issue: (Importation of Flue-cured and Burley Tobaccos)

IMPORTATION OF FLUE-CURED AND BURLEY TOBACCOS PRESENTS POLITICAL PROBLEMS WITH ELECTED OFFICIALS IN TOBACCO-GROWING AREAS. AS OUR VOLUME GROWS, PARTICULARLY FOR LOWER-PRICED AND EXPORT BRANDS WITH LARGER OFFSHORE CONTENT, OUR LEVEL OF IMPORTS WILL RISE. THE PRESENT SUPPLY OF OFFSHORE BURLEY TOBACCO IS VERY LIMITED AND EXCESS INVENTORIES DO NOT EXIST IN ANY OF OUR KEY MARKETS.

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### Strategy:

We will encourage increased burley production in key offshore countries and at the same time take the necessary political steps to allow for the imports of our required quantities.

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### Action Plan:

**1991-1995**

- Develop specific programs with leaf dealers to encourage increased production in the most critical offshore markets. Although burley is our priority, programs to increase flue-cured production will also be put in place. Brazil and Argentina will be given special attention. Limited potential also exists in Central America. Paying a fair price is a key factor in developing these markets. (1991-1995)

**1991-1995**

- Manage purchases and inventories of offshore tobaccos to avoid drastic fluctuations in imported quantities. (1991-1995)
- Develop appropriate responses to elected officials concerning rising imports. (Ongoing)

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## Issue: (Oriental Tobacco)

IN ALL ORIENTAL-PRODUCING COUNTRIES EXCEPT TURKEY, PRODUCTION HAS FALLEN SHARPLY (I.E., YUGOSLAVIA, ITALY, BULGARIA AND LEBANON). GREECE HAS HAD A GENERAL DECLINE OVER THE PAST FIVE YEARS AND THE OUTLOOK IS NOT OPTIMISTIC.

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### Strategy:

In Turkey, the oriental crop has been growing due in part to consistent price increases and is projected to continue to be large enough to support demand. Our strategy is to support oriental tobacco cultivation in other countries in order to counter the increasing cost of oriental tobaccos.

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### Action Plan:

**1991-1995**

- Continue to support, through purchases and agronomic assistance, the growth of Oriental tobaccos in Thailand. Explore, with Universal Leaf Tobacco, the potential to grow substantially more oriental tobacco in Malawi. (1991-1995)



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MARKETING

# MARKETING

PM-USA'S market share is projected to increase 7.4 share points over the plan period reaching 49.6% in 1995, mainly due to the growth of PM-USA's existing price/value brands (+5.7 share points) and Marlboro (+3.1 share points). Our other full margin brands are expected to continue declining (-1.4 share points), although at lower rates than the overall industry. Over the next 5 years, industry full margin volume is expected to decline at a compound annual rate of 6.3%. In contrast, Marlboro's volume is forecasted to decline only 0.4% per year and Benson & Hedges, Merit and Virginia Slims combined will decrease an average of 4.9% annually. PM-USA's overall full margin share is forecasted to grow 1.7 share points to 39.0% with our share of the segment growing from 46.2% in 1990 to 58.3% in 1995. PM-USA's share of the price/value category is projected to be 32.1% in 1995, up from 25.9% in 1990.

Full Margin

PM-USA's marketing strategy will emphasize our four major full margin brands — Marlboro, Benson & Hedges, Merit and Virginia Slims. We must enhance Marlboro's performance and prevent the aging of our other full margin brands. Line extensions, which will play an integral role in this strategy, will be designed to not only expand our full margin brands' appeal beyond their traditional demographic strengths, but also to force competitors to utilize marketing resources to defend their full margin franchises.

Strengthening our young adult smoker base will be a critical element of our marketing strategy during the plan period. In 1990, PM-USA's share of smokers aged 18-24 was 67.5%, with Marlboro achieving a 59.4% share of young adult smokers. However, Marlboro's share among young adult men has eroded slightly due to Camel's growing share and the introduction of price/image brands. Marlboro must make every effort to continue growing share among young adult smokers, especially men, while our other full margin brands must reverse their eroding shares among adult smokers under age 25. Strategies to do so include:

- Developing and implementing "block out" promotions for Marlboro that cut across all trade channels and media to provide added value to consumers.

- Launching Marlboro Medium, a low tar Red packaged, cork tipped line extension (1991) to provide an alternative for current Marlboro and competitive full flavor smokers who want to switch down the tar spectrum. A second low tar Marlboro extension is planned for 1993.

- Introducing B&H King Size (1992) to contemporize the brand and address the brand's weakness among young adult, male smokers, primarily ethnic. This packing will improve PM-USA's penetration of the menthol category.

Protecting our existing full margin volume base in an environment of industry decline and price pressure is another key issue facing PM-USA over the plan period. Given the aging population, accelerating growth within the 25-44 year old segment is critical to achieving business objectives. The demographic profiles of Merit, B&H and Virginia Slims make them particularly vulnerable to quitting and price/value inroads. We must refresh existing trademarks to make them more relevant to smokers under 35. More contemporary advertising and packaging, as well as value-added premium offers consistent with brand strengths, will be offered. New B&H 100's "Quality Time" advertising, as well as slightly modified packaging, is being prepared for launch in the second quarter 1991. Contemporizing Virginia Slims to make it relevant to young adult female smokers is also planned.



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Strategic line extensions will also help retain smokers as they age, reduce outswitching to price/value and attract competitive smokers, especially those under age 35. In addition to the Marlboro and B&H extensions listed above, three extensions are planned for Merit and Virginia Slims, as follows:

- Two super low tar ("the best of the lowest") line extensions — regular and menthol — are planned for Merit (1992 and 1994). They will leverage the brand's flavor/technological heritage and add new news to the franchise.

- A Virginia Slims extension is planned for 1993.

Price/Value

The price/value category continues to be the fastest growing industry segment. Between 1990 and 1995, industry price/value volume is projected to increase an average of 8.5% annually, reaching 151.2 billion units and a 33.2% industry share in 1995. PM-USA's price/value volume growth is expected to outpace the industry's, growing at a compounded annual average of 13.3%.

During the plan period, PM-USA will concentrate on improving the volume and profitability of our four primary branded price/value franchises: Cambridge, Bristol, Bucks and Alpine. No new PM-USA price/value entries are planned and competitive initiatives will be addressed through existing brands.

The proliferation of price/value entries is causing aggressive price competition (couponing as well as a new lower price tier) as competitors seek to protect and build market share. These industry marketing tactics over the last five years have minimized profitability in the price/value segment. As a result, the average retail price gap between full margin brands and the "lowest price" entries widened to approximately 44% in 1990.

PM-USA's price/value pricing strategy is to reduce retail price pressure on our more profitable full margin products. The gap between the lowest and highest priced products will be reduced from 44% in 1990 to 32% in 1995. The retail price differential between branded generics and sub-generics will be reduced to less than $3.00 and maintained throughout the plan period. On FVB we will balance the list price and trade allowances to develop a price comparable to the lowest priced branded product in the market. If a fourth tier should be initiated by the competition, we will use an existing trademark as a fighting brand.

The rapid growth of the price/value category, the proliferation of new product introductions, and retail trends favoring in-line fixturing are making it increasingly difficult for PM-USA to maintain necessary levels of retail inventory space and in-store visibility. Existing merchandising programs will be evaluated and strengthened to ensure competitive payment structure and flexibility. Important elements for improving our retail profile are increasing the placement of free-standing permanent displays, maintaining a wide range of point of sale materials, and obtaining large volume, off-rack displays/end-caps in high volume outlets.

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# MARLBORO

## Positioning

- Where men smoke for flavor

## Geography

National marketing to support national brand positioning.

- Restore share position where brand is under attack, especially from price/value and Camel inroads.
- Capitalize on all geographic opportunities to maximize Marlboro growth.
- Give special attention to geographies where Marlboro sales are softening.

## Demographics

Core Audience - young adult men; attract young adults and hold them as they age.
Key Audience - 25-44 years of age; prevent older smokers from leaving Marlboro and trading down to price/value.

## Trade Class

Convenience Outlets - Pack Purchases

- Restore Marlboro momentum among young adult pack buyers using a major promotional focus on pack sales.

Supermarket Outlets - Carton Purchases

- Lever momentum, as Marlboro is under-developed among 25 to 44 year old carton buyers, by implementing an end aisle carton display and volume promotion programs.

## Strategic Approach

- Marlboro must act swiftly and boldly, while still vital, to grow share across all age segments.
- Image focus will be on continuing to grow young adult smoker share.
- Volume focus will be on accelerating smoker share growth within 25 to 44 year old segment.
- Key to maximizing growth:
  a) two line extensions: Marlboro Medium and another low tar or ultra low tar
  b) aggressive offensive promotion to lever Marlboro smoker's price sensitivity and to deliver contemporary images

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## Marlboro

Camel has effectively tapped into Marlboro's most important demographic segment, young adult men, growing from 9.5% in early 1989 to 13.7% in mid-1990. Concurrently, Marlboro's share decreased from 66.4% to 62.3% among this segment. Camel's success has come from its repositioning as the contemporary flavor cigarette for men and continuous dealing in package outlets. Although price/value is not currently a dominant force among adult smokers under age 25, the introduction of price/image brands (Magna and Bucks) directed at young adult smokers poses an additional threat to Marlboro.

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### Issue:

MARLBORO'S SHARE AMONG YOUNG ADULT MEN HAS ERODED SLIGHTLY DUE TO CAMEL'S GROWING SHARE AND THE INTRODUCTION OF PRICE/IMAGE BRANDS. MARLBORO MUST MAKE EVERY EFFORT TO CONTINUE GROWING SHARE AMONG YOUNG ADULT SMOKERS, ESPECIALLY MEN.

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### Strategy:

Invest heavily in the core, young adult male franchise on a national level. Reinforce contemporary, male, flavor image via advertising and promotion. Supplement national plan with special programs in opportunity markets where share is underdeveloped, yet growing to accelerate young adult smoker share growth momentum. Launch line extensions that expand Marlboro's dominant masculine appeal using "Red" cues.

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### Action Plan:

**1991-1992**

- Deliver highest reach, frequency and total advertising impressions, as well as high-perceived value incentives, against core young adult smokers. (1991-1992)
- Triple level of value-added multi-pack promotions in pack outlets. (1991-1992)
- Improve presence and retail visibility in pack outlets through continuous product display and bold, contemporary, uniform POS signage. (1991-1992)
- Continue image-enhancing national event sponsorships including auto racing, country music and ski. (1991-1992)
- Focus proprietary, high impact young adult marketing programs in top 9 opportunity sections. Blitz 7 markets within these sections. (1991) An additional 7-10 markets will be targeted. (1992-1995)
- Field club night programs in major metro and resort markets. (1991)

**1991-1992**

- Test a themed promotional sweepstakes around "Adventure Team" competition. (1991-1992)
- Test sponsorship of motorcycle racing. (1991-1992)
- Execute 3 urban retail pack promotions using unique displays and incentives. (1991)
- Support new Menthol full flavor box packing in Region 1 with trial-generating product offer and continuity bounceback. (1991)
- Launch Marlboro Medium, a low tar line extension with a cork filter in a red package. (1991)

**1993-1995**

- Expand Adventure Team program to national level. (1993-1995)
- Potentially expand motorcycle racing sponsorship. (1993-1995)

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## Marlboro

Currently, 25-44 year olds represent over half (52%) of all smokers and 56% of all Marlboro smokers. Marlboro is the dominant brand among 25-44 year old smokers, posting a 29.6% share among this age segment. The competitive smoker in this age segment offers significant business building opportunities for Marlboro, especially when considering aging U.S. demographics.

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### Issue:

ACCELERATED GROWTH WITHIN THE 25-44 YEAR OLD SEGMENT IS CRITICAL TO ACHIEVING BUSINESS OBJECTIVES, GIVEN THE AGING POPULATION. MARLBORO'S SHARE AMONG 25-44 YEAR OLD SMOKERS IS UNDERDEVELOPED VIS-A-VIS ITS COMMANDING 60% SHARE OF ADULT SMOKERS UNDER AGE 25.

---

### Strategy:

Marlboro must increase its retention of smokers as they age into the 25-44 year old age segment. Additionally, we must switch smokers within the well developed and vulnerable competitive 25-44 year old segment. Marlboro will support smokers with Marlboro Country advertising and field both offensive and defensive promotions in the carton universe. We will launch new products which are appealing to the target audience and are image reinforcing.

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### Action Plan:

**1991-1992**

- Field quarterly carton promotions in the supermarket universe utilizing a combination of value-added and feature price promotions. (1991)
- Continue advertising support to the audience via print and outdoor. (1991-1992)
- Execute two blind insert programs in 100MM soft pack cartons to engender loyalty/ continuity of purchase among the most price sensitive Marlboro smokers. (1991)
- Deliver an on-carton sleeve continuity offer good on any style Marlboro. (1991)
- Increase military price support in this high price sensitive environment. (1991-1992)
- Launch a low tar, cork tipped, Red line extension. (1991)
- Leave Ultra Lights test markets open. (1991-1992)

**1991-1992**

- Utilize direct marketing to offensively deliver promotion offers to increase alternate usage of, and conversion to, Marlboro by competitive smokers. (1991-1992)
- Test defensive direct marketing program targeted to Marlboro's most vulnerable, price sensitive smokers to increase loyalty and reduce alternate competitive brand purchases. (1991-1992)

**1993-1995**

- Test a second low tar, Red line extension. (1993)
- Increase use of direct marketing program against key audiences, as appropriate. (1993-1995)

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## Marlboro

Convenience outlets represent Marlboro's most important and best developed trade class, accounting for 36% of Marlboro sales and a 30% share. It is in these outlets that Marlboro's key smoker group, young adult smokers, purchase cigarettes. Marlboro continues to generate significant volume gains as industry volume moves into this channel. However, our share flattened during 1990 due to accelerated growth of the price/value category and Camel Filters.

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### Issue:

OUR COMPETITIVE POSITION IN CONVENIENCE STORES HAS BEEN WEAKENED. MARLBORO MUST RESTORE AND SUSTAIN SHARE MOMENTUM IN CONVENIENCE OUTLETS, A HEIGHTENED "PRICE/DEALING" UNIVERSE.

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### Strategy:

Marlboro must increase its retail promotion support behind pack sales nationally, with a strong focus on convenience outlets. We will improve our availability and visibility and manage increased support and more frequent promotion to avoid the pitfall of conditioning smokers to deals, reducing inherent value and committing ourselves to never ending support increases. We will also support retailer driven special pricing.

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### Action Plan:

**1991-1992**

- Field 10 national multi-pack promotions, including two 5 pack product promotions with deep quantities. (1991)
- Execute one national gas convenience account specific program to generate extensive visibility and volume. (1991)
- Utilize backup incentive quantities and sleeve offer to extend promotion visibility and depth of reach. (1991)
- Run a proprietary racing sweepstakes promotion in media and extend it to retail. (1991)
- Test and utilize Marlboro multi-pack price feature promotions as needed. (1991-1992)
- Test cross merchandising program with gas convenience accounts. (1991)
- Maintain Marlboro visibility and inventory with continuous prime position on pack racks. (1991-1992)

**1991-1992**

- Test unified look POS plan. Offer fewer, but deeper quantities, of permanent POS materials. (1991-1992)
- Develop Marlboro plan for key national accounts. (1991)
- Test half-carton merchandising unit. (1991-1992)
- Test use of 25's as a price fighter. (1991-1992)
- Enhance distributor involvement in assembly of Marlboro retail promotions. (1991-1992)
- Explore alternate packaging/delivery vehicles for value-added retail promotions. (1992)
- Explore appropriate value-added promotions and cross-merchandising opportunities. (1992)
- Test micro-market targeting via new information systems. (1992)

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**1993-1995**

- Expand/refine unified POS look program nationally. (1993-1995)
- Continue to refine use of price/product promotions and cross-merchandising vehicles. (1993-1995)
- Expand half-carton merchandising and/or 25's promotions/pricing. (1993-1995)
- Expand use of alternate packaging/delivery vehicles for value-added Marlboro retail promotions. (1993-1995)

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## Marlboro

Marlboro's second most important trade class is supermarkets at 19% of sales. Marlboro is the market leader with a 19% share. The Brand exhibits continued share momentum and has room to grow in this trade class. Marlboro's largest demographic segment, 25-44 year old smokers, is growing as the population ages, delivering more and more smokers into this price driven carton universe. Older competitive full margin franchises are extremely vulnerable as price discounting has conditioned reduced loyalty, alternate purchasing behavior, and switching to price/value brands. Marlboro must defend its core business and has a clear opportunity to increase competitors' alternate purchases in this trade class.

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### Issue:

CARTON OUTLETS SHOULD CONTINUE TO PROVIDE GROWTH OPPORTUNITIES FOR MARLBORO, DUE TO AGING DEMOGRAPHICS AND REDUCED LOYALTY AMONG COMPETITIVE FULL MARGIN BRANDS. PM-USA MUST BUILD ON MARLBORO'S PERFORMANCE IN CARTON OUTLETS.

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### Strategy:

Turn price sensitivity and Marlboro's leadership into a competitive advantage via offensive promotions. These promotions will be designed to generate increased volume and smoker share while further distinguishing Marlboro from all other competitive brands. The brand will continue to field defensive carton promotions against the most vulnerable Marlboro smokers. In addition, it will capitalize on a move to pack sales within this trade class by focusing on front-end pack merchandising.

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### Action Plan:

**1991-1992**

- Field 4 quarterly themed carton display programs across supermarket universe (400-800+ CPW). (1991)
- Utilize feature pricing, cross merchandising, value added incentives and bonus packs as elements. (1991-1992)
- Increase carton display payments to achieve greater penetration of large end cap display. (1991-1992)
- Field one value added carton promotion in self-service mega-volume outlets and deliver 6 programs in non self-service mega-outlets. (1991)
- Execute one carton sleeve continuity offer to reward current and occasional Marlboro smokers for loyalty and attract competitive smokers. (1991)

**1991-1992**

- Insert 2 blind added value carton offers in Marlboro soft pack 100's packings to reward loyalty. (1991)
- Improve creative presentation on racks and POS materials. (1991-1992)
- Test half-carton merchandising unit. (1991-1992)
- Test micro-market targeting via new information systems. (1992)

**1993-1995**

- Continue to refine and build penetration of quarterly themed mega carton promotion. (1993-1995)
- Expand half-carton merchandising and/or 25's promotions/pricing. (1993-1995)
- Maximize promotion opportunities in deal driven trade classes. (1993-1995)



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# BENSON AND HEDGES

## Positioning

- The highest quality and most sophisticated brand

## Geography

- Focus spending in key markets: B&H is the most geographically concentrated major brand (West, Southwest, Southeast).

## Demographics

- White female skew, 40+
- Black and Hispanic, female skew, 30+
- B&H King Size: male skew, 25-34, ethnic

## Trade Class

Convenience Outlets - Pack Purchases
- Dramatic increase in promotional support.

Supermarket Outlets - Carton Purchases
- Occasional couponing, quality "Signature Collection" premium offers.

Urban - Pack
- Reach ethnic audience with pack premiums.

## Strategic Approach

- Market to diverse target groups.
- Build on premium image.
- Build ethnic franchise.
- Line extend to Kings menthol smokers.

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# VIRGINIA SLIMS

## Positioning

- Cigarette for Women

## Geography

- Defend share position from competitive attacks, and capitalize on geographic opportunities for growth, by focusing marketing efforts primarily on key markets and accounts/trade classes.

## Demographics

Primary Audience - Adult females LA-44.
Secondary Audience - Adult females LA-24.

## Trade Class

Drug and Convenience Outlets - Pack Purchases
- Maintain momentum among adult female pack buyers, regain momentum among adult smokers under age 25.

Supermarket Outlets - Carton Purchases
- Maintain momentum among 25-44 year old carton buyers.

## Strategic Approach

- Maintain position as contemporary, unique, leading brand for women.
- Image focus will be on continuing to grow adult female LA-44 share.
- Volume focus will be on accelerating smoker share growth among adult females 25-44.
- Launch line extension to rejuvenate brand and expand its demographic appeal.
- Defend core franchise via aggressive promotion to counter consumer price-sensitivity, add value and reinforce brand imagery.

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# MERIT

## Positioning

- Great tasting, low tar cigarette

## Geography

Regional Marketing

- Aggressively defend Merit against price/value category inroads on a geographic basis.
- Target consumer promotions to capitalize on growth opportunities in Merit's key trading areas.

## Demographics

Primary Audience - 35-54 year old smokers.
Secondary Audience - 25-34 year old smokers.

## Trade Class

Convenience Outlets - Pack Purchases

- Restore Merit momentum among young adult pack buyers.

Supermarket Outlets - Carton Purchases

- Defend Merit carton business against attractive price-off brands.

## Strategic Approach

- Increase the percentage of Merit's promoted volume to 8-10% annually.
- Develop regional retail promotions which address specific areas of geographic brand strength or weakness.
- Decrease Merit's advertising frequency while increasing impact and recall.
- Increase Merit's appeal among 25-34 year old smokers.
- Develop and launch 2 super low tar line extensions (Regular and Menthol) to attract competitive smokers and add "new" news to the Merit franchise.



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## Benson & Hedges, Virginia Slims and Merit

The core franchises of these 3 brands are aging rapidly, disproportionate to declines in younger smoker incidence. Marlboro's strength in under 25 smokers, Newport's strength among under 25 black smokers (67% share), and the resurgence of Camel, have largely eliminated B&H, V.S. and Merit from smokers' entry level competitive set. The fact that B&H and V.S. are 100's only also continues to be a barrier to entry for younger smokers; 100's are skewed toward older, female smokers and perceived as such. In addition, the proliferation of low tar brands, especially in the price/value segment, has made Merit vulnerable to the competition.

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### Issue:

THE OLDER DEMOGRAPHIC PROFILES OF THESE THREE BRANDS MAKE THEM PARTICULARLY VULNERABLE TO QUITTING AND PRICE/VALUE INROADS. THEIR FUTURES WILL BE LARGELY DEPENDENT ON BUILDING BRAND SHARE AMONG ADULT SMOKERS UNDER AGE 35.

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### Strategy:

Position the brands to be more relevant to smokers under 35 through more contemporary advertising and packaging, special events and premium offers consistent with brand strengths and current smokers' perception of the brands. Pack promotion programs will be increased to encourage trial and address the pack purchasing patterns of young adult smokers. Utilize direct marketing programs to deliver continuity programs designed to keep smokers within these franchises. Importantly, add to the product offerings of these brands to become more relevant to the preferences of today's adult smokers under 35. These extensions must add new "news" to the franchises and provide significant competitive in-switching.

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### Action Plan:

**1991-1992**

*Benson & Hedges*

- Launch new "Quality Time" B&H advertising campaign with multiple young adult smoker directed executions. (1991)
- Launch new, more contemporary packaging across the full-line. (1991)
- Expand "Benson & Hedges Blues" concert events, publicity, advertising, and retail tie-ins to brand's top 6 markets. Build awareness and B&H ownership of this music venue. (1991)
- Emphasize Lights packings in advertising and promotion as it's extremely underdeveloped, a key to smoker's trading-up and the greatest packaging improvement. (1991-1992)

**1991-1992**

*Benson & Hedges*

- Increase pack promotions to 10 in 1991 versus 7 in 1990. (1991)
- Continue "Signature Collection" to build B&H's proprietary image of quality and sophistication, encouraging young adult smokers to trade-up. (1991-1992)
- Introduce B&H King size (menthol) directed at young adult and predominantly male smokers. (1992)

**1993-1995**

- Increase use of pack promotions. (1993-1995)



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### 1991-1992

*Virginia Slims*

- Introduce new advertising with a young adult skew, yet consistent with brand equities. (1991)
- Contemporize Virginia Slims packaging. (1991)
- Keep Virginia Slims Superslims advertising and packaging especially relevant to young adult female smokers. (1991-1992)
- Use media-delivered and retail promotions with premiums and themes skewed to young adult female smokers. (1991-1992)
- Use "Slimsclub" direct mail to reach young adult smokers - current and competitive - and tailor premium offers by age grouping. (1991-1992)

### 1993-1995

*Virginia Slims*

- Introduce a line extension directed toward young adult female smokers. (1993)
- Increase frequency of pack programs. (1993-1995)

### 1991-1992

*Merit*

- Increase Merit's promoted volume from 2% to 8-10%. (1991-1992)
- Utilize continuity bounceback offers on all retail/direct promotions to generate competitive trial and encourage continued use. (1991-1992)
- Conduct defensive volume building programs in high development price/value areas (Regions 3 and 5). (1991)
- Utilize the Direct Marketing database to deliver continuity offers to price sensitive Merit smokers and to encourage disenfranchised Camel Lights smokers to switch to Merit. (1991-1992)
- Continue to utilize the Blind Challenge to attract and convert competitive low tar smokers. (1991-1992)
- Alter current Merit advertising to provide "image-protection" against further price/ value erosion. (1991-1992)

### 1991-1992

*Merit*

- Incorporate a geographic spending approach, targeting areas of the country with specialized retail, media and direct mail programs. (1991-1992)
- Develop and test line extension opportunities such as Super Ultra Low Tar (1 mg or 2 mg tar) alternatives to Carlton and Now. Introduce Regular line extension nationally. (1992)

### 1993-1995

- Evaluate potential price options for Merit, i.e., continuous coupons on a regional basis. (1993)
- Roll-out second line extension (Menthol). (1994)

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**Benson & Hedges, Virginia Slims and Merit**

The dramatic increase in PM-USA and competitive new product introductions and line extensions, coupled with full margin category declines, have created intense competition for display activity. In addition, promotion has become more important as consumers have become increasingly price sensitive given intense industry couponing and price/value proliferation.

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**Issue:**

BENSON & HEDGES', VIRGINIA SLIMS' AND MERIT'S RETAIL VISIBILITY IS NOT COMMENSURATE WITH THE BRANDS' MARKET SHARES IN KEY MARKETS. THE BRANDS TEND TO BE SKEWED GEOGRAPHICALLY. THEIR RETAIL VISIBILITY MUST BE IMPROVED TO REACH TARGET AUDIENCES AND ENHANCE THE BRANDS' SHARES AND ABILITY TO EFFECTIVELY EXECUTE PROMOTIONS IN KEY MARKETS.

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**Strategy:**

Focus on brands' geographic, demographic and trade class strengths through national account programs and chain specific promotions outside of the PPP. Programs will be developed for key accounts in key sections. Be flexible and look for brand promotion opportunities with Sales.

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**Action Plan:**

**1991-1992**

- Introduce programs designed specifically for National Accounts. (1991-1992)
- Increase promoted volume to 8-10% from 3-5%. (1991)
- Develop annual retail promotion plan directly with key chains via Sales, i.e. Phar Mor in 1991. (1991-1992)

**1991-1993**

- Develop pre-packed promotion units. (1991-1993)

**1991-1995**

- Target feature pricing and display programs in key sections in key accounts. (1991-1995)
- Utilize National Urban Account PPP to feature menthol. (1991-1995)

2048360368

# CAMBRIDGE

## Positioning

- Brand of choice for price sensitive consumers.

## Geography

National Scope
- Reinstate pre-1990 growth momentum.

Regional Scope
- Close Doral share gaps in ten key sections.

## Trade Class

Carton Outlets
- Increase promotion penetration in chains.
- Maximize volume in mega volume outlets.

Pack Outlets
- Generate trial and purchase continuity.
- Maintain visibility.

## Strategic Approach

- Maintain price competitiveness.
- Improve retail presence.
- Establish brand position through media, reinforce at retail.
- Heavy-up marketing efforts in key geographies and trade classes.
- Gain retail presence and drive volume with value added retail programs.

2048360369

# ALPINE

## Positioning

- Legitimate refreshing menthol alternative for Salem/menthol smokers at a lower price.

## Geography

Alpine will continue to develop regionally with regions 2, 3 and 4 contributing over 72% of Alpine's volume. Heavy-up support in highly developed menthol and Salem markets.

## Demographics

Core Audience - B&C counties, slight female skew, 35+ years.
Key Audience - Full Margin, Salem/menthol smokers.

## Trade Class

Convenience Outlets - Pack Purchasers
- Achieve trial and prominent merchandising and promotion to access menthol's traditionally strong pack performance.

Supermarket Trade Class - Carton Purchasers
- Correct merchandising and distribution shortfalls to provide Alpine sufficient availability in carton outlets to support loyal buyers.

## Strategic Approach

- Focus support and spending in strong Salem/menthol markets.
- Achieve off-rack display.
- Cause RJR to spend defensively to protect Salem franchise.

2048360370

# BUCKS

## Positioning

- Male oriented P/V entry, primarily pack driven
- Defensive/Offensive Corporate positioning
  - Defensive: Marlboro losses to P/V category
  - Offensive: Camel, Winston, Magna
- Irreverent attitude that breaks through category clutter; less overt price communication.

## Geography

- Nationally marketed during year 1 until the brand develops geographically.
- Capitalize on geographic opportunities to capture competitive P/V downswitchers (Camel, Winston).

## Demographics

Primary Audience - Male: 21-44; Price sensitive

## Trade Class

Pack Outlets

- Heavily promoted P/V entry to participate in growth of P/V and defend against competitive promoted volume in Convenience Stores.
- Induce trial, continuity and create awareness through display/promotion.

Carton Outlets

- Induce trial, continuity, and carton trade-up through media delivered coupons, retail bonus-packs and couponing display programs.

## Strategic Approach

- Provide heavy penetration of promotion in pack outlets.
- Utilize high degree of trial-inducing offers delivered through retail, media, direct, and sampling.
- Ensure adequate level of carton promotion support (bonus packs, pulsed-coupon displays).

2048360371

# BRISTOL

## Positioning

• A quality product at the lowest branded price point in the industry.

## Geography

National Marketing

- Achieve broad geographic distribution while focusing retail support and marketing resources in a limited retail environment in which off-rack display and signage can be secured on a regular basis.

## Demographics

Key Audience - 35+ years of age
- Lower income and education
- Predominantly white
- C&D counties

## Trade Class

Independent Supermarket, Grocery, Mega Volume Outlets.

- Utilize off-rack display and traditional packaged goods deals to maintain momentum.

Convenience Outlets

- Secondary in importance to carton outlets, our objective is to ensure Bristol availability with limited promotional support to provide trial.

## Strategic Approach

- Gradually expand distribution where the opportunity for sub-generic performance exists.
- Utilize standard package goods "deals" to obtain off-rack display as well as find a permanent merchandising position for Bristol.
- Key to maximizing growth:
  1) Provide Field Sales Force tools such as co-op advertising, P.O.S. and displays to continuously work the Brand outside PM-USA's promotion schedule.
  2) Aggressive promotion that adds value for the consumer and retailer.
  2) Develop a phase II campaign based on differentiating Bristol from other sub-generics.

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### Price/Value

Industry market practices over the last five years have minimized profitability in the Price/Value segment and, simultaneously, widened the retail price gap to 44% between full margin brands and the "lowest price" entries. The proliferation of Price/Value entries has caused more aggressive price competition (couponing as well as a new lower price tier) to protect and build share.

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### Issue:

PM-USA NEEDS PRICE/VALUE VOLUME GROWTH, BUT AT THE SAME TIME, WE WANT TO INCREASE THE PROFITABILITY OF THE SEGMENT AND MINIMIZE THE NEGATIVE VOLUME IMPACT ON FULL MARGIN BUSINESS.

---

### Strategy:

A four point strategy is planned:

- Reduce the net retail price pressure on the full margin segment by closing the noncouponed retail price gap between the highest and lowest offerings from 44% to 32% by 1995.
- Reduce the gap between branded and sub-generics to less than $3.00 and maintain over the plan period.
- Maintain retail price competitiveness using appropriate price reduction vehicles.
- Utilize extensive value-added retail carton and pack promotions to obtain off-rack display, maintain existing consumer base and attract competitive price/value and price-sensitive consumers.

---

### Action Plan:

#### 1991-1992

- Utilize on carton coupons for Cambridge at values and rates that ensure price competitiveness with Doral. (1991-1992)
- Price reduce 62% of Alpine volume utilizing carton and pack coupons at retail. (1991-1992)
- Ensure Bristol price competitiveness with comparable sub-generics by couponing/ stickering retail price on 20% of retail volume. (1991-1992)
- Maintain price reduction funding reserve to enable immediate response to competition. (1991-1992)
- Utilize 20-24 geographically and trade class targeted retail promotions that entice retailers to provide off-rack, free standing display. (1991-1992)

#### 1991-1992

- Increase promoted volume to the following levels: Cambridge/Alpine= 76%; Bucks= 33%; Bristol= 20%. (1991)
- Use FVP on a targeted account basis to utilize price/value merchandising advantage. (1991-1992)
- Maintain continuous supply of intrusive price point communication point of sale material. (1991-1992)

#### 1993-1995

- Utilize Bristol as the "price fighter" to counter competitive initiatives to introduce lower price tier. (1993-1995)

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## Price/Value

The acceleration of new price/value introductions and the growth of the segment, coupled with trends toward in-line departments and counter display proliferation, threaten PM-USA's ability to maintain necessary levels of retail inventory space and in-store visibility. Despite continued gains in distribution, share and distribution in Supermarkets and Mega-volume outlets still lag competition. Not withstanding, the significant gains in counter display placements in pack outlets, visibility and proximity to point of purchase are generally inferior to the competitors who utilize their only display for price/value offerings.

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### Issue:

CURRENT RETAIL SPACE AVAILABILITY AND VISIBILITY ARE CONSTRAINTS TO PROJECTED PM-USA PRICE/VALUE GROWTH.

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### Strategy:

Improve PM-USA's price/value retail profile by strengthening existing merchandising programs to ensure competitiveness in payment structure and flexibility. Utilize standard package goods "deals" to obtain off-rack display, promotability, signage and price call out.

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### Action Plan:

**1991-1992**

- Enhance carton merchandising incentives and flexibility to increase placement of free-standing permanent displays and/or improve inventory, positioning, and visibility of price/value offerings on in-line fixtures.
- Continue utilization of customer incentives to obtain large volume, off-rack displays/end-caps in high volume outlets. (1991-1992)
- Introduce utilization of factory applied carton couponing in high volume carton outlets in order to improve sales force efficiency. (1991)
- Enhance payment structure and modify hardware for pack display program in order to increase flexibility and improve in-store positioning. (1991)
- Provide sales force with twelve month promotion plan for entire price/value segment including instructional materials, display allocations and selling brochures. (1991)

**1991-1992**

- Maintain wide range of point-of-sale materials that optimize brand recognition and pricing. (1991-1992)
- Expand use of discretionary spending budget allowing Section Directors greater flexibility in executing price reduction and promotional programs. (1991-1992)

**1993-1995**

- Implement calendar marketing agreements to enhance the utilization of promotional programs. (1993)
- Eliminate sales force application of price reduction vehicles. (1993)



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## Price/Value

Since the emergence of the price/value category, the primary positioning of all brands in the category has been price. However, the increasingly diverse price/value consumer base includes shoppers motivated by more than just price when purchasing a brand. Product quality, taste and brand imagery are important elements for differentiation within the category.

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### Issue:

PRICE IS NO LONGER A COMPETITIVE ADVANTAGE WITHIN THE CATEGORY.

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### Strategy:

Establish and build four solid and distinct brand franchises that accentuate each brand's differentiation to avoid a "commodity perception" by consumers.

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### Action Plan:

**1991-1992**

- Enhance consumer loyalty with clearly defined brand images integrated throughout advertising, promotion, packaging, and direct marketing. (1991-1992)
- Develop and implement new advertising campaign that positions Cambridge as "smart shopper" brand. (1991)
- Continue current Alpine campaign; shift spending to outdoor and schedule concurrent with retail promotions to maximize awareness. (1991-1992)
- Maintain substantial media spending behind Bucks to build brand awareness and establish credibility. Evaluate need for second generation campaign. (1991)
- Develop Bristol advertising campaign to build awareness and differentiate from other low price products. (1991-1992)
- Utilize direct marketing to generate trial from key competitive brands: Cambridge vs. Doral; Alpine vs. Salem; Bucks vs. Camel, Winston, Magna and Viceroy. (1991-1992)

**1991-1992**

- Modify Cambridge packaging to convey more contemporary and less "generic" image. (1991)
- Evaluate methods of communicating Alpine's proposition directly on-carton. (1991-1992)
- Utilize retail promotions combining parity pricing with value added incentives. (1991-1992)
- Develop promotional programs for Commander and/or Bristol non-filter. (1992)

**1993-1995**

- Expand emphasis on image based advertising to communicate brand positioning. (1993-1995)
- Evaluate the potential for grass roots sponsorships to enhance brand imagery and awareness. (1993-1995)



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## Media

PM-USA continues to maintain solid overall leadership in terms of tobacco media spending, with significant dominance in the magazine and outdoor categories. 1990 spending for current established brands is $281MM and estimated to be $235MM for 1991. During the rest of the plan period, industry and PM-USA media spending is expected to continue declining, with print declining more significantly than outdoor (in the absence of legislative restrictions). However, PM-USA's projected levels of advertising support will allow the company to maintain, and possibly improve, its leadership position in the near term. It is presumed that PM-USA will maintain its basic advertising support strategy during the plan period and, even with some shift from media to promotional programs, significant magazine and outdoor leadership is expected through 1995.

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### Issue:

DESPITE THE INCREASINGLY PROMOTION DRIVEN AND REGULATED MARKET ENVIRONMENT, MEDIA STILL PROVIDES AN OPPORTUNITY FOR PM-USA TO DIFFERENTIATE ITSELF FROM THE COMPETITION. PM-USA MUST PROVIDE MAXIMUM IMPACT AND EFFICIENCY IN ALL MEDIA PROGRAMS CONSISTENT WITH OUR INDUSTRY LEADERSHIP POSITION.

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### Strategy:

Refine print and out-of-home planning, negotiation and evaluation systems to maximize effective and efficient delivery of defined audiences in appropriate geographies consistent with brand creative. These systems will evaluate all current media vehicles on a quantitative (efficiency), qualitative (impact) and geographic (focus) basis. In addition, they will factor in non-media opportunities to include consumer promotions, consumer/trade/opinion leader entertainment and synergistic opportunities with other Operating Companies. Finally, they will identify all appropriate new media opportunities.

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### Action Plan:

**1991-1992**

- Implement quarterly program to maximize Operating Companies rate efficiencies through selective utilization of media vehicles. (1991)
- Implement comprehensive out-of-home market specific tracking/evaluation system. (1991)
- Develop and implement impact planning and scheduling program to maximize advertising effectiveness on a time-specific geographical basis and minimize tobacco clutter in print and out-of-home. (1991-92)
- Develop and implement program to generate brand specific consumer-oriented media merchandising/promotional opportunities for all vehicles. (1991-92)

**1991-1992**

- Complete implementation of computerized media scheduling system (Compass) to maximize effective use of Media group time. (1991)

**1993-1995**

- Develop and implement specific out-of-home space utilization program to allow Operating Companies access to PM-USA inventories to protect continued availabilities of key vehicles. (1993)
- Develop dialogue with Operating Companies to maximize potential for cost efficient multi-media agreements. (1993-95)
- Fully utilize all media merchandising/promotional opportunities on a PM Companies basis. (1993-95)



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## Direct Marketing

Direct Marketing's mission is to build and enhance our business by delivering focused direct marketing programs which are consistent with PM-USA brand objectives. Direct has proven to be an efficient and effective tool in engendering loyalty among our smokers while providing us with the tactical capability of reaching large numbers of competitive smokers quickly. The Direct Marketing database must contain a large, diverse smoker population to support PM-USA brands' direct marketing programs.

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### Issue:

THE MARKETING ENVIRONMENT IS LIKELY TO BECOME MORE RESTRICTIVE DURING THE PLAN PERIOD, INCLUDING POTENTIAL BANS ON OUTDOOR AND EVENT SPONSORSHIP. THIS NECESSITATES CREATING ALTERNATIVE AVENUES OF REACHING THE CONSUMER. DEVELOPING A SMOKER NAME DATABASE WILL ENABLE US TO EFFECTIVELY REACH A LARGE NUMBER OF SMOKERS.

---

### Strategy:

Continue to develop a database of 27MM adult smokers (55% of the smoking population) by gathering names through internal and external processes. Develop new unbranded name generation and requalification techniques that outperform current methods based on cost per smoker and smoker responder profile measures. Use ongoing Brand, Event, and Corporate Affairs efforts which may have some requalification and/or name generation application.

---

### Action Plan:

**1991-1992**

- Expand name generation efforts in proven traditional media vehicles.
- Increase presence at major events and use as a source for name generation.
- Continue to identify and test non-traditional media.
- Improve direct mail packages for requalification and name generation.
- Continue relationship with coop survey supplier which identifies smokers through surveys delivered through FSI's and direct mail.

**1993-1995**

- Develop internal sources of smoker name identification and requalification such that external efforts are minimal.
- Maintain presence at all Events for smoker name identification.
- Develop, test and roll-out Philip Morris Companies corporate coop survey (cooperative effort with KGF, MBC, and other non-competitive companies).

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## Directed/Local Marketing

As all U.S. cigarette manufacturers strive for market share and unit volume, the next five years will present local opportunities and competitive threats which will require greater Sales and Marketing flexibility, quicker response times and additional promotional tools.

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### Issue:

THE INCREASINGLY COMPETITIVE MARKETING ENVIRONMENT WILL NECESSITATE IMPROVING MARKETING'S AND SALES' ABILITY TO FOCUS NATIONAL PROMOTIONAL EFFORTS WHILE PROVIDING THE CAPABILITY TO AUGMENT THOSE EFFORTS WITH LOCAL INITIATIVES. EACH SECTION'S ABILITY TO FOCUS PROMOTIONS MUST BE IMPROVED SO THEY CAN BE CONDUCTED ON A TIMELY BASIS.

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### Strategy:

Continue to direct PPP promotions and visibility allocations where appropriate (geographic, trade class, demographics). Enable the Sales organization to go beyond Product Promotion Plan (PPP) activities by providing the necessary promotional materials, budget resources and approval process.

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### Action Plan:

**1991-1992**

- Improve PPP information provided to Sales Sections to better focus promotions within markets/territories, book retail space and more effectively develop local programs. (1991)
- Provide Section Sales management with better information regarding their sales territories and improve the promotional material ordering process. (1991)
- Create and maintain an inventory of temporary POS materials to draw upon as needed. (1991) Expand to include a variety of promotional materials and residual quantities of PPP promotions. (1991-1992)
- Create a menu of "turn key" promotions (cross merchandising, etc.) which Section Management and National Accounts can use to supplement PPP activities. (1991)
- Develop and provide Sales Sections with promotional vehicles (mobile kiosks, booths, tents, store opening kits) to enhance delivery of local promotions. (1991-1992)
- Reserve a portion of each brand's budget to fund local initiatives. Develop a consistent and efficient method to approve field requests for local programs. (1991-1995)

**1991-1992**

- Develop merchandising vehicles which can be modified in the field to suit individual store needs. (1991-1992)
- Identify and evaluate outside organizations to implement local marketing programs. (1991-1992)
- Determine feasibility of creating Section teams who would blitz markets with POS. (1991) If practical, rollout nationally. (1991-1992)

**1993-1995**

- Provide a means for the field to request services of outside organizations for local programs. (1993-1995)
- On an ongoing basis, review the Marketing and Sales organization to ensure that the proper structure exists to maximize local opportunities. (1992-1995)
- Continue to provide Field Sales with greater latitude and guidance so that they can modify the PPP as needed to address local market conditions. (1992-1995)



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## Merchandising Materials

Visibility and presence at retail will become increasingly important, difficult and costly to gain, given the competition for space among both cigarette and other product categories. The declining interest in supporting the cigarette category in certain trade classes compounds this issue. In addition, PM-USA's growing number of products and their differing pricing and promotion needs increase the difficulty of adequately supporting all of the brands at retail.

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### Issue:

ENSURING THAT ALL OF OUR BRANDS ARE VISIBLE, AVAILABLE, ADVERTISED AND PROMOTED AT THE POINT-OF-PURCHASE WILL BECOME MORE DIFFICULT GIVEN THE INCREASING COMPETITION FOR SPACE AMONG CIGARETTE AND OTHER PRODUCT CATEGORIES.

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### Strategy:

Develop cigarette merchandising vehicles and permanent point-of-sale materials that maximize inventory, availability and visibility of PM-USA products in the best in-store positions. Design all materials to enhance our brands' images while servicing the needs of the various trade classes.

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### Action Plan:

**1991-1995**

- Introduce a more contemporary designed carton rack with superior graphic treatment, less intrusive security shields, available electronic security, and the ability to promote. (1991)
- Expand the available pack Plan R and C options for both display and promotion. (1991-1992)
- Offer a redesigned, more contemporary overhead pack merchandiser with lighted graphics, down lighting, dual brand advertising panels and retailer customization features. (1991-1992)
- Develop a more contemporary pack "B" rack system to help gain the main cash register position. (1991-1992)
- Introduce a new permanent Marlboro POS system to establish a consistent look across all materials. (1991-1992)
- Identify permanent POS materials for the secondary brands to gain in-store visibility in key markets/trade classes. (1991-1992)

**1991-1995**

- Develop merchandising materials for specific needs of new trade classes. (1991-1992)
- Investigate and develop a full range of carton and pack security options for self-serve and non self-serve outlets. (1991-1993)
- Continually test new merchandising and POS concepts via the custom side of the business for eventual inclusion as standard items. (1991-1995)
- Explore developing a complete rack system for C-Stores that coordinates all displays and cleans-up the counter, allowing our brands the primary position. (1992-1993)
- Work with store designers/architects to ensure PM-USA fixtures are the preferred units, specified at the store design state. (1991-1995)
- Research new cigarette dispensing/merchandising equipment to stay abreast of leading edge developments. (1991-1995)

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SALES

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# SALES

Since 1987, the PM-USA Sales Plan has been focused against three major trends within the cigarette marketplace: pack sales strength, price/value growth, and promotional activity.

Sales time has been utilized primarily to increase carton and pack rack presence consistent with different trade channel opportunities (price/value racks in pack outlets, carton and pack racks in carton outlets) and to implement increasing levels of promotional activity. Available Sales' man-days numbers increased 41% between 1986 and 1989, while demand for in-store time increased 44% due to increased rack placements and increased promotion placement. During this time, the number of stores covered by Sales decreased 2%, while frequency of coverage decreased 7%, largely due to a 69% increase in the number of promotions implemented by Sales.

Additionally, Sales fielded the Masters in Distribution Excellence Program, focused primarily at distributors. Customers represent 87% of our direct account volume participation in Masters. Our most meaningful results are achieved in tobacco distributors where Masters helps insure, within the customer, a more disciplined approach to managing our business.

It is apparent that despite a major (41%) increase in manpower between 1986 and 1990 that most of our share growth can be attributed to the greater availability and aggressive promotion of lower-priced cigarettes.

During the plan period, the Sales Force's role will need to go beyond in-store execution to include the enlistment of customers in marketing cigarettes via increased promotion and presence activity. To this end, PM-USA Sales needs to create a competitive advantage for our brands with customers, within geographies/markets and with consumers at the point of purchase.

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## Issue:

IN-STORE PRESENCE FOR PM-USA BRANDS CONTINUES TO BE A PRIMARY SALES MISSION, BUT PROMOTION HAS BECOME AN IMPORTANT AND TIME-CONSUMING REQUIREMENT THAT DRIVES VOLUME TO A GREATER DEGREE THAN TRADITIONAL RACK MERCHANDISING. MORE FOCUS AND TIME FOR SELLING IS NEEDED TO TAKE ADVANTAGE OF THIS TREND.

---

## Strategy:

Streamline retail execution to create new brand, existing brand and promotion advantages at the point of consumer purchase.

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## Action Plan:

### 1991-1992

- Identify less labor-intensive promotion vehicles.
  - Test short-term performance contracts.
  - Test off labels/bonus packs.
  - Test near pack premiums.
  (1991-1992)
- Use alternative labor sources.
  - Enlist distributors.
  - Test contracted part-time merchandisers.
  - Test pack outlet assembled premium packs.
  - Explore secondary manufacturing for coupon packs.
  (1991-1992)

### 1991-1992

- Double coverage frequency.
  - Build a model geography to test and track results. (1991-1992)



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Issue:

AN INCREASINGLY COMPLEX SALES ENVIRONMENT REQUIRES BETTER QUALITY PEOPLE WITH NEW SKILLS, BROADER BUSINESS EXPERIENCE AND MORE FOCUS ON SELLING.

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Strategy:

Create a people advantage.

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**Action Plan:**

**1991-1992**

- Seed the key leadership group. (1991-1992)
- Develop the leadership group. Teach skills in the areas of collaborative leadership, change management negotiation skills, strategic planning and customer operations. (1991-1992)
- Improve entry level quality of sales force manpower through college recruiting programs and target career pathing. (1991-1992)

**1991-1992**

- Raise performance standards.
  - Redefine roles and standards for each job.
  - Tie to performance review/performance development process.
  - Implement reward recognition system more directly tied to individual and team results. (1991-1992)



2048360383

Issue:

A MORE COMPETITIVE MARKETPLACE AND INCREASED CUSTOMER DIFFERENTIATION REQUIRES RESPONSIVE, LOCALIZED DECISION MAKING TO ENSURE WE EFFECTIVELY SPEND TRADE MERCHANDISING AND PROMOTION DOLLARS.

---

Strategy:

Operate with a simple direction - setting process and structure that localizes decision.

---

Action Plan:

1991-1992

- Build a structure based on geographic hierarchy.
  - Design market units and territories below sections.
  - Establish management roles for each geography with accounts and people.
  - Design objective setting and tracking process by geography.
  (1991-1992)

- Build a trade marketing resource within Sales.
  - Structure around brands for promotion.
  - Structure around trade channels for merchandising.
  - Tie field communication to group.
  - Design and implement a promotion-planning process.
  - Reposition category programs in group.
  (1991-1992)

- Make the region the focal point for planning.
  - Establish budgets.
  - Set up volume planning process at region level.
  - Position region promotion and merchandising resources.
  (1991-1992)

1991-1992

- Establish and communicate a Sales purpose strategy and objective set in a way that creates ownership.
  - Set up collaboration teams to create involvement and improve decision making.
  - Design a communication process that connects all of sales.
  - Complete process to sales rep level by February 1992.
  (1991-1992)

- Focus on what works - STEP UP AND GROW!
  - Establish STEP UP objectives at all levels.
  - Establish STEP UP tracking system and publish to section level monthly.
  - Develop appropriate GROW measures and tracking system.
  (1991-1992)

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## STEP UP
## 1991 Step Up Objectives

| | Current Level | 1991 Objectives | Change vs. Year Ago |
|---|---|---|---|
| • *Space/share* | | | |
| - Inventory sales ratio | | | |
| Marlboro | 53 | 58 | +9% |
| All Other | 120 | 117 | (2.5%) |
| • *Total Coverage* | 87% | 95% | +9% |
| • *Effective Distribution* | 95 | 98 | +3% |
| - Ratio PM-USA vs. RJR | | | |
| • *Promotions and Presence* | | | |
| - Pack outlet penetration | | | |
| Promotions | 33 | 40 | +21% |
| Displays/Merchandisers | 76 | 75 | - |
| - Carton outlet penetration | | | |
| Promotions | 30 | 35 | +17% |
| Fixtures/Merchandisers | 37 | 50 | +13% |
| • *Utilize Resources* | $796.4 | $847.7 | +6.5% |
| • *Profitable Volume* | | | |
| Full Margin | 194.5 | 192.0 | (1.2%) |
| Price/value | 19.9 | 21.1 | +17.8% |
| Subgenerics & FVB | 8.1 | 9.6 | +18.5% |
| TOTAL | 220.5 | 222.7 | +1.0% |

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Issue:

CUSTOMERS ARE GROWING AS AN INFLUENCE OVER CONSUMER DECISIONS. THEY ARE BECOMING MORE RELIANT ON A FEW KEY SUPPLIERS AS PARTNERS IN DEVELOPING CATEGORY STRATEGIES TO STIMULATE CONSUMER RESPONSE.

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Strategy:

Combine people quality, relationship building and category expertise to become the first-tier supplier to customers.

---

Action Plan:

**1991-1992**

- Upgrade quality, experience and focus applied to key customers.
  - Assign accounts to all managers.
  - Restructure national accounts around trade classes.
  - Balance account loads with people responsibility.
  (1991-1992)

- Use trade relations to develop specific customers/trade classes and understand their needs.
  - Develop a series of individual customers events.
  - Build the PM Customer Council around future CEO's.
  - Develop trade channel specific events with business substance.
  (1991-1992)

**1991-1992**

- Develop concepts, ideas and information that differentiates us from competitors.
  - Design a computer-aided, profit-based shelf plan-o-gram selling program.
  - Explore video shopping as a basis for selling in-store promotion.
  - Develop a KGF tie-in for food store promotion.
  - Do "shopping habit" research as basis for selling fixtures using "micro-merchandis-ing."
  - Fully develop the "share" concept as a sales program.
  (1991-1992)

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CORPORATE
AFFAIRS

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# CORPORATE AFFAIRS

PM-USA's socio-political objective is to minimize government interference in the production and marketing of cigarettes, and to protect smokers rights.

During the plan period, PM-USA will have to accomplish its volume, share and profit objectives in an increasingly hostile socio-political environment. One of the industry's greatest threats is taxation. State excise taxes are forecast to continue increasing over the plan period from an average 1990 tax of 23.8 cents per pack in 1990 to 36.2 cents in 1995. This represents a 10% average annual increase, 2.5 percentage points higher than the 1990 - 1994 Plan forecast of 7.5%. The higher excise tax forecast reflects the influence of two factors. First, the organized anti-smoking movement has made higher cigarette excise taxes an important part of their legislative agenda, stating that smokers should pay for the alleged "social costs" imposed on the economy; second, the poor fiscal health of many populous states, particularly those in the Northeast such as New York and Massachusetts. Surveys conducted by the Federal Government indicate that 50% of the states face potentially serious revenue shortfalls in the near future, raising the probability of cigarette tax increases. It is PM-USA's objective to defeat all cigarette excise tax proposals and promote the development of stable fiscal/tax policies which distribute the tax burden equitably.

Other major challenges over the plan period, include altering the public perception of the health dangers of environmental tobacco smoke (ETS) and preventing marketing restrictions on sampling, vending, sponsorships, and advertising. PM-USA will work closely with the Tobacco Institute to lobby government officials and mobilize smokers to promote legislation protecting smokers from discrimination by employers. Also, we will work to defeat legislation concerning government mandated product specifications such as fire safe, ingredient labeling and solid waste legislation affecting our products and packaging.

Five Year Plan goals for PM-USA Corporate Affairs include:

### Taxation

- Minimize overall rate of excise tax increases.
- Reform legislative ballot process to limit tax initiatives.
- Promote a progressive and equitable tax structure.
- Refute alleged "social costs" placed on society by smokers.

### Product

- Preserve freedom to advertise/promote.
- Demonstrate commitment to market only to adults.
- Prevent government mandated product specifications.

### Consumers

- Defeat\modify state and local smoking restrictions.
- Prohibit employment discrimination.
- Promote accommodation in public and private sectors.

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## Taxation

An economic forecast of state fiscal conditions prepared by the National Association of State Budget Officers indicates that 50 percent of the states face potentially serious revenue shortfalls in fiscal year 1991. This occurs at a time when governors and legislators are under increasing pressure to provide services and fund escalating infrastructure, education and medicare costs. This significantly raises the probability of tax increases, specifically cigarette excise taxes which continue to be a revenue source for legislators seeking to close budget deficits.

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### Issue:

STATE EXCISE TAX INCREASES RAISE THE RETAIL PRICE OF CIGARETTES AND CONTRIBUTE TO INDUSTRY VOLUME DECLINE.

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### Strategy:

Defeat cigarette excise tax proposals by participating in the developmental stages of tax policy through the dissemination of information to public policy analysts, as well as executive officers and legislators. These lobbying efforts are designed to cultivate them into reliable and well versed allies.

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### Action Plan:

**1991-1992**

- Develop and publish studies:
  - Bootlegging/cross-border activities
  - Regressive nature of proposed taxes
  - Demonstrate earmarking is an inflexible, unstable revenue source
  - Progressive solutions to government deficits
  - Examining the efficiency of local taxing authority
  - Wasteful government programs and excessive spending
  - Tobacco impact analysis (targeted)
  - Stability of taxes derived via the ballot vs. those derived via the legislature.
- Promulgate analysis of alternative revenue sources.
- Co-sponsor forums and special events to strengthen constituency development:
  - Role of private sector in the delivery of government services and efficient government.
  - History of the tax initiative and its impact on development of fiscal and tax policies.

**1991-1992**

- Initiate, coordinate and develop grass roots lobbying activities through Smokers' Caucus, "Mobilizations", Smokers' Advocate.
- Identify and address community, civic and business groups on excise taxes and tax ballot initiatives.
- Publish editorials on tax developments inefficiency of tax ballot initiatives, government waste and regressivity, etc.

**1993-1995**

- Introduce and pass legislation which would modify the tax initiative process and require higher quotas for passage.
- Introduce and pass industry favorable rollback initiatives.

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## "Social Costs"

Cigarette smoking has been inappropriately associated with a spectrum of health and socioeconomic "ills." Productivity losses, absenteeism, rising health care costs and increases in various types of insurance coverages are just a few.

The association of smoking with these societal problems has spawned numerous anti-smoking policies. Smoking bans and restrictions, divestiture of tobacco stocks/support, segregation and privacy infringement are activities which have been promoted in the name of "social cost" correction. These promote contraction of the industry's market, increase the cost of product marketing and reduce long-term profit expectations.

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### Issue:

THE ASSOCIATION OF SMOKING AND ALLEGED HEALTH/SOCIOECONOMIC COSTS IS BEING LEVERAGED BY ANTI-TOBACCO FORCES TO ADVANCE ANTI-TOBACCO LEGISLATION.

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### Strategy:

The emphasis of the plan is to educate the media, public policy makers and relevant business and civic groups. It is critical to create a truthful, balanced view of the "social cost" issue.

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### Action Plan:

**1991-1992**

- Develop and publish studies:
  - Systematic, external micro-economic models to provide a clear picture of smoking's impact on society.
  - Applicability and measurement of social costs and social benefits to fiscal/tax policy development.
  - The value of free choice in a democratic society.
- Identify and address political groups, fiscal/tax analysts groups and appropriate governmental bodies on social costs and the value of individual freedoms.
- Develop, disseminate and publish editorials on social cost theory.
- Write OP/ED pieces on various policy decisions which have incorrectly used social cost theory as a basis for justification.

**1993-1995**

- Sponsor sessions at annual conferences on social cost theory and its application in public policy development.
- Co-sponsor symposiums with Centers in Public Policy and Society of Government Economists on social cost theory for legislators and other government officials.



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## Marketing and Sales Restrictions

The organized anti-smoking movement is attempting to restrict or ban our ability to reach smokers through marketing and sales vehicles considered legitimate tools for virtually all other products. Restrictions on advertising, sponsorships, sampling and couponing prevent us from maintaining our consumer base, as well as increasing market-share relative to other cigarette manufacturers. In addition, restricting our ability to advertise reduces our public credibility in selling a legal product.

PM-USA's goal is to defeat proposed marketing and sales restrictions or bans. PM-USA is taking a proactive approach by introducing legislation to prohibit these restrictions. The company has responded to the youth issue by developing a series of programs to demonstrate its commitment to ensuring that smoking remains an adult practice.

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### Issue:

THE ORGANIZED ANTI-SMOKING MOVEMENT IS USING FAULTY HEALTH AND YOUTH ARGUMENTS TO ADVANCE LEGISLATION TO RESTRICT OR BAN THE SALE AND MARKETING OF CIGARETTES.

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### Strategy:

PM-USA 's strategy to combat marketing restrictions is twofold. First, it is critical to advance our position that the tobacco industry believes that smoking is an adult custom and does not want minors to smoke. Second, demonstrate to elected officials, public policy decision makers, consumers and the media that advertising, sampling and sponsorship are a form of free speech protected by the First Amendment.

---

### Action Plan:

**1991-1992**

*Youth and Smoking*

- Promote Tobacco Institute new series of "youth programs":
  - Retail Awareness Program
  - Responsible Living Program
  - Youth Guidelines
  - Minimum Age Legislation
  - Vending Machine Sales Legislation
- Introduce legislation pertaining to minors (minimum age (18), supervised vending).
- Use PM-USA communication vehicles (Magazine, Advocate and Smokers' Caucus) to discuss the Company's position on youth smoking.

**1991-1992**

*Youth and Smoking*

- Communicate the Company's position through advertorials in Teacher, Police and Government Publications on youth smoking targeted for specific states or municipalities where further cigarette sales and marketing restrictions are anticipated.

**1993-1995**

- Develop and disseminate a "Helping Youth Decide" course and materials for school curricula.

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## 1991-1992

*First Amendment Issues*

- Coordinate activities with local American Civil Liberties Union affiliates in opposition to bans or restrictions (Freedom of Speech).
- Work with the National Conference of State Legislators and other government associations to oppose resolutions.
- Sponsor U.S. Symposium on Imagery and Sponsorship to review use and benefits.
- Develop arguments to counter anti-smoker's claims on "targeting." Coordinate with minority interest groups to reduce opposition to outdoor advertising.

## 1991-1992

*First Amendment Issues*

- Analyze impact of brand sponsorships on local economies.
- Address community and civic groups on marketing and sales practices through Speakers Bureau.
- Develop grass roots lobbying activities to assist field staff.
- Identify authors for articles on free speech and sales issues.
- Monitor articles in state and local newspapers which are supporting bans and restrictions.



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## Mandated Product Specifications

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**Issue:**

PUBLIC CONCERN OVER ENVIRONMENTAL AND FIRE PREVENTION ISSUES COULD PLACE UNREASONABLE REQUIREMENTS ON OUR PRODUCTS AND PACKAGING.

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### *Environmental Plan Development - Solid Waste Issues*

Environmentalist-fueled public concern has culminated in the introduction of legislation and referenda which would mandate recycling levels. Over 800 bills were proposed in 1990 of which most involved the following:

- Mandate minimum recycling levels in packaging coming into the state;
- Mandate levels for the recyclability of packaging;
- Prohibit certain heavy metals, plastics and packaging;
- Establish fees, fines and/or taxes to create regulatory agencies and assist in land fill clean-up.

Before the company can move from a defensive to an offensive footing, we will establish our own environmental goals and the criteria by which we can judge our own progress. The PM-USA Environmental Plan will address the following areas:

### I.) Post-Consumer Waste Stream

Defined as: 1) materials disposed of after they are used to bring our products to the market, such as shipping crates, 2) materials thrown away by consumers after our product is used, such as cartons, packaging (including the wrapper and foil) and filters.

Post-consumer wastes are at the center of the solid-waste problem, particularly because the public handles them and states and municipalities have to dispose of them. Much of the solid-waste reduction legislation affecting us is designed to reduce wastes by imposing restrictions on our products. PM-USA's solid-waste policy will:

- Establish targets to reduce our packaging solid-wastes through source reduction, recycling and degradability;

- Define long-term political objectives related to the statement concerning our support for either state or federal government solid-waste programs;

- Establish a Corporate Affairs/Operations/Legal working group to advise on ongoing programs;

- Conduct or sponsor research on new methods for waste reduction, particularly in the area of packaging development;

- Poll consumer attitudes vis-a-vis company solid-waste initiatives.

### II.) Staff Activities

Wastes in this area are generally created from management activities (computer paper, stationary, toner, etc.).

What we do to reduce our contribution to the non-packaged good solid-waste stream can be significant public relations benefit. Fostering "good will" with the public and environmentalists can



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reduce pressure on states and municipalities to pass new regulations. A number of programs can be implemented to demonstrate our environmental commitment:

- Contract with a recycler to sort office wastes for collection (sorting copier toner, computer ribbons and cleaning solvent wastes for collection and disposal)
- Promote the use of recycled copier/computer paper and stationary
- Establish a double-siding program to eliminate paper wastes
- Utilize recycled materials in our commissaries wherever possible (plastic plates and utensils) or increasing the use of non-disposables.
- Employee Involvement

## III. ) Manufacturing Activities

Solid-wastes in this area are: 1) devices to store raw materials (hogsheads, pallets), 2) by-products created during manufacturing (waste-water, solvents and cleansers), 3) materials remaining after manufacturing (TOW, tobacco, cigarette paper, etc.).

Wastes generated through manufacturing have a significant impact on the communities where our facilities are located. Efforts to reduce wastes in this area can realize significant cost savings for the company as well as for these communities. Guidelines and targets will be established for the following:

- Plan emissions (compliance with federal, regional and state air and water standards);
- Reduction of wastes (TOW, non-hazardous waste oils and solvents, hogsheads and pallets, etc.) including recycling, waste water treatment, landfill and co-generation incineration;
- Separating waste materials at our facilities and contracting with recyclers to collect our wastes;
- Determining the best vehicles to enable our environmental people to work with state and local refuse officials and foster public support.

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**Action Plan:**

**1991-1992**

- Promote research on solid-waste through third parties to make available to government coalitions.
- Develop working groups with favorable legislators and environmental groups.
- Develop newsletters, fact-sheets and bulletins for use in lobbying.

**1991-1992**

- Participate in business coalitions:
  - Tobacco Institute
  - National Association of Manufacturers
  - Grocery Manufactures Association
  - Coalition for Solid-waste Solutions
  - Coalition for Responsible Waste Management
- Cross-reference our data-base to locate areas where PM employees are concentrated, or where major suppliers are located.

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**1991-1992**

- Develop a vehicle for PM-USA regional people to meet with environmental groups to address issues.
- Develop advertorials, op-eds, editorials and opponent responses, on PM-USA's environmental position and the company's progress.
- Conduct polling and publicize results supporting our positions.

**1993-1995**

- Draft and sponsor our own ballot initiatives concerning solid waste and recycling.
- Draft model state legislation.

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### *Fire-Safe Cigarette*

The fire prevention community alleges that cigarettes are one of the most identifiable causes of fire. The Moakley Bill was signed into law in 1990. It authorizes the Technical Study Group (TSG) to examine the feasibility of producing and marketing a fire-safe cigarette for three years. The goal is to create a standard to measure cigarette ignition propensity. During this three year examination period, PM-USA will build coalitions among the fire prevention community and public policy makers to diffuse support for other restrictive fire-safe legislation at the state or federal level.

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**Action Plan:**

**1991-1992**

- Work with National Conference of State Legislators and other government associations to oppose fire-safe resolutions.
- Coordinate lobbying activities on state bills with state fire, police and paramedic organizations.
- Sponsor fire-safety awareness programs and symposiums for key groups.
- Use experts to develop information on costs and impact of other causes of fire.
- Use Business Round Table/Committee Against Regressive Taxation Programs to educate employees in other industries.
- Feature articles in PM Magazine on fire-safety/prevention and on highlighting significant achievements of fire, policy and paramedic professionals.

**1991-1992**

- Use PM-USA's communication vehicles to educate smokers on fire-safety and prevention.

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## Anti-discrimination and Privacy

Increasingly, legal off-the job activities and lifestyle choices are used as criteria for employment decisions including hiring, promotion and dismissal. Employee privacy rights are violated by employer mandates regulating off-work activities and testing mechanisms established by employers to ensure compliance with these mandates. Employers argue that these measures are necessary to control costs, including health care benefits and productivity allegedly linked to certain lifestyle choices and behavior.

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### Issue:

LEGAL AVOCATIONAL ACTIVITIES UNRELATED TO JOB PERFORMANCE ARE BEING USED BY EMPLOYERS IN MATTERS OF HIRING, PROMOTIONS AND DISMISSAL.

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### Strategy:

Demonstrate to elected officials and private sector decision makers that the public supports individual privacy rights that protect legal, avocational activities. In addition, show that the public favors only the use of job performance criteria for employment decisions.

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### Action Plan:

**1991-1992**

- Use privacy experts for speeches, expert witness testimony in court cases, legislative/ rule making bodies, media: op-ed, editorial visits and feature articles, etc.
- Demonstrate public support for privacy rights and nondiscrimination.
- Build coalitions with labor unions, ACLU, minority associations, and other organized groups who suffer from discrimination.
- Develop Victim Profile Program: identifying victims and providing legal/technical assistance in court cases.
- Place privacy/anti-discrimination articles and op-eds in print and broadcast media.
- Utilize PM-USA communication vehicles such as PM magazine, Smokers' Advocate and Smokers' Caucus to:
  - Identify aggrieved parties.
  - Raise public awareness of privacy and discrimination issues.
  - Specifically alert smokers to private/public sector infringements.

**1991-1992**

- Use Speakers' Bureau to raise public awareness about privacy and discrimination issues.
- Pass legislation prohibiting discrimination in employment conditions based on smoking status in 30 states.

**1993-1995**

- Pass anti-discrimination legislation in remaining states.



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## Accommodation

PM-USA is taking a proactive approach to smoking bans and restrictions by promoting accommodation programs as the primary legislative and private sector alternative. The company is also promoting the use of non-differential rate structures for insurance coverage of smokers and non-smokers.

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## Issue:

ONEROUS RESTRICTIONS AND BANS REDUCE THE NUMBER OF ENVIRONMENTS AND ULTIMATELY THE TIME INDIVIDUALS CAN ELECT TO SMOKE.

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## Strategy:

Demonstrate to elected officials, public policy decision-makers, industry, unions and trade associations that the public supports accommodation programs. Bans and restrictions impose costs on the private sector, reduce tax revenue and promote government interference in business.

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## Action Plan:

**1991-1992**

- Place articles describing success of accommodation programs in government and trade journals.
- Use indoor air quality experts as witnesses, testimony, op-ed and editorial visits to promote sound indoor air quality programs and demonstrate the problem of sick building syndrome.
- Determine economic impact of smoking bans on business and government.
- Introduce and market restaurant accommodation program with state restaurant associations, restaurateurs and chains.
- Develop and market work place and service venue accommodation programs with:
  - National Federation of Independent Businesses
  - American Manufacturers Association
  - International Council of Shopping Centers
  - Hospitality/service associations
- Sponsor study of:
  - Costs of work place bans (e.g. morale, productivity)
  - The fallacy of costs savings (e.g. health, absenteeism claims).
  - Present in trade journals

**1991-1992**

- Implement EPA "Class A" mitigation strategy:
  - Host Indoor Air Quality Workshop with NFIB Foundation and National Chamber Foundation.
  - Develop a business coalition to advocate uniform federal risk assessment guide lines.
  - Persuade OSHA to establish acceptable ETS threshold levels for the workplace.
  - Encourage further investigation of proce dural biases in EPA review process.
- Use PM-USA communication vehicles for features on accommodation (PM Magazine and identify elected officials voting for/or against accommodation programs.

**1993-1995**

- Publicize Pittsburgh Benedum Project and other innovative indoor air quality technology through journal articles, trade publications, etc.
- Design an integrated consulting firm to assist firms to solve indoor air quality problems, comply with smoking laws and reduce air quality related illness.

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EMPLOYEE
RELATIONS

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# EMPLOYEE RELATIONS

The environment in which PM-USA operates, and the Company's response to it, has a direct and significant impact on our work force. As competitive pressures in the industry intensify over the next five years, throughout the organization, productivity increases will be needed to support income objectives. While capital expenditures in facilities and equipment provide the foundation to achieve these increases, better human resource management provides the blocks with which to build.

PM-USA provides developmental opportunities, challenging assignments and high-visibility projects for high potential employees including females and minorities. It is critical that PM-USA prepare more of these individuals for management positions, recognizing the different skills, perspectives and ideas they add to the corporate culture. Entwined with this are the issues of compensation and employee benefits which need to be adequately managed to satisfy both the employee and the Corporation.

The key areas to be addressed by Employee Relations over the course of the plan period include:

- *Employment*: As perceptions about the cigarette industry evolve and our organizational growth slows, the challenge becomes one of maintaining current employee morale, continuing to attract qualified candidates, and providing sufficient opportunities for advancement.

- *Affirmative Action*: From now until the end of the century, 88% of work force growth will come from women, blacks and people of Hispanic or Asian origin. The diversity of the new work force presents many opportunities and obstacles for PM-USA.

- *Labor Relations*: Management has negotiated an extension of the Long-Term Agreement through 1994 and performed an LTA cost/benefit analysis, and will reach a decision with regards to future extension of the agreement.

- *Employee Benefits*: With double digit increases anticipated this year nationally for health care, controlling employee benefit costs while satisfying the diverse needs of our work force will continue to be a primary concern.

- *Compensation:* Strategies need to be developed to link performance with monetary compensation to motivate and reward employees.

- *Leadership Development:* Strategic thinkers with analytical and leadership skills are necessary to lead PM-USA into the 21st century.

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## Employment

There is a voluminous flow of negative information from vocal anti-smoking forces which portrays the tobacco industry as an undesirable career choice. This may result in significant increases to our cost per hire during the plan period with no assurances that the required talent will be obtainable.

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## Issue:

THE INCREASINGLY HOSTILE, ANTI-TOBACCO MARKETPLACE LIMITS PM-USA'S ABILITY TO ATTRACT HIGHLY QUALIFIED CANDIDATES.

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## Strategy:

Counteract the flow of negative information concerning the tobacco industry, its stability and acceptability. Aggressive measures will inform members of the professional community, college academic leaders and students, and the general labor market, of the positive career opportunities available at PM-USA.

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## Action Plan:

**1991-1992**

- Identify and promote internal candidates for open assignments when highly skilled candidates can be identified and upward mobility goals can be met. Recruit highly skilled external talent to supplement internal skills base and/or meet upward mobility skills. Upward mobility is particularly critical at and above grade 12. (1991-1992)
- Determine which universities produce graduates whose academic training is compatible with our entry-level positions. (1991-1992)
- Survey and analyze industry programs and solicit input of academic leaders concerning visits or presentations. (1991-1992)
- Target professional organizations, conferences and colleges to increase applicant flow. (1991-1992)
- Create an employee referral system for identification of minority and female candidates. (1991-1992)
- Formulate a hiring plan that will prevent unexpected hiring surges, and unanticipated use of executive search firms and employment agencies. (1991-1992)

**1991-1992**

- Review current recruitment literature; modify or develop. (1992)
- Project supervision, production worker, and craft recruiting needs and develop a thorough recruiting and selection system to match projected needs. (1991)
- Implement campus recruiting advertisement campaign. (1992)
- Continue to explore/experiment with open-house and other recruiting methods. (1991-1992)

**1993-1995**

- Survey grant requirements to universities. (1993)
- Study the possibility of developing an Aid-to-Education Program that will be targeted at key universities. (1993)
- Develop close relationships with and provide clear communication of recruiting needs to targeted universities. (1993)



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### Affirmative Action

During the plan period and beyond, the mix of new job applicants will shift sharply away from white males. By the year 2000, white males are projected to represent only 15% of the new entrants to the work force, in sharp contrast to their 47% representation in today's work force and virtual dominance of the executive ranks. Although we have been successful in hiring females and, to a lesser degree, minorities into entry level jobs, the upward mobility of these individuals has been an issue. Minorities and females are underrepresented in promotional opportunities. In 1988, 81% to of all placements at the middle manager level and above (grade 12+) were filled by white males.

Upward mobility and the broader issue of effective management of cultural diversity, becomes the focus for the future. Affirmative Action, therefore, is not only a social, ethical, and legal mandate, it is a business necessity.

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### Issue:

CULTURAL DIVERSITY IN OUR WORK FORCE DEMANDS MANAGEMENT'S FULL ATTENTION TO CAPITALIZE ON OUR HUMAN RESOURCE POTENTIAL.

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### Strategy:

To accomplish this, a threefold strategy will be implemented. First, continue aggressive recruiting and development programs aimed at upward mobility gains. Second, develop and implement work/life programs that are "family friendly" and aimed at making us the "preferred employer". Third, provide appropriate awareness, education and training programs.

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### Action Plan:

**1991-1992**

- Establish a position in the Affirmative Action Department that coordinates our efforts to:
  - Encourage management to welcome and value all employees. Hold management accountable for creating a favorable climate that values diversity and the contribution of each employee.
  - Continue to train management in areas such as:
    - Valuing diversity
    - Managing employee productivity
    - AA/EEO fundamentals
    - Employee motivation
    - Communication
    - Performance appraisal
    - Recruiting and selection
    - Harassment in the work place

**1991-1992**

- Review all policies and benefit programs and consider "family friendly" revisions, such as:
  - Flexible and part-time hours
  - Flexible benefits
  - Dependent care
  - Personal leaves of absence
- Implement an Affirmative Action Recognition Program.
  (1991-1992)

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**1991-1995**

- Establish a goal of 20% minority and 50% female representation in all of our salaried grade groupings by 2010. (1991-1995)

- Tie Upward Mobility, Succession Planning, and Affirmative Action Planning together as a joint process with identical timing setting annual goals. Involve appropriate management and hold them accountable for plans and results. Discuss succession plans, career potential and development plans with identified successors. (1991-1995)

- Ensure that opportunities arise to make placements.
  - Implement an annual executive review of grade 15+ employees and an annual management review of grade 12-14 employees to determine relative strength and projected contribution. Identify those employees to be out-placed.
  - Develop a formal outplacement program to include counseling, communication, placement, and financial components. (1991-1995)

- Commit to external hiring at any level when necessary to meet annual representation and placement targets.

**1991-1995**

  - Devote adequate human and financial resources to aggressively recruit minority and female talent at all levels of the organization.
  - Experiment with additional methods of recruiting.
  - Ensure that MBA hiring reflects targeted placement rate. (1991-1995)

- Commit resources to the educational systems that provide talented candidates to the locations in which we operate.
  - Establish strong relationships with a small number of excellent colleges and universities that graduate minorities in the disciplines for which we recruit. Provide financial support, faculty exchange programs, and internships in the appropriate disciplines.
  - Provide remedial education/training to our employees on site, after work hours, free of charge.
  - Establish strong relationships with several high schools in each of our locations. Provide financial support and leadership for programs that support our needs. (1991-1995)



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## Labor Relations

Contracts under the original Long Term Agreement and its current extension have been negotiated without the threat of strike action. This assured, non-interruption of production has been a large factor in enabling PM-USA to realize efficiencies in the manufacturing environment and to implement our marketing strategies.

While the cost associated with the original LTA were abated by the extended (1988-1994) agreement, costs directly attributable to the LTA continue. An LTA cost/benefit analysis is indispensable in reaching a rational decision regarding the future extension of the LTA. PM-USA will seek a cost effective decision which will not adversely impact our ability to meet market demand.

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### Issue:

IN ORDER TO BECOME THE LOW-COST PRODUCER IN THE INDUSTRY AND INSURE RESPONSIVENESS TO MARKET DEMANDS, THE COMPANY MUST CONTROL HOURLY WAGE AND BENEFIT COSTS, IMPROVE PRODUCTIVITY, AND ACHIEVE GREATER OPERATING FLEXIBILITIES WHILE AT THE SAME TIME SECURE A COST-EFFECTIVE EXTENSION TO THE LTA WHICH IS ACCEPTABLE TO OUR UNIONS.

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### Strategy:

Negotiate local agreements which buy long-term productivity and flexibility improvements and negotiate a competitive joint economic package which leverages an extension to the LTA.

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### Action Plan:

**1991-1992**

- Establish 1991 Maximum Negotiation Parameter which:
  - Leverages acceptance of an extended no-strike guarantee through 2001.
  - Is defensible in the event of interest arbitration relative to B&W comparability. (1991)

- Establish 1991 Target Parameter which:
  - Positions PM competitively against RJR relative to cost per thousand attributable to hourly labor.
  - Repositions traditional fixed compensation entitlements, i.e. Cost of Living Allowance, Deferred Profit Sharing, or General Wage increases, to variable based compensation. (1991)

**1991-1992**

- Negotiate Basic Agreements in 1991 and 1994 to meet the following long term objectives:
  - Upgrade quality of current workforce to meet demands of new technology.
  - Produce competitive conversion cost vis-a-vis hourly workforce.
  - Secure contractual flexibilities which will enhance responsiveness and reduce



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## Employee Benefits

While the country has experienced a general price inflation of around 5% per year, the cost of health care has been rising at double digit rates. Health care cost increased 25.5% between 1988-1989 and another 17.6% in 1990 to an estimated $83.4 million. Post retirement health care costs must be addressed as a result of FASB 89. In addition, further government intervention in the form of tax reform and compliance regulations will increase the complexity of benefits administration.

PM-USA's benefits package is a major consideration for job candidates. In some cases, the benefits package is the "swing vote". Furthermore, current employees have indicated a clear desire for "more choice" with respect to benefit election.

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### Issue:

THE BENEFIT PACKAGE REPRESENTS A SIGNIFICANT COST AND MUST BE MANAGED TO ENSURE COMPETITIVENESS AT A REASONABLE COST.

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### Strategy:

Evaluate and implement programs that provide cost effective benefits which are competitive and address the needs of employees.

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### Action Plan:

**1991-1992**

- Refine recommended design changes on:
  - Post-retirement health care
  - Managed health care
  - Flexible benefits
  
  Targeting 1992 implementation. (1991-1992)
- Continue to develop target administrative fees and performance guarantees for use in negotiations with carriers and vendors to include enhancements to managed health care offerings. (1991-1992)
- Continue to finalize new PM-USA responsibilities as a result of Corporate decentralization. (1991)
- Present health care cost issues and recommendations to management and union leadership prior to 1991 negotiations. (1991)

**1991-1992**

- Continue to educate workforce on the issue of rising health care costs. (1991-1992)
- Utilize computerized system to streamline the open enrollment process, internally administer flexible benefits, prepare hourly benefit statements and produce benefit cost reports. (1991-1992)
- Conduct external survey on hourly benefits labor/management contract negotiations. (1991-1992)
- Implement plan design changes for the salaried work force. (1992)

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**1993-1995**

- Implement a phased-in introduction of a voice response benefits information system for direct employee access of personal benefit information. (1991-1993)
- Rebid carrier contract(s), consolidate vendor relationships and develop communications. (1991-1993)

**1993-1995**

- Conduct semi-annual meetings with management and union leadership to examine health care and other benefit issues. (1992-1995)
- Implement and communicate negotiated benefits, maintain market position at 75th percentile of a select group of companies. (1992-1995)

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## Compensation

During the 1991-1995 Five Year Plan period, the key focus for compensation will be developing overall strategies for the operating company that clearly link compensation to results against goals. Additionally, compensation programs must be aggressive and innovative to help mitigate the political and social issues which are negatively impacting recruiting and retaining key employees. Finally, innovative job design concepts will be necessary to attract and retain the growing number of professionals unable to work traditional schedules.

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### Issue:

COMPENSATION PROGRAMS MUST BE COMPETITIVE AND AGGRESSIVE TO ATTRACT AND RETAIN THE KNOWLEDGE AND SKILLS NEEDED IN OUR BUSINESS. INCENTIVE PLANS MUST HAVE A CLEAR LINK TO BUSINESS GOALS TO EFFECTIVELY MOTIVATE EMPLOYEES AND REWARD RESULTS.

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### Strategy:

A multi-step strategy will be employed to:

- Develop overall pay policies and programs for the operating company that provide a cohesive foundation for recruiting, cross-training, transferring and motivating employees.
- Design and implement variable compensation programs that motivate employees to achieve business goals and reinforce those efforts.
- Develop and implement recommendations which provide alternative work situations for professional employees.

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### Action Plan:

**1991-1992**

*Pay Policy*

- Implement national pay structure for PM-USA E10 and above. (1991)
- Consolidate ranges and merit guidelines where possible. (1991)
- Implement lump sum program to address high Richmond base pay. (1991)
- Address pay related issues from Management Attitude Survey. (1991)
- Assess job evaluation issues related to the Hay Plan and continue to improve the process and the consistency. (1991-1992)

**1993-1995**

*Pay Policy*

- Assess success of merit pay strategies and adjust programs as required. (1993-1995)
- Assess impact on key technical groups, production and technicians. (1993-1995)
- Continue educating management on the goals and process. (1993-1995)



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## 1991-1992

*Variable Compensation*

- Implement two-tier monetary recognition program for salaried employees. (1991)
- Implement the new Management Incentive Program. (1991)
- Develop sales incentives program. (1991-1992)

*Job Design*

- Implement flexible employment for dependent care reasons. (1991-1992)

## 1993-1995

*Variable Compensation*

- Assess success of program and quality of selections. (1993-1995)
- Continue fine-tuning IC Program and assure that quality department goals are determined and the program is understood and managed effectively. (1993-1995)

*Job Design*

- Continue to assess pros and cons of program. (1994-1995)



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## Leadership Development

Our business challenges require that we have strategic thinkers and managers in positions of authority with the business perspective, analytical and leadership skills to make decisions necessary to take advantage of the opportunities in the future. These executives and managers must be equipped to take responsibility for utilizing and developing the members of an increasingly diverse work force. To maintain and improve on our record of performance in an environment of change and uncertainty will necessitate better assessment and development of such skills.

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### Issue:

SELECTION AND DEVELOPMENT OF CURRENT AND FUTURE MANAGEMENT.

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### Strategy:

Utilize succession planning, expand assessment and leadership development programs and enhance performance evaluation processes to identify future leaders.

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### Action Plan:

**1991-1992**

- Continue to offer the Middle Manager Training Program for identified successors and/or high potential managers. (1991-1992)
- Implement a skills assessment program for middle management (the Center for Leadership Effectiveness) and utilize results for selection and development planning. (1991-1992)
- Continue the MBA Development program and continue on-site MBA program for current employees. (1991-1992)
- Continue use of structured selection procedures and testing for hourly and salaried personnel to continue upgrading the competency of our work force. (1991-1992)
- Develop and implement a program to identify high potential first-line to mid level supervisors for future management development (the Employee Assessment and Development Program). (1991-1992)
- Implement a program to identify and develop future Tobacco Sales Force front-line managers. (1991-1992)

**1991-1992**

- Develop and implement a training program for identified successors and/or high potentials from the Employee Assessment and Development Program or Career Insight Center. (1991-1992)
- Link succession planning to Upward Mobility and Affirmative Action planning process and expand the process to identify future job requirements. (1991-1992)

**1993-1995**

- Develop new approaches to in-house executive development programs to include cross functional job assignments and/or lateral moves. (1993-1995)
- Develop format for integration of Marketing, Sales, Operations, etc. succession plans with PM International succession plans. (1993-1995)

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LEGAL

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# LEGAL

PM-USA, as industry leader, will come under increasing scrutiny during the plan period as the social and political environment becomes increasingly hostile toward smoking. The Company is likely to face attacks from several fronts — competitors, anti-smoking forces and the government — which seek to regulate, restrict or injure our ability to do business. In addition, product liability will continue to be a threat.

Legal will implement strategies to help protect the Company's traditional way of doing business, while preparing it for competitive challenges and potential changes in the laws, business environment and social climate.

- Tort reform will continue to be of major importance, as Legal helps to identify key states for reform, draft acceptable language for bills, and monitor and oppose legislative developments which could undercut smokers' rights.
- Litigation will be pursued where necessary to protect trademark and patent positions.
- A series of legal compliance reviews or "audits" for many regular company activities will continue during the plan period. Records management seminars will also be conducted.
- Refining and administering the PM-USA crisis management plan and training all relevant personnel will help the Company respond to unanticipated events.
- Finally, Legal will continue to aggressively defend all product liability actions against the Company.

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## Legal

In the past 35 years, the courts have been facing the issue of a cigarette manufacturer's liability for the alleged health risks of smoking. The industry has never settled any of these suits and has never paid any plaintiff damages for such claims. It is imperative that we defend the company vigorously and continue to strengthen our position in the courts. As of January 3, 1991, 50 cases were pending against the industry, including 24 against PM-USA.

---

## Issue:

CONTROL THE PRODUCT LIABILITY THREAT TO PM-USA.

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## Strategy:

A dual strategy of litigation and tort reform will be pursued throughout the plan period to control product liability.

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## Action Plan:

**1991-1995**

- *Litigation:* PM-USA shall continue to aggressively defend all product liability actions against the company. (1991-1995)

- *Tort Reform:* PM is spearheading the industry's program to bring about legislative relief by working to improve the legal environment. There are specific jurisdictional objectives, but this critical, ongoing action also has no specific time dimension. (1991-1995)

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## Legal

As PM-USA has emerged as the industry leader, all of the Company's activities have come under greater scrutiny. Moreover, the social and political environment has become increasingly hostile to the industry. This mounting visibility may lead to increasing attacks designed to injure or curtail PM-USA's business. Finally, the maturing of the U.S. cigarette industry has forced competitors to resort to strategies with substantial legal implications, including litigation or the possibility of litigation.

---

### Issue:

PROVIDE CREATIVE USE OF LEGAL RESOURCES TO ADVANCE PM-USA'S OBJECTIVES IN PROTECTING AND ENHANCING OUR COMPETITIVE ADVANTAGE.

---

### Strategy:

PM-USA has become more vigilant in policing the activities of its competitors and shall challenge activities that seriously impinge upon the rights of the Company. Also, the Legal Department is aggressively pursuing litigation where appropriate to help preserve smokers' rights and to challenge legislation or other efforts in contravention of such rights. PM-USA is also actively guarding its technology.

---

### Action Plan:

**1991-1992**

- Establish smokers' rights litigation capability within the industry. (1991-1992)
- Aggressively protect trademark and patent positions by direct action, including litigation where necessary. (1991-1992)
- Monitor Competitor's Advertising claims and Competitive conduct; when appropriate, demand that competitor provide substantiation for ads or cessation of unfair practices. (1991-1992)

**1993-1995**

- Enlist and educate existing national network of PM-USA law firms to support our causes. (1993-1995)



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## Legal

PM-USA must recognize the vulnerability of its product in the marketplace and develop plans for countering any possible product contamination. We must ensure the integrity of the product supply and put the safety of our customers at the forefront of our actions.

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### Issue:

BE PREPARED TO RESPOND TO UNANTICIPATED EVENTS.

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### Strategy:

Continue to refine PM-USA crisis management plan; administer the supervision of the plan and the training of relevant personnel.

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### Action Plan:

**1991-1992**

- Continue to assess and modify where appropriate PM-USA's crisis management plan. (1991)
- Conduct periodic training sessions for members of the Crisis Response Team, Screening Committee and their back-ups. (1991-1992)
- Train all relevant personnel who may receive product-related information to know how to handle the information and how to disseminate it. (1991)
- Schedule regular Screening Committee meetings to refine existing procedures. (1991)

**1993-1995**

- Continue training on regular basis. (1993-1995)
- Continue to revise plan as appropriate. (1993-1995)



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INFORMATION
SERVICES

# INFORMATION SERVICES

Creating competitive advantage for Philip Morris USA through information technology is the mission of Information Services. This will be accomplished by:

1) Providing management with information pertaining to all areas of strategic importance through an Executive Information System.

2) Accelerating the decision making process through the use of Decision Support Systems that will convert data into information and rapidly deliver it throughout the organization.

3) Enabling the streamlining of business practices by installing operational systems integrated across organizational lines.

4) Continuing to provide highly reliable computing utilities to ensure the timely completion of basic business transactions.

To accomplish these goals, a strong partnership must be developed between Information Services and the business areas that are the users of information technology. Information Services is committed to developing a better understanding of the business practices of its customers, and a commitment is needed from the business areas to play a more active role in defining information requirements. Working together, Philip Morris USA can realize a competitive advantage through information technology.

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## Strategic Decision Making

The business environment of the U.S. cigarette industry has undergone significant change in the past few years with the emergence of price tiers, regional brands and a change in the manufacturer/retailer relationship. As a result, Philip Morris USA is in the process of streamlining its decision making to respond quickly to marketplace changes. This philosophy is driving decision making further down into the functional organizations, providing the management closest to the issue with the ability to respond. This raises two critical issues for Information Services, 1) providing a wider range of management with decision support tools (see next issue), and 2) providing executive management with the ability to monitor the implementation of strategic plans while maintaining control over critical operating policies.

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### Issue:

TO EXERT STRATEGIC/POLICY CONTROL OVER A MORE COMPLEX OPERATING ENVIRONMENT, EXECUTIVE MANAGEMENT REQUIRES RAPID ACCESS TO INFORMATION ACROSS A BROAD SPECTRUM OF ISSUES.

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### Strategy:

Design and develop an Executive Information System that will provide management with information pertaining to all areas of strategic importance. Key system features include; push-button access, preformatted reporting, and graphical presentation of information.

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### Action Plan:

**1991-1992**

- Project team will assess the informational needs of management. This will be accomplished by conducting interviews with key members of management. (1991-1992)
- Technology platform for the system will be determined. (1991-1992)
- Focus during this period will be to provide information pertaining to Sales, Marketing and Finance. (1991-1992)

**1992-1995**

- Information from other functional areas will be assessed and integrated into the system. (1992-1995)
- On-going systems support will be provided. (1992-1995)



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## Decision Support Systems

Decentralized decision making requires more powerful tools to convert data into information that can be delivered to all levels of management. The necessary information systems must be implemented to support decision making horizontally across business functions as well as vertically within departments and provide management the ability to focus on decisions of strategic importance. Philip Morris USA is a company within an industry that are both very rich in data resources. Competitive advantage will be achieved by the company that can access this data quickly, combining sources and views in the right way to recognize and implement programs against these identified opportunities.

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### Issue:

THE DECISION MAKING PROCESS CAN BE ACCELERATED BY PROVIDING MORE POWERFUL TOOLS THAT CONVERT DATA INTO INFORMATION AND DELIVER IT THROUGHOUT THE ORGANIZATION.

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### Strategy:

A new set of consistent easy-to-use tools will be developed to allow fast access to information, wherever it resides, inside or outside of Philip Morris USA. These tools will also empower the users of the system with the required analytical capability with no intervention from Information Services. This information will be collected once, at its source, be that an internal operational systems or an external provider. It will be made available to all systems and departments which require it.

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### Action Plan:

**1991-1992**

Begin development of an integrated information system for Sales and Marketing. This system will provide access to multiple data sources as well as easy-to-use tools to assist in analysis. A new approach will be used in the development of this system. A project team will be formed with members from Sales, Marketing and Information Services. This team will be fully dedicated to the project. This approach should result in a more complete and usable system for the Sales and Marketing areas. Key priorities addressed will include:

- Hand Held computers for the Field Sales Force that will improve the flow of information to and from the field. (1991-1992)

**1991-1992**

- A system for the Sales Section Office that will provide them with all the necessary information to run the office as a stand-alone business. This would include volume as information regarding promotions and merchandising plans. (1991-1992)

- A system for the Brand Groups to provide the information to assist them in managing their Brands. This would include information from all of the Marketing support groups, Sales, Finance and external suppliers; such as, Nielsen and MSA.

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**1993-1995**

Develop an integrated Manufacturing Data Base to allow manufacturing information to be shared among the cigarette manufacturing and support community for better problem analysis and decision making.

- Continue to populate the Sales, Marketing and Manufacturing data bases with information from operational systems and external data sources. (1993-1995)

**1993-1995**

- Continue to assess easy-to-use tools to support the analytical and decision-making process. (1993-1995)



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## Cross-Functional Integration

The trend to flatter organizations necessitates the need to increase the information flow across organizations. In the past, most systems were designed vertically to automate single business functions and management was relied upon to communicate information across organizations. A reevaluation of Philip Morris USA business practices will be required to achieve further savings or improvements in effectiveness. New systems are an important part of reengineering and integrating business processes, regardless of the organizational alignment.

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### Issue:

TO ENABLE THE REDESIGN AND STREAMLINING OF THE BUSINESS PROCESSES, NEW SYSTEMS MUST INTEGRATE ACROSS ORGANIZATIONAL LINES.

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### Strategy:

To support new business processes, IS will build highly modular, integrated computer systems. In most cases, the information provided by these systems will be located in one location, with access provided to all appropriate business areas.

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### Action Plan:

#### 1991-1992

The Manufacturing Supply Chain Project will redesign and streamline activities involved in incoming logistics and production planning and scheduling, utilizing such innovative techniques as vendor partnering and fast flow delivery of direct materials. IS will use this project and it's approach as the starting point for integrating other business functions in Philip Morris USA. Other projects that will adopt this approach include:

- System to collect bill of material and product information. (1991-1992)
- Determination of a Master Production Schedule for factory allocation. (1991-1992)
- System to enhance the Point-of-Sale materials planning of procurement process. (1991-1992)

#### 1993-1995

- Develop an integrated MRO/EDI System for paperless processing of business transactions. (1993-1995)
- Develop new interfaces between Employee Relations systems to reduce redundant work efforts. (1993-1995)

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## Infrastructure

It is imperative that Philip Morris USA's business functions are provided with information systems that perform reliably and quickly to process basic business transactions. As integrated automation continues, these business areas will become even more dependent on information systems to perform their daily functions. This dependence necessitates a stable service level that can only be provided by Information Services maintaining the appropriate infrastructure.

---

### Issue:

HEAVY RELIANCE ON COMPUTER SYSTEMS TO AUTOMATE BUSINESS ACTIVITIES MEANS THAT STABLE SERVICE MUST BE PROVIDED TO CRITICAL FUNCTIONS. INFORMATION SERVICES MUST STAY ON THE FOREFRONT OF TECHNOLOGICAL CHANGE TO ENSURE THE APPROPRIATE SERVICE LEVEL.

---

### Strategy:

Continue to evaluate and develop automated tools for monitoring and controlling hardware on a daily basis, looking for problem areas, and preventing outages before they occur. Continuously upgrade the Philip Morris USA network as necessary to support the business in a reliable and cost effective manner. Develop better interfaces to integrate data between our technology platforms. Extend Computer Aided Software Engineering tools to improve programmer productivity in the DEC and workstation environments as we have done for the mainframe. Look for ways to streamline IS procedures to open up bottlenecks and speed systems development, while ensuring compatibility and reliability of new systems.

---

### Action Plan:

#### 1991-1992

- Enhance data and voice communication networks to improve performance, reliability, and cost effectiveness. (1991-1992)
- Establish the initial technical environment for 24 hour, 7 day/week operation of the IBM mainframes. Upgrade the backup and recovery process for storage devices to promote continuous availability of data. (1991-1992)
- Provide architectural direction for distributed systems and networking, ensuring that the appropriate technical solutions are available to the development organizations to ensure speedy delivery and integration of systems. (1991-1992)

#### 1993-1995

- Evaluate new computing technologies and develop the most cost effective approach to satisfy business demands for the next five years. (1993-1995)
- Evaluate the cost/benefit of consolidating all Richmond Data Centers into one location. (1993-1995)
- Evaluate and recommend appropriate development tools in the newly emerging field of object oriented programming. (1993-1995)

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## PM-USA FIVE YEAR PLAN INCOME FORECAST
($ Millions)

| | Actual 1985 | Actual 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1990-1995 C.A.G. |
|---|---|---|---|---|---|---|---|---|
| Unit Volume (Billions) | | | | | | | | |
| Domestic | 213.6 | 220.5 | 221.3 | 224.0 | 225.0 | 225.7 | 226.0 | |
| Overseas Military | | 2.2 | 1.8 | 1.6 | 1.5 | 1.5 | 1.5 | |
| Total Units | 213.6 | 222.7 | 223.1 | 225.6 | 226.5 | 227.2 | 227.5 | |
| Operating Revenues | $6,592.7 | $10,369.5 | $11,598.1 | $12,921.7 | $14,639.1 | $15,955.6 | $17,260.0 | 10.7% |
| Variable Cost | $3,141.5 | $3,400.3 | $3,882.8 | $4,182.5 | $4,986.1 | $5,141.1 | $5,155.4 | 8.7% |
| Shipping | 63.1 | 72.2 | 80.5 | 85.8 | 90.5 | 95.3 | 100.3 | 6.8% |
| LIFO Adjustment | (37.4) | 87.2 | 50.4 | 103.0 | 79.6 | 76.9 | 77.0 | -2.5% |
| Fixed Cost | 397.0 | 502.1 | 489.2 | 518.8 | 540.4 | 577.8 | 610.5 | 4.0% |
| Available Profit | $3,028.5 | $6,307.7 | $7,095.2 | $8,031.6 | $8,942.5 | $10,064.5 | $11,316.8 | 12.4% |
| % of Sales | 45.9% | 60.8% | 61.2% | 62.2% | 61.1% | 63.1% | 65.6% | |
| Marketing | $836.9 | $1,854.0 | $2,042.5 | $2,340.9 | $2,511.5 | $2,779.6 | $3,076.4 | 10.7% |
| Corporate Affairs | 6.5 | 92.1 | 91.0 | 101.3 | 102.6 | 113.8 | 116.3 | 4.8% |
| General & Administrative | 86.4 | 117.0 | 129.2 | 136.1 | 145.8 | 156.0 | 167.1 | 7.4% |
| Research & Development | 48.7 | 54.0 | 57.8 | 59.8 | 62.9 | 66.4 | 69.8 | 5.3% |
| Other Deductions/(Income) | 2.7 | (15.5) | (13.5) | (21.4) | 69.8 | 72.2 | 74.0 | 14.4% |
| Operating Income | $2,047.3 | $4,206.1 | $4,788.2 | $5,414.9 | $6,049.9 | $6,876.5 | $7,813.2 | 13.2% |
| % of Sales | 31.0% | 40.6% | 41.3% | 41.9% | 41.3% | 43.1% | 45.3% | |
| Change Over Prior Years | 17.4% | 16.8% | 13.8% | 13.1% | 11.7% | 13.7% | 13.6% | |

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## BALANCE SHEET FORECAST
## DECEMBER 31, 1985, 1990-1995
## ($ Millions)

| | Actual 1985 | Actual 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|---|
| ASSETS: | | | | | | | |
| Cash | $0.1 | $0.1 | $0.1 | $0.1 | $0.1 | $0.1 | $0.1 |
| Receivables | 478.5 | 442.8 | 511.0 | 577.4 | 641.7 | 695.1 | 762.7 |
| Inventories at LIFO | 1,470.5 | 1,977.5 | 2,248.8 | 2,407.9 | 2,726.0 | 2,818.0 | 2,885.9 |
| Prepaid Expenses | 38.0 | 37.3 | 44.1 | 45.8 | 47.9 | 50.7 | 53.5 |
| Total Current Assets | $1,987.1 | $2,457.7 | $2,804.0 | $3,031.2 | $3,415.7 | $3,563.9 | $3,702.2 |
| Net Property, Plant & Equipment | $1,635.5 | $1,740.3 | $1,869.7 | $2,153.1 | $2,536.5 | $2,741.3 | $2,807.8 |
| Other Assets | 0.2 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 |
| Total Assets | $3,622.8 | $4,200.1 | $4,675.8 | $5,186.4 | $5,954.3 | $6,307.3 | $6,512.1 |
| LIABILITIES & CAPITAL: | | | | | | | |
| Current Portion Long-Term Debt | $0.1 | $1.0 | $1.0 | $1.0 | $1.0 | $1.0 | $1.0 |
| Accounts Payable & Accrued Liabilities | 278.5 | 818.4 | 925.4 | 678.4 | 717.3 | 764.1 | 810.3 |
| Federal Excise & Other Taxes | 196.8 | 145.7 | 101.5 | 102.1 | 123.9 | 126.6 | 128.5 |
| Total Current Liabilities | $475.4 | $965.1 | $1,027.9 | $781.5 | $842.2 | $891.7 | $939.8 |
| Other Liabilities | $17.4 | $23.3 | $22.2 | $20.2 | $148.2 | $285.0 | $429.9 |
| Net Income-Current Year | 1,053.5 | 2,526.5 | 2,875.7 | 3,281.6 | 3,688.9 | 4,215.9 | 4,754.9 |
| Intra-Company Balance | 2,076.5 | 685.2 | 750.0 | 1,103.1 | 1,275.0 | 914.7 | 387.5 |
| Total Liabilities & Capital | $3,622.8 | $4,200.1 | $4,675.8 | $5,186.4 | $5,954.3 | $6,307.3 | $6,512.1 |
| ROMI-Income From Operations | | 186.4% | 242.4% | 252.6% | 243.7% | 253.4% | 278.1% |



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# FUNDS FLOW ANALYSIS
## FOR YEARS 1985, 1990-1995
## ($ Millions)

| | Actual 1985 | Actual 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|---|
| AFTER TAX CASH FLOW FROM OPERATIONS | | | | | | | |
| Net Earnings | $1,053.5 | $2,603.1 | $2,963.9 | $3,354.2 | $3,747.8 | $4,260.3 | $4,841.2 |
| Depreciation | 127.2 | 177.0 | 184.9 | 193.5 | 203.7 | 225.6 | 243.7 |
| Other | - | 53.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Cash Flows from Operations | $1,180.7 | $2,833.5 | $3,148.8 | $3,547.7 | $3,951.5 | $4,485.9 | $5,084.9 |
| Changes in Assets & Liabilities | ($120.2) | ($113.6) | ($283.5) | ($475.6) | ($195.8) | $38.1 | $54.8 |
| Net Cash Flows from Operating Activities | $1,060.5 | $2,719.9 | $2,865.3 | $3,072.1 | $3,755.7 | $4,524.0 | $5,139.7 |
| Cash Flows from Investing Activities | | | | | | | |
| Capital Expenditures | ($101.8) | ($171.1) | ($323.6) | ($481.7) | ($592.1) | ($435.8) | ($315.6) |
| Disposals-Fixed Assets/ Other | 5.2 | 11.4 | 9.3 | 4.8 | 5.0 | 5.4 | 5.4 |
| Net Cash Flows-Investing Activities | ($96.6) | ($159.7) | ($314.3) | ($476.9) | ($587.1) | ($430.4) | ($310.2) |
| Cash Flows-Financing Activities | | | | | | | |
| Net Cash Flows-Long Term Debt | $0.2 | ($0.4) | ($1.1) | $0.0 | $0.0 | $0.0 | $0.0 |
| Net Cash Flow-Total Year | $964.1 | $2,559.8 | $2,549.9 | $2,595.2 | $3,168.6 | $4,093.6 | $4,829.5 |
| Cummulative Cash Flow 1991-1995 | | | | | | | $17,236.8 |

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APPENDIX

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# APPENDIX



2048360426

## PM-USA VOLUME
(BILLIONS OF UNITS)

### PLAN PROJECTIONS

| Year Plan Prepared | Period | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1984 | 1985-1989 | Actual 191.2 | Actual 199.4 | Actual 204.4 | Actual 204.7 | 3rd RF 208.0 | 214.0 | 222.0 | 228.5 | 235.0 | 241.6 | - | - | - | - | - | - |
| 1985 | 1986-1990 | - | - | - | - | Actual 211.6 | 3rd RF 213.6 | 217.0 | 220.6 | 224.1 | 227.5 | 230.9 | - | - | - | - | - |
| 1986 | 1987-1991 | - | - | - | - | - | Actual 213.6 | 3rd RF 214.5 | 216.0 | 217.4 | 218.7 | 219.8 | 220.9 | - | - | - | - |
| 1987 | 1988-1992 | - | - | - | - | - | - | Actual 214.6 | 3rd RF 215.3 | 218.9 | 222.5 | 226.2 | 230.1 | 233.5 | - | - | - |
| 1988 | 1989-1993 | - | - | - | - | - | - | - | Actual 215.6 | 3rd RF 218.9 | 220.8 | 224.5 | 228.4 | 231.9 | 235.0 | - | - |
| 1989 | 1990-1994 | - | - | - | - | - | - | - | - | Actual 219.3 | 3rd RF 220.8 | 223.0 | 226.4 | 229.4 | 232.0 | 234.2 | - |
| 1990 | 1991-1995 | - | - | - | - | - | - | - | - | - | Actual 219.5 | Actual 220.5 | 221.3 | 224.0 | 225.0 | 225.7 | 226.0 |

## OPERATING INCOME
($ MILLIONS)

### PLAN PROJECTIONS

| Year Plan Prepared | Period | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1984 | 1985-1989 | Actual 870 | Actual 1,018 | Actual 1,256 | Actual 1,409 | Actual 1,798 | 2,020 | 2,353 | 2,737 | 3,149 | 3,619 | - | - | - | - | - | - |
| 1985 | 1986-1990 | - | - | - | - | - | Actual 2,047 | 2,328 | 2,672 | 3,065 | 3,518 | 4,033 | - | - | - | - | - |
| 1986 | 1987-1991 | - | - | - | - | - | - | Actual 2,366 | 2,683 | 3,016 | 3,354 | 3,745 | 4,174 | - | - | - | - |
| 1987 | 1988-1992 | - | - | - | - | - | - | - | Actual 2,714 | 3,081 | 3,506 | 3,962 | 4,484 | 5,091 | - | - | - |
| 1988 | 1989-1993 | - | - | - | - | - | - | - | - | Actual 3,087 | 3,706 | 4,206 | 4,774 | 5,418 | 6,150 | - | - |
| 1989 | 1990-1994 | - | - | - | - | - | - | - | - | - | Actual 3,606 | 4,206 | 4,785 | 5,415 | 6,144 | 6,976 | - |
| 1990 | 1991-1995 | - | - | - | - | - | - | - | - | - | - | Actual 4,206 | 4,788 | 5,415 | 6,050 | 6,876 | 7,813 |

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## INDUSTRY VOLUME
(BILLIONS OF UNITS)

## PLAN PROJECTIONS

| Year Plan Prepared | Period | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1984 | 1985-1989 | Actual 616.7 | Actual 626.5 | Actual 622.3 | Actual 596.0 | 3rd RF 591.6 | 589.5 | 595.2 | 595.0 | 595.0 | 595.0 | - | - | - | - | - | - |
| 1985 | 1986-1990 | - | - | - | - | Actual 599.7 | 3rd RF 589.5 | 587.7 | 580.8 | 574.0 | 567.3 | 560.7 | - | - | - | - | - |
| 1986 | 1987-1991 | - | - | - | - | - | Actual 594.7 | 3rd RF 580.0 | 571.0 | 561.3 | 551.8 | 542.4 | 533.2 | - | - | - | - |
| 1987 | 1988-1992 | - | - | - | - | - | - | Actual 581.9 | 3rd RF 565.0 | 554.0 | 538.5 | 523.4 | 508.8 | 494.5 | - | - | - |
| 1988 | 1989-1993 | - | - | - | - | - | - | - | Actual 570.0 | 3rd RF 554.0 | 537.2 | 522.2 | 507.5 | 493.3 | 479.5 | - | - |
| 1989 | 1990-1994 | - | - | - | - | - | - | - | - | Actual 557.8 | 3rd RF 523.8 | 519.7 | 504.1 | 489.0 | 474.3 | 460.1 | - |
| 1990 | 1991-1995 | - | - | - | - | - | - | - | - | - | Actual 523.6 | Actual 521.8 | 507.9 | 495.3 | 479.0 | 467.1 | 455.5 |

## PM-USA MARKET SHARE
(%)

## PLAN PROJECTIONS

| Year Plan Prepared | Period | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1984 | 1985-1989 | Actual 31.0 | Actual 31.8 | Actual 32.9 | Actual 34.3 | 3rd RF 35.2 | 36.3 | 37.3 | 38.4 | 39.5 | 40.6 | - | - | - | - | - | - |
| 1985 | 1986-1990 | - | - | - | - | Actual 35.3 | 3rd RF 36.2 | 36.9 | 38.0 | 39.0 | 40.1 | 41.2 | - | - | - | - | - |
| 1986 | 1987-1991 | - | - | - | - | - | Actual 35.9 | 3rd RF 37.0 | 37.8 | 38.7 | 39.6 | 40.5 | 41.4 | - | - | - | - |
| 1987 | 1988-1992 | - | - | - | - | - | - | Actual 36.9 | 3rd RF 38.1 | 39.5 | 41.3 | 43.2 | 45.2 | 47.2 | - | - | - |
| 1988 | 1989-1993 | - | - | - | - | - | - | - | Actual 37.8 | 3rd RF 39.5 | 41.1 | 43.0 | 45.0 | 47.0 | 49.0 | - | - |
| 1989 | 1990-1994 | - | - | - | - | - | - | - | - | Actual 39.3 | 3rd RF 42.2 | 42.9 | 44.9 | 46.9 | 48.9 | 50.9 | - |
| 1990 | 1991-1995 | - | - | - | - | - | - | - | - | - | Actual 41.9 | Actual 42.3 | 43.6 | 45.2 | 47.0 | 48.3 | 49.6 |

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## CIGARETTE INDUSTRY VOLUME AND COMPANY MARKET SHARES
(%)

| Year | Volume (Billions) | PM-USA | RJR | B&W | Lorillard | American | Liggett |
|---|---|---|---|---|---|---|---|
| | | Market Share | | | | | |
| 1980 | 616.7 | 31.0 | 32.7 | 13.7 | 9.6 | 10.7 | 2.3 |
| 1981 | 626.5 | 31.8 | 33.1 | 14.0 | 9.0 | 9.5 | 2.6 |
| 1982 | 622.3 | 32.8 | 33.5 | 13.4 | 8.6 | 8.8 | 2.9 |
| 1983 | 596.0 | 34.4 | 31.5 | 11.5 | 9.1 | 8.7 | 4.8 |
| 1984 | 599.7 | 35.3 | 31.6 | 11.3 | 8.2 | 7.9 | 5.7 |
| 1985 | 594.7 | 35.9 | 31.6 | 11.9 | 8.1 | 7.6 | 4.9 |
| 1986 | 581.9 | 36.9 | 32.4 | 11.7 | 8.1 | 7.1 | 3.8 |
| 1987 | 570.0 | 37.8 | 32.5 | 11.0 | 8.2 | 6.9 | 3.6 |
| 1988 | 557.8 | 39.3 | 31.8 | 10.9 | 8.2 | 7.0 | 2.8 |
| 1989 | 523.6 | 41.9 | 28.5 | 11.4 | 7.9 | 7.0 | 3.3 |
| 1990 | 526.8 | 42.3 | 29.6 | 10.3 | 7.6 | 6.8 | 3.4 |
| 1991E | 507.9 | 43.6 | 28.7 | 10.1 | 7.3 | 7.0 | 3.3 |
| 1992E | 495.3 | 45.2 | 27.6 | 9.8 | 7.0 | 7.1 | 3.3 |
| 1993E | 479.0 | 47.0 | 26.2 | 9.8 | 6.6 | 7.3 | 3.1 |
| 1994E | 467.1 | 48.3 | 25.1 | 9.6 | 6.3 | 7.6 | 3.1 |
| 1995E | 455.5 | 49.6 | 24.1 | 9.5 | 5.9 | 7.8 | 3.1 |

## TOP TEN BRAND MARKET SHARES
(%)

| Year | Marlboro | Winston | Salem | Kool | Newport | Camel | Doral* | B&H | Merit | V.S. |
|---|---|---|---|---|---|---|---|---|---|---|
| 1980 | 17.8 | 13.3 | 8.7 | 8.8 | 1.9 | 4.3 | - | 4.5 | 3.2 | 2.3 |
| 1981 | 18.3 | 13.3 | 8.8 | 8.4 | 2.2 | 4.8 | - | 4.4 | 4.5 | 2.5 |
| 1982 | 19.2 | 13.2 | 8.8 | 8.2 | 2.4 | 4.9 | - | 4.7 | 4.5 | 2.5 |
| 1983 | 20.2 | 11.9 | 8.1 | 7.2 | 2.8 | 4.6 | - | 4.9 | 4.4 | 2.5 |
| 1984 | 21.5 | 11.7 | 8.1 | 7.1 | 3.0 | 4.4 | 0.4 | 4.8 | 4.3 | 2.6 |
| 1985 | 22.4 | 11.4 | 7.9 | 6.8 | 3.4 | 4.3 | 1.2 | 4.6 | 4.1 | 2.8 |
| 1986 | 23.1 | 11.2 | 7.8 | 6.4 | 3.8 | 4.3 | 2.1 | 4.3 | 4.0 | 2.9 |
| 1987 | 23.6 | 11.1 | 7.7 | 6.0 | 4.2 | 4.2 | 3.0 | 4.2 | 3.9 | 3.1 |
| 1988 | 24.9 | 10.7 | 7.3 | 6.0 | 4.4 | 4.3 | 3.4 | 3.9 | 3.8 | 3.0 |
| 1989 | 26.4 | 9.0 | 6.2 | 6.0 | 4.7 | 3.9 | 3.6 | 3.8 | 3.8 | 3.2 |
| 1990 | 26.0 | 8.8 | 6.1 | 4.9 | 4.6 | 4.4 | 4.3 | 3.5 | 3.5 | 3.1 |
| 1991E | 26.5 | 7.9 | 5.6 | 4.7 | 4.3 | 4.5 | 4.6 | 3.3 | 3.1 | 2.9 |
| 1992E | 27.3 | 6.8 | 4.9 | 4.1 | 4.0 | 4.4 | 4.9 | 3.5 | 3.3 | 2.8 |
| 1993E | 28.0 | 6.1 | 4.5 | 3.7 | 3.7 | 4.2 | 5.3 | 3.8 | 3.1 | 2.7 |
| 1994E | 28.6 | 5.7 | 4.2 | 3.3 | 3.5 | 4.1 | 5.7 | 3.5 | 3.0 | 2.7 |
| 1995E | 29.1 | 5.2 | 3.9 | 3.0 | 3.3 | 3.9 | 6.1 | 3.3 | 3.0 | 2.7 |

* Doral was re-established as a price/value brand in 1984.

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## PM-USA BRAND PERFORMANCE MARKET SHARE
(%)

| Year | Marlboro | Merit | B&H | V.S | Cambridge | Parliament | All Others | Total PM-USA |
|---|---|---|---|---|---|---|---|---|
| 1980 | 17.8 | 4.2 | 4.5 | 2.3 | - | 1.2 | 1.0 | 31.0 |
| 1981 | 18.3 | 4.5 | 4.4 | 2.5 | - | 1.1 | 1.0 | 31.8 |
| 1982 | 19.2 | 4.5 | 4.7 | 2.5 | - | 1.1 | 0.9 | 32.9 |
| 1983 | 20.2 | 4.4 | 4.9 | 2.5 | - | 1.1 | 1.3 | 34.4 |
| 1984 | 21.5 | 4.3 | 4.8 | 2.6 | - | 1.0 | 1.1 | 35.3 |
| 1985 | 22.4 | 4.1 | 4.6 | 2.8 | - | 1.0 | 1.0 | 35.9 |
| 1986 | 23.1 | 4.0 | 4.3 | 2.9 | 0.6 | 0.9 | 1.1 | 36.9 |
| 1987 | 23.6 | 3.9 | 4.2 | 3.1 | 1.1 | 0.9 | 1.0 | 37.8 |
| 1988 | 24.9 | 3.8 | 3.9 | 3.0 | 1.7 | 0.9 | 1.1 | 39.3 |
| 1989 | 26.4 | 3.8 | 3.8 | 3.2 | 2.3 | 0.9 | 1.5 | 41.9 |
| 1990 | 26.0 | 3.5 | 3.5 | 3.1 | 2.5 | 0.8 | 2.9 | 42.3 |
| 1991E | 26.5 | 3.1 | 3.3 | 2.9 | 2.8 | 0.8 | 4.2 | 43.6 |
| 1992E | 27.3 | 3.3 | 3.5 | 2.8 | 3.2 | 0.8 | 4.3 | 45.2 |
| 1993E | 28.0 | 3.1 | 3.8 | 2.7 | 3.7 | 0.7 | 5.0 | 47.0 |
| 1994E | 28.6 | 3.0 | 3.5 | 2.7 | 4.2 | 0.7 | 5.6 | 48.3 |
| 1995E | 29.1 | 3.0 | 3.3 | 2.7 | 4.8 | 0.7 | 6.0 | 49.6 |

## PM-USA BRAND PERFORMANCE VOLUME
(BILLIONS OF UNITS)

| Year | Marlboro | Merit | B&H | V.S | Parliament | Others | Cambridge | Alpine | Bristol | FVB | PM USA |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1980 | 109.6 | 26.0 | 27.4 | 14.2 | 7.5 | 6.5 | - | - | - | - | 191.2 |
| 1981 | 114.8 | 28.1 | 27.8 | 15.5 | 7.1 | 6.1 | - | - | - | - | 199.4 |
| 1982 | 119.6 | 28.0 | 29.3 | 15.5 | 6.8 | 5.2 | - | - | - | - | 204.4 |
| 1983 | 120.1 | 26.0 | 29.3 | 15.0 | 6.3 | 8.0 | - | - | - | - | 204.7 |
| 1984 | 129.0 | 25.5 | 28.9 | 15.7 | 6.1 | 6.4 | - | - | - | - | 211.6 |
| 1985 | 133.3 | 24.2 | 27.3 | 16.7 | 5.8 | 6.2 | - | - | - | 0.1 | 213.6 |
| 1986 | 134.2 | 23.1 | 25.0 | 16.9 | 5.4 | 6.2 | 3.3 | 0.4 | - | 0.4 | 214.9 |
| 1987 | 134.6 | 22.2 | 24.1 | 17.5 | 5.1 | 4.8 | 6.4 | - | - | 0.9 | 215.6 |
| 1988 | 138.8 | 21.4 | 21.9 | 16.8 | 4.8 | 3.9 | 9.8 | 0.5 | - | 1.4 | 219.3 |
| 1989 | 138.0 | 20.1 | 20.1 | 16.5 | 4.6 | 3.2 | 11.9 | 3.2 | 0.2 | 1.7 | 219.5 |
| 1990 | 135.6 | 18.2 | 18.5 | 16.0 | 4.3 | 3.7 | 13.0 | 3.2 | 4.5 | 3.5 | 220.5 |
| 1991E | 134.8 | 15.9 | 16.8 | 14.8 | 4.0 | 5.0 | 14.3 | 3.1 | 7.7 | 4.9 | 221.3 |
| 1992E | 135.0 | 16.3 | 17.2 | 13.7 | 3.7 | 4.9 | 15.8 | 3.0 | 9.7 | 4.7 | 224.0 |
| 1993E | 134.2 | 14.7 | 18.1 | 12.9 | 3.5 | 4.4 | 17.8 | 3.0 | 11.8 | 4.6 | 225.0 |
| 1994E | 133.8 | 14.2 | 16.3 | 12.8 | 3.2 | 4.3 | 19.7 | 2.9 | 14.0 | 4.5 | 225.7 |
| 1995E | 132.6 | 13.8 | 15.0 | 12.1 | 3.1 | 4.2 | 21.8 | 2.9 | 16.1 | 4.4 | 226.0 |



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| PRICE/VALUE BRAND BREAKOUT (AS OF DECEMBER 1990) | | | | | | |
|---|---|---|---|---|---|---|
| | PM-USA | RJR | B&W | American | Lorillard | Liggett |
| Price-Off: On-Carton Coupon | | Sterling (4)* | | Malibu (7) Lucky Strike (5) | Heritage (2) | Saavy (3) Chesterfield Lights (2) |
| Branded Generic | Cambridge (7) Alpine (6) Bucks (2) | Doral (10) Magna (4) | Viceroy (7) Richland (6) Belair (4) | American Filter (5) | *Old Gold (3)*** *Harley Davidson (2)*** | |
| Sub-Generics | Bristol (8) | | Raleigh Extra (6) | Montclair (7) Misty Slims (2) Bull Durham (2) | *Style (2)* | Pyramid (9) |
| Value 25's/30's | Players 25's (4) | Century (5) | Richland (5) | | | *L&M 30's (2)*** |
| Black & Whites | Famous Value and Private Label (10) | Best Value and Private Label (8) | GPC Generics (11) | | | Q Seal and Private Label (12) |

*(#) Number of Packings
** Italicized = test brands

## PRICE/VALUE MARKET SHARE BY SUBSEGMENT
(%)

| Year | Branded Generics | Price-Off | Sub-Generics | Value 25's/30's | Black & Whites | Total |
|---|---|---|---|---|---|---|
| 1980 | - | - | - | - | 0.04 | 0.04 |
| 1981 | - | - | - | - | 0.45 | 0.45 |
| 1982 | - | - | - | - | 0.95 | 0.95 |
| 1983 | 0.36 | - | - | 0.05 | 2.92 | 3.33 |
| 1984 | 0.38 | - | - | 0.78 | 4.35 | 5.52 |
| 1985 | 1.38 | - | - | 1.30 | 4.62 | 7.30 |
| 1986 | 2.69 | 0.01 | - | 1.90 | 4.30 | 8.90 |
| 1987 | 4.34 | 0.24 | - | 1.70 | 3.95 | 10.23 |
| 1988 | 6.05 | 0.60 | - | 1.20 | 3.27 | 11.12 |
| 1989 | 9.55 | 0.74 | 0.94 | 0.91 | 2.76 | 14.90 |
| 1990 | 10.42 | 0.99 | 3.50 | 0.72 | 3.61 | 19.24 |
| 1991 | 11.29 | 1.53 | 5.33 | 0.55 | 4.10 | 22.80 |
| 1992 | 12.39 | 1.59 | 6.84 | 0.48 | 4.00 | 25.30 |
| 1993 | 13.82 | 1.53 | 8.41 | 0.43 | 4.01 | 28.20 |
| 1994 | 14.93 | 1.47 | 9.87 | 0.40 | 4.03 | 30.70 |
| 1995 | 16.04 | 1.41 | 11.32 | 0.38 | 4.05 | 33.20 |

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## INDUSTRY CATEGORY SHARES
(%)

| Year | 85's | 100's | 120's | Menthol | Box | Price Value |
|---|---|---|---|---|---|---|
| 1980 | 58.1 | 31.9 | 1.8 | 28.5 | 10.4 | - |
| 1981 | 57.0 | 33.2 | 2.0 | 28.5 | 11.5 | 0.0 |
| 1982 | 56.1 | 34.6 | 2.1 | 28.7 | 12.9 | 1.0 |
| 1983 | 55.2 | 35.9 | 2.2 | 28.0 | 15.0 | 3.3 |
| 1984 | 54.6 | 37.0 | 2.2 | 28.0 | 16.4 | 5.5 |
| 1985 | 54.8 | 37.1 | 2.3 | 28.0 | 17.5 | 7.3 |
| 1986 | 54.5 | 37.5 | 2.5 | 27.8 | 18.7 | 8.9 |
| 1987 | 54.2 | 38.1 | 2.5 | 27.7 | 19.6 | 10.2 |
| 1988 | 54.5 | 38.4 | 2.4 | 27.5 | 21.5 | 11.1 |
| 1989 | 54.6 | 38.6 | 2.5 | 27.2 | 23.2 | 14.9 |
| 1990 | 54.5 | 39.1 | 2.3 | 26.3 | 23.6 | 19.2 |

## INDUSTRY CATEGORY SHARES
(%)

| Year | Full Flavor | Low Tar | Ultra Low Tar | Total Reduced Tar | Non-Filter |
|---|---|---|---|---|---|
| 1980 | 50.3 | 33.5 | 8.0 | 41.5 | 8.2 |
| 1981 | 48.7 | 33.8 | 9.8 | 43.6 | 7.7 |
| 1982 | 47.5 | 35.1 | 10.3 | 45.4 | 7.1 |
| 1983 | 45.2 | 37.4 | 10.7 | 48.1 | 6.7 |
| 1984 | 45.4 | 38.2 | 10.1 | 48.3 | 6.3 |
| 1985 | 45.1 | 38.9 | 10.2 | 49.1 | 5.8 |
| 1986 | 44.5 | 39.8 | 10.2 | 50.0 | 5.5 |
| 1987 | 44.4 | 40.2 | 10.6 | 50.8 | 4.8 |
| 1988 | 44.0 | 40.1 | 11.2 | 51.3 | 4.7 |
| 1989 | 44.0 | 40.2 | 11.5 | 51.7 | 4.3 |
| 1990 | 43.5 | 40.5 | 12.0 | 52.5 | 4.0 |

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## PM-USA OPERATING AND FINANCIAL STATISTICS

($ MILLIONS)

| Year | Revenues | Income from Operations | Total (1) Assets | Capital (2) Expenditures | CPLH |
|---|---|---|---|---|---|
| 1980 | 3,272 | 787 | 1,988 | 192 | 13,100 |
| 1981 | 3,762 | 905 | 2,626 | 432 | 13,301 |
| 1982 | 4,330 | 1,101 | 2,910 | 428 | 13,465 |
| 1983 | 5,520 | 1,337 | 3,195 | 278 | 13,300 |
| 1984 | 6,133 | 1,744 | 3,292 | 124 | 14,469 |
| 1985 | 6,611 | 2,047 | 3,031 | 102 | 15,300 |
| 1986 | 7,053 | 2,366 | 2,843 | 106 | 16,000 |
| 1987 | 7,641 | 2,714 | 2,655 | 135 | 16,000 |
| 1988 | 8,501 | 3,087 | 2,767 | 366 | 17,200 |
| 1989 | 9,474 | 3,606 | 2,993 | 321 | 17,600 |
| 1990 | 10,369 | 4,206 | 2,984 | 171 | 19,400 |
| 1991 | 11,598 | 4,788 | 2,972 | 324 | 20,000 |
| 1992 | 12,922 | 5,415 | 3,152 | 482 | 20,300 |
| 1993 | 14,639 | 6,050 | 3,547 | 592 | 20,200 |
| 1994 | 15,956 | 6,876 | 3,720 | 436 | 21,800 |
| 1995 | 17,260 | 7,813 | 3,834 | 316 | 23,000 |

(1) Net of PM-International allocation.
(2) Includes capital interest.

## PM-USA CIGARETTE PRODUCTION

(BILLIONS OF UNITS)

| Year | Domestic | Export | Total |
|---|---|---|---|
| 1980 | 190.6 | 44.8 | 235.4 |
| 1981 | 203.6 | 43.9 | 247.5 |
| 1982 | 194.6 | 48.0 | 242.6 |
| 1983 | 208.1 | 39.5 | 247.6 |
| 1984 | 213.9 | 40.5 | 254.4 |
| 1985 | 214.7 | 41.8 | 256.5 |
| 1986 | 214.6 | 46.3 | 260.9 |
| 1987 | 215.8 | 68.3 | 284.1 |
| 1988 | 225.2 | 70.4 | 295.6 |
| 1989 | 221.7 | 81.9 | 303.6 |
| 1990 | 229.4 | 106.6 | 336.0 |
| 1991 | 221.5 | 112.2 | 333.7 |
| 1992 | 227.3 | 132.5 | 359.8 |
| 1993 | 228.2 | 138.6 | 366.8 |
| 1994 | 228.9 | 144.8 | 373.7 |
| 1995 | 229.2 | 150.0 | 379.2 |

Note: 1991 through 1995 includes 1.5 billion units of unsaleables.

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## PM-USA MANUFACTURING COST PER 1000*

| Year | Variable | Fixed | Total |
|---|---|---|---|
| 1980 | 4.83 | 1.00 | 5.83 |
| 1981 | 5.45 | 1.13 | 6.58 |
| 1982 | 6.09 | 1.37 | 7.46 |
| 1983 | 6.52 | 1.68 | 8.20 |
| 1984 | 6.63 | 1.71 | 8.34 |
| 1985 | 6.71 | 1.86 | 8.57 |
| 1986 | 6.56 | 1.94 | 8.50 |
| 1987 | 6.79 | 1.87 | 8.66 |
| 1988 | 6.70 | 1.98 | 8.68 |
| 1989 | 7.45 | 2.23 | 9.68 |
| 1990 | 7.54 | 2.14 | 9.68 |
| 1991 | 7.95 | 2.20 | 10.15 |
| 1992 | 8.32 | 2.37 | 10.69 |
| 1993 | 8.68 | 2.46 | 11.14 |
| 1994 | 8.86 | 2.56 | 11.42 |
| 1995 | 9.21 | 2.69 | 11.90 |

* Excluding LIFO and federal excise tax.

## TAX INCIDENCE ON RETAIL CIGARETTE PRICES

| Year | Weighted Average (1) Price Per Pack | Federal Excise Tax Per Pack | State Tax Per Pack | Taxes as a Percentage of Average Retail Price |
|---|---|---|---|---|
| 1980 | 63.0 cents | 8.0 cents | 13.0 cents | 33.3% |
| 1981 | 70.0 | 8.0 | 13.0 | 30.0 |
| 1982 | 82.0 | 8.0 | 13.0 | 25.6 |
| 1983 | 95.0 | 16.0 | 15.0 | 32.6 |
| 1984 | 105.0 | 16.0 | 15.2 | 29.7 |
| 1985 | 111.0 | 16.0 | 15.7 | 28.6 |
| 1986 | 118.0 | 16.0 | 16.8 | 27.8 |
| 1987 | 126.0 | 16.0 | 17.4 | 26.5 |
| 1988 | 138.0 | 16.0 | 18.4 | 24.9 |
| 1989 | 155.0 | 16.0 | 21.9 | 24.5 |
| 1990 | 167.0 | 16.0 | 23.8 | 23.8 |

Source: Tax Burden on Tobacco/PM-USA Market Research
(1) Weighted average includes full margin and price/value retail prices.



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## PHILIP MORRIS U.S.A.
## PRICE HISTORY

| | Full Margin Filter | | Price/Value | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | Branded Generic | | Value 25's | | Black & White (FVB) | |
| | 85mm | 100/120mm | 85mm | 100mm | 85mm | 100mm | 85mm | 100mm |
| May 1980 | 17.65 | 18.15 | | | | | | |
| Nov 1980 | 18.50 | 19.00 | | | | | | |
| Apr 1981 | 19.35 | 19.85 | | | | | | |
| Sep 1981 | 20.20 | 20.70 | | | | | | |
| Feb 1982 | 21.20 | 21.70 | | | | | | |
| Aug 1982 | 22.60 | 23.10 | | | | | | |
| Oct 1982 | 24.20 | 25.20 | | | | | | |
| Nov 1982 | 26.20 | 27.20 | | | | | | |
| Jan 1983 | 26.90 | 27.90 | | | | | | |
| Jun 1983 | 28.40 | 29.40 | | | | | | |
| Aug 1983 | 28.40 | 29.40 | | | | | | |
| Jan 1984 | 29.15 | 30.15 | | | | | | |
| Jun 1984 | 30.15 | 31.15 | | | | | | |
| Dec 1984 | 31.15 | 32.15 | | | | | | |
| Jan 1985 | 31.15 | 32.40 | | | | | 19.75 | 19.75 |
| Jun 1985 | 31.90 | 33.15 | | | | | 19.75 | 19.75 |
| Jun 1985 | 32.15 | 33.40 | | | | | 19.75 | 21.00 |
| Dec 1985 | 33.15 | 34.65 | 19.75 | 21.00 | 28.30 | 29.60 | 19.75 | 21.00 |
| Jun 1986 | 34.40 | 35.90 | 21.00 | 22.25 | 27.52 | 28.72 | 21.00 | 22.25 |
| Dec 1986 | 35.65 | 37.15 | 22.25 | 23.50 | 28.52 | 29.72 | 22.25 | 23.50 |
| Jun 1987 | 36.90 | 38.40 | 24.00 | 25.25 | 29.52 | 30.72 | 24.00 | 25.25 |
| Jun 1987 | 37.15 | 38.65 | 24.25 | 25.50 | 29.72 | 30.92 | 24.00 | 25.25 |
| Dec 1987 | 39.15 | 40.65 | 26.75 | 28.00 | 31.32 | 32.52 | 26.50 | 27.75 |
| Jun 1988 | 41.15 | 42.65 | 29.25 | 30.50 | 32.92 | 34.12 | 29.25 | 30.50 |
| Dec 1988 | 43.65 | 45.15 | 31.75 | 33.00 | 34.92 | 36.12 | 31.75 | 33.00 |
| Jun 1989 | 46.15 | 47.65 | 34.25 | 35.50 | 36.92 | 38.12 | 32.75 | 34.00 |
| Dec 1989 | 48.65 | 50.15 | 36.75 | 38.00 | 38.92 | 40.12 | 32.75 | 34.00 |
| May 1990 | 51.15 | 52.65 | 39.25 | 40.50 | 40.92 | 42.12 | 32.75 | 34.00 |
| Jul 1990 | 51.15 | 52.65 | 39.25 | 40.50 | 40.92 | 42.12 | 34.00 | 35.25 |
| Nov 1990 | 53.65 | 55.15 | 41.75 | 43.00 | 42.92 | 44.12 | 36.00 | 37.25 |
| Jan 1991 | 55.75 | 57.25 | 43.85 | 45.10 | 44.42 | 45.82 | 38.10 | 39.35 |

| | Price/Value | | | |
|---|---|---|---|---|
| | Bristol | | Basic | |
| | 85mm | 100mm | 85mm | 100mm |
| Dec 1989 | 21.75 | 23.00 | - | - |
| Mar 1990 | 21.75 | 23.00 | 19.10 | 20.35 |
| Jul 1990 | 21.75 | 23.00 | 20.35 | 21.60 |
| Oct 1990 | 24.50 | 25.75 | 20.35 | 21.60 |
| Nov 1990 | 27.00 | 28.25 | 22.35 | 23.60 |
| Jan 1991 | 29.10 | 30.35 | 24.45 | 25.70 |

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## REVIEW OF DECEMBER 1990 PM-USA MERCHANDISING PROGRAMS BY RETAIL TRADE CLASS

| | TOTAL | SUPER-MARKETS | CONV/CGAS/GAS | DRUG | MASS MERCH | GROCERY | HST/CIG/LIQ. | ALL OTHER |
|---|---|---|---|---|---|---|---|---|
| CARTON | | | | | | | | |
| Carton Rows (000's) | 3,417 | 1,595 | 739 | 120 | 393 | 308 | 172 | 90 |
| Plans A/AL | 42,255 | 18,679 | 9,833 | 1,480 | 5,330 | 4,215 | 1,832 | 886 |
| Carton Fixtures | 18,028 | 3,489 | 6,616 | 2,415 | 1,064 | 2,378 | 1,508 | 558 |
| Value Centers | 33,979 | 5,710 | 17,851 | 1,839 | 664 | 4,568 | 1,994 | 1,353 |
| Marlboro (AM) | 3,024 | 27 | 2,044 | 62 | 13 | 439 | 355 | 84 |
| Plan AN | 3,158 | 347 | 60 | 2,573 | 123 | 13 | 23 | 19 |
| PACKAGE | | | | | | | | |
| B Counter Displays (BL,BM) | 93,713 | 391 | 63,875 | 8,275 | 629 | 9,622 | 8,544 | 2,377 |
| Supplemental Counter (BV, BC) | 114,679 | 2,568 | 71,888 | 9,936 | 720 | 15,632 | 10,806 | 3,129 |
| Centralized Pack (R) | 14,839 | 11,332 | 181 | 738 | 1,176 | 1,162 | 160 | 90 |
| Overhead Fixtures | 77,408 | 1,142 | 52,025 | 1,635 | 322 | 12,346 | 6,861 | 3,077 |
| Front End (Plan C) | 4,890 | 4,255 | 21 | 140 | 157 | 298 | 14 | 5 |

## HISTORICAL REVIEW PM-USA MERCHANDISING PLANS/FIXTURES

| | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| CARTON | | | | | | | | | | | |
| Carton Rows (000's) | N.A. | N.A. | N.A. | 2,220 E | 2,300 E | 2,327 | 3,009 | 3,699 | 3,975 | 4,053 | 3,417 |
| Plans A/AL | 35,179 | 30,390 | 21,264 | 43,070 | 43,362 | 43,989 | 46,612 | 48,049 | 50,983 | 49,658 | 42,255 |
| Carton Fixtures | N.A. | 70 | 95 | 316 | 334 | 1,011 | 5,122 | 11,182 | 15,300 | 16,810 | 18,028 |
| Supplemental Carton Fixtures: | | | | | | | | | | | |
| Marlboro (AM) | - | - | - | - | - | - | - | 1,272 | 8,514 | 4,660 | 3,024 |
| Value Center | - | - | - | - | - | - | 11,753 | 25,452 | 41,475 | 38,553 | 33,979 |
| Non Self-Service (AN) | - | - | - | - | - | - | - | - | 56 | 2,150 | 3,158 |
| PACKAGE | | | | | | | | | | | |
| B Counter Displays | 66,683 | 73,325 | 77,174 | 80,694 | 83,787 | 82,958 | 85,835 | 90,783 | 92,936 | 93,258 | 93,713 |
| Supplemental Counter | - | - | - | - | - | - | 34,930 | 56,692 | 91,786 | 104,625 | 114,679 |
| Centralized Pack (R) | - | - | - | - | N.A. | 911 | 1,858 | 2,221 | 3,794 | 6,493 | 14,839 |
| Front End (Plan C) | - | - | - | - | - | - | - | - | 142 | 4,328 | 4,890 |
| Overhead Fixtures | - | - | - | 7,441 | 15,592 | 20,556 | 28,004 | 35,211 | 49,063 | 63,111 | 77,408 |

N.A. = Not Available
E = Estimate

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## TOP 50 SUPERMARKET CHAINS

| | Name | City | ST | Stores | Total CPW |
|---|---|---|---|---|---|
| 1 | The Kroger Company | Cincinnati | OH | 1,252 | 883,912 |
| 2 | American Stores Co. | Salt Lake City | UT | 1,167 | 554,325 |
| 3 | Winn Dixie Stores Inc. | Jacksonville | FL | 1,207 | 555,220 |
| 4 | Safeway Corp Hq | Oakland | CA | 863 | 494,499 |
| 5 | A&P General Hq | Montvale | NJ | 932 | 343,908 |
| 6 | Food Lion, Inc. | Salisbury | NC | 754 | 327,990 |
| 7 | Albertsons All Level | Boise | ID | 490 | 304,290 |
| 8 | Publix Markets Inc. | Lakeland | FL | 361 | 205,409 |
| 9 | Suprmkts Gen Corp. | Edison | NJ | 204 | 153,612 |
| 10 | The Vons Companies | Arcadia | CA | 313 | 155,561 |
| 11 | Grand Union Co. | Wayne | NJ | 297 | 132,165 |
| 12 | Hyvee | Chariton | IA | 151 | 116,723 |
| 13 | Bruno Food Stores | Birmingham | AL | 141 | 101,238 |
| 14 | Bilo Inc. | Mauldin | SC | 174 | 100,050 |
| 15 | Stop & Shop Suprmkts | Quincy | MA | 117 | 78,156 |
| 16 | H.E. Butt | San Antonio | TX | 156 | 83,928 |
| 17 | Schrivner, Inc. | Ok City | OK | 152 | 83,904 |
| 18 | Giant Food Inc. | Landover | MD | 149 | 83,142 |
| 19 | Ingles Markets | Black Mtn | NC | 162 | 80,676 |
| 20 | Hannaford Shop n Sav | Scarboro | ME | 81 | 61,560 |
| 21 | First National Inc. | Maple Hts | OH | 106 | 63,706 |
| 22 | Furrs Inc. | Lubbock | TX | 122 | 69,052 |
| 23 | Harris Teeter Inc. | Matthews | NC | 129 | 63,339 |
| 24 | Weis Markets Inc. | Sunbury | PA | 116 | 65,888 |
| 25 | Ralphs Grocery Co. | Compton | CA | 142 | 67,734 |
| 26 | Smith Mgt Corp Nat | Salt Lake City | UT | 89 | 66,483 |
| 27 | Marsh Super Markets | Yorktown | IN | 79 | 60,909 |
| 28 | McCarty-Holman Co. | Jackson | MS | 91 | 46,046 |
| 29 | National Tea Co. | Rosemont | IL | 88 | 52,096 |
| 30 | Fleming Corp Hq | Ok City | OK | 119 | 56,882 |
| 31 | Super Value Mpls Div | Hopkins | MN | 87 | 48,024 |
| 32 | Homeland Stores Inc. | Ok City | OK | 106 | 52,576 |
| 33 | Brookshire Groc Co. | Tyler | TX | 89 | 49,039 |
| 34 | Delchamps | Mobile | AL | 107 | 52,430 |
| 35 | Kash n Karry | Tampa | FL | 109 | 56,135 |
| 36 | Stater Bros | Colton | CA | 102 | 56,916 |
| 37 | Nash-Finch Co. | Minneapolis | MN | 80 | 52,000 |
| 38 | Penn Traffic River | Dubois | PA | 78 | 46,098 |
| 39 | Tops Mkts | Buffalo | NY | 59 | 47,731 |
| 40 | Giant Eagle | Pittsburgh | PA | 53 | 56,763 |
| 41 | Giant Food Carlisle | Carlisle | PA | 52 | 40,040 |
| 42 | Riser Foods Inc. | Bedford Hts | OH | 49 | 42,875 |
| 43 | Super Valu Inc. | Eden Prairie | MN | 42 | 43,554 |
| 44 | Piggly Wiggly South | Vidalia | GA | 78 | 33,228 |
| 45 | Shaws Northern | So. Portland | ME | 35 | 33,355 |
| 46 | ABCO Markets | Phoenix | AZ | 74 | 44,178 |
| 47 | Schnuck Mkts Inc. | St. Louis | MO | 59 | 42,952 |
| 48 | Cullum Companies | Dallas | TX | 60 | 43,740 |
| 49 | Wegmans Mkt Inc. | Rochester | NY | 41 | 44,977 |
| 50 | Eagle Food Centers | Milan | IL | 106 | 38,690 |
| | Total Top 50 Supermkt Chains | | | 11,670 | 6,437,704 |
| | All Supermarkets | | | 28,225 | 13,802,025 |
| | Top 50 as a Percent of Total | | | 41% | 47% |

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## TOP CONVENIENCE/GAS & GAS CHAINS ACCOUNTS

| | Name | City | ST | Stores | Total CPW |
|---|---|---|---|---|---|
| 1 | Southland Corp | Dallas | TX | 6,874 | 1,612,734 |
| 2 | Circle K Corp | Phoenix | AZ | 3,865 | 591,345 |
| 3 | Emro Marketing Comp | Springfield | OH | 1,612 | 570,648 |
| 4 | Mobil Oil | Fairfax | VA | 1,414 | 292,698 |
| 5 | Super America Group | Lexington | KY | 663 | 232,050 |
| 6 | Amoco Corporation | Chicago | IL | 1,224 | 204,408 |
| 7 | Dairy Mart Corporation | Enfield | CT | 1,250 | 202,500 |
| 8 | Cumberland Farms | Canton | MA | 1,022 | 190,092 |
| 9 | Clark Oil Corp | St. Louis | MO | 919 | 176,448 |
| 10 | Atlantic Richfield Corp | Los Angeles | CA | 932 | 156,576 |
| 11 | National Convenience | Houston | TX | 1,043 | 152,278 |
| 12 | Kroger GO (Turkey Farms) | Cincinnati | OH | 941 | 151,501 |
| 13 | Total Petroleum | Denver | CO | 537 | 149,286 |
| 14 | Texaco USA | Houston | TX | 793 | 119,743 |
| 15 | BP America | Cleveland | OH | 778 | 113,588 |
| 16 | Racetrac Petroleum | Smyrna | GA | 168 | 105,672 |
| 17 | Diamond Shamrock | San Antonio | TX | 667 | 102,051 |
| 18 | Wawa Hdqts | Wawa | PA | 448 | 94,528 |
| 19 | Quik Trip Corp Hq | Tulsa | OK | 282 | 90,522 |
| 20 | Conoco Oil Co. | Houston | TX | 467 | 86,395 |
| 21 | Convenient Food Mart | Schaumburg | IL | 439 | 81,654 |
| 22 | Caseys General Store | Ankeny | IA | 710 | 78,100 |
| 23 | HESS Mart | Woodbridge | NJ | 324 | 77,112 |
| 24 | Coastal Mart | Houston | TX | 547 | 73,298 |
| 25 | Exxon Co. USA | Houston | TX | 342 | 68,058 |
| 26 | Mapco Petroleum Inc. | Tulsa | OK | 316 | 66,676 |
| 27 | The Pantry Inc. | Sanford | NC | 446 | 66,008 |
| 28 | White Hen Pantry | Elmhurst | IL | 388 | 65,572 |
| 29 | Majik Mkt Toc-Centrl | Casselberry | FL | 387 | 62,694 |
| 30 | The Customer Company | Benicia | CA | 88 | 60,192 |
| 31 | Shell Oil Corp | Houston | TX | 261 | 48,285 |
| 32 | Allsups Conv Stores | Clouis | NM | 305 | 48,190 |
| 34 | Wareco Oil Company | Jacksonville | IL | 97 | 45,784 |
| 34 | Admiral Petroleum | Coopersville | MI | 28 | 42,588 |
| 35 | Shell Oil Company | Oak Brook | IL | 209 | 42,218 |
| 36 | Huntley Jiffy Foods | Orange Park | FL | 317 | 39,625 |
| 37 | Uni-Marts Inc. | State College | PA | 333 | 39,294 |
| 38 | Holiday Companies | Minneapolis | MN | 214 | 38,520 |
| 39 | Beacon Oil Company | Hanford | CA | 206 | 35,020 |
| 40 | Sunshine Stores | Downey | CA | 144 | 33,840 |
| 41 | E-Z Mart | Texarkana | TX | 289 | 33,524 |
| 42 | Village Pantry | Pendleton | IN | 166 | 32,038 |
| 43 | Christy's Markets | Brockton | MA | 130 | 31,590 |
| 44 | Kwik Trip Foods Inc. | Lacrosse | WI | 209 | 30,723 |
| 45 | Sheetz | Altoona | PA | 155 | 30,070 |
| 46 | United Refining - PA | Warren | PA | 270 | 29,700 |
| 47 | Pilot Oil Corp | Knoxville | TN | 79 | 29,151 |
| 48 | ATL Ref & Mkt | King of Prussia | PA | 151 | 28,388 |
| 49 | United Dairy Farmer | Cincinnati | OH | 206 | 27,810 |
| 50 | Farm Store Food Corp | Miami | FL | 236 | 26,432 |



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## TOP CONVENIENCE/GAS & GAS CHAINS ACCOUNTS

| | Name | City | ST | Stores | Total CPW |
|---|---|---|---|---|---|
| 51 | Store 24 Inc. | Waltham | MA | 103 | 26,471 |
| 52 | Illico Indep Oil Co. | Lincoln | IL | 37 | 26,085 |
| 53 | Sunshine-Jr Stores | Panama City | FL | 293 | 26,077 |
| 54 | Thornton Oil Co. | Louisville | KY | 88 | 25,960 |
| 55 | Lil Champ Food Store | Jacksonville | FL | 228 | 25,308 |
| 56 | Holland Oil Wholesale | Akron | OH | 29 | 25,143 |
| 57 | WILCO (Williams Oil) | Winston Salem | NC | 97 | 24,638 |
| 58 | Stewarts Ice Cream | Saratoga Springs | NY | 176 | 24,464 |
| 59 | Minit Mart Foods | Bowling Green | KY | 96 | 24,192 |
| 60 | Gate Marketing | Jacksonville | FL | 127 | 23,368 |
| 61 | Quick Chek | Whitehouse Sta | NJ | 96 | 23,232 |
| 62 | Merit Oil Corp | Haverford | PA | 92 | 22,908 |
| 63 | USA Petroleum Corp | Santa Monica | CA | 79 | 22,515 |
| 64 | Krauszers Food Strs | Edison | NJ | 117 | 22,113 |
| 65 | Kwik Farm - Getty MA | Roanoke | VA | 145 | 21,605 |
| 66 | Certified Oil Co. | Columbus | OH | 134 | 21,440 |
| 67 | Crown Oil Fast | Norcross | GA | 185 | 20,905 |
| 68 | Discount Food Marts | Ft. Payne | AL | 75 | 20,325 |
| 69 | Food-N-Fuel Partners | Ft. Worth | TX | 136 | 20,264 |
| 70 | Sun Refining | Philadelphia | PA | 96 | 19,968 |
| 71 | Wilson Farms | Buffalo | NY | 76 | 19,912 |
| 72 | Fina Oil & Chemical | Dallas | TX | 134 | 19,564 |
| 73 | Town & Country Food | San Angelo | TX | 133 | 19,418 |
| 74 | Venta Inc. | Denver | CO | 46 | 18,906 |
| 75 | Golden Gallon | Chattanooga | TN | 100 | 18,900 |
| 76 | Jackpot/Time Oil | Seattle | WA | 131 | 18,733 |
| 77 | Kocolene Oil Corpgas | Seymour | IN | 62 | 18,662 |
| 78 | Tri Star Marketing | Urbana | IL | 39 | 18,408 |
| 79 | Fast Fare District | Cary | NC | 149 | 17,731 |
| 80 | Scotchman Conv Store | Wilmington | NC | 164 | 17,712 |
| 81 | PDQ Foods Inc. | Middletown | WI | 88 | 17,688 |
| 82 | Suwannee Swifty | Quitman | GA | 206 | 17,510 |
| 83 | High's of Baltimore | Baltimore | MD | 130 | 17,160 |
| 84 | Martin Oil Marketing | Alsip | IL | 42 | 17,010 |
| 85 | Sinclair Oil Co. | Salt Lake City | UT | 151 | 16,912 |
| 86 | Xtra Mart | Fabyon | CT | 82 | 16,892 |
| 87 | Wesco | Muskegon | MI | 30 | 16,890 |
| 88 | Total Petroleum | Lansing | MI | 64 | 16,704 |
| 89 | APSI | Irving | TX | 121 | 16,577 |
| 90 | Miller Enterprises | Crecent City | FL | 128 | 16,512 |
| 91 | Hucks Convenience | Carmi | IL | 93 | 16,089 |
| 92 | Strasburger Enterprises | Temple | TX | 100 | 15,900 |
| 93 | Lil Peach | No Billerica | MA | 61 | 15,677 |
| 94 | Omega Oil Co. | Dayton | OH | 57 | 15,675 |
| 95 | Phillips 66 Petro | Chesterfield | MO | 68 | 15,640 |
| 96 | Merit Oil Corp | Salem | MA | 45 | 15,525 |
| 97 | Tedeschi Food Shops | Rockland | MA | 66 | 14,718 |
| 98 | Food Bag Div Gen | Kensington | CT | 50 | 14,600 |
| 99 | Pick Kwik Stores | Tampa | FL | 93 | 14,415 |
| 100 | Krause Gentle Oil | West DesMoines | IA | 129 | 14,190 |
| | Total Top 100 Convenience/Gas and Gas | | | 39,158 | 7,784,428 |
| | All Convenience/Gas and Gas | | | 113,117 | 19,795,475 |
| | Top 100 as a Percent of Total | | | 35% | 39% |



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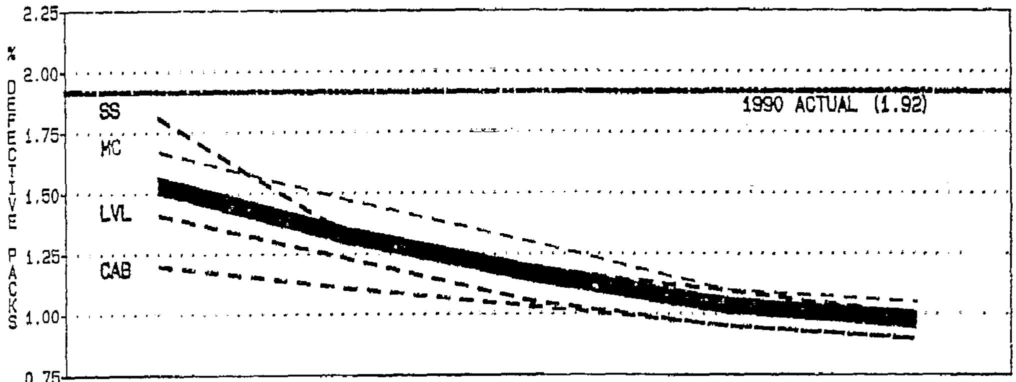
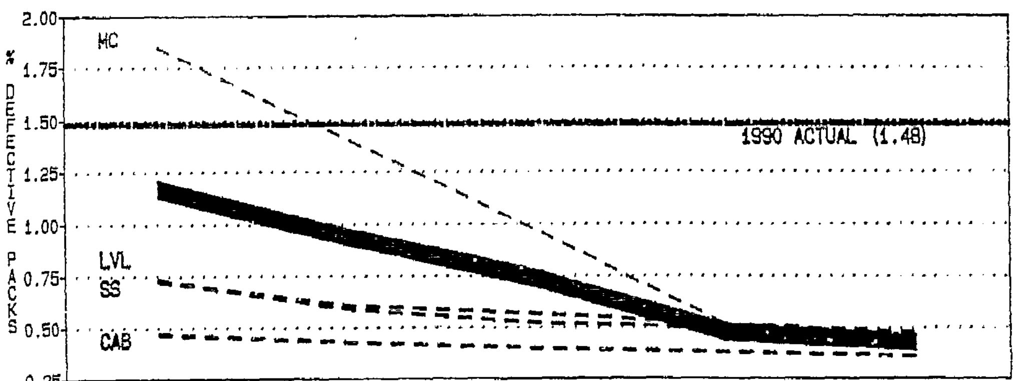
## QUALITY AUDIT CRITICAL CIGARETTE DEFECTS
1991 - 1995 PLAN



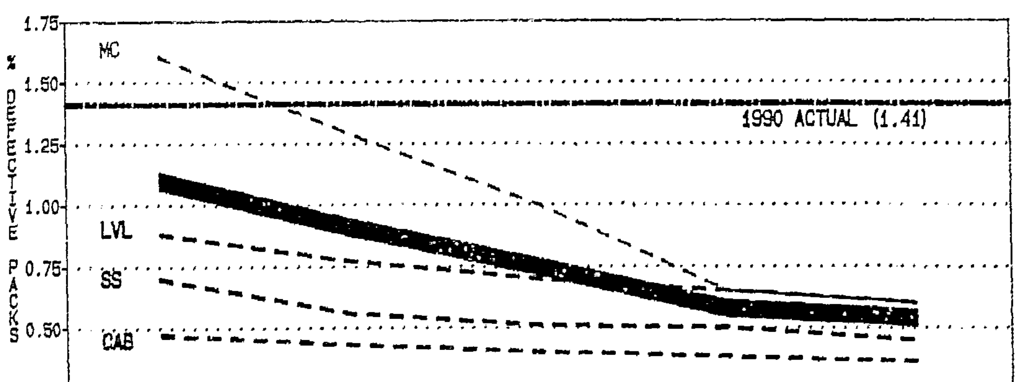

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| COMP | 1.54 | 1.33 | 1.17 | 1.04 | 0.98 |
| CAB | 1.20 | 1.11 | 1.03 | 0.95 | 0.90 |
| LVL | 1.41 | 1.23 | 1.05 | 0.95 | 0.90 |
| MC | 1.67 | 1.47 | 1.29 | 1.10 | 1.05 |
| SS | 1.81 | 1.33 | 1.19 | 1.10 | 1.00 |

## QUALITY AUDIT CRITICAL SOFT PACK DEFECTS
1991 - 1995 PLAN




| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| COMP | 1.17 | 0.94 | 0.74 | 0.48 | 0.43 |
| CAB | 0.47 | 0.43 | 0.40 | 0.38 | 0.36 |
| LVL | 0.73 | 0.61 | 0.57 | 0.52 | 0.48 |
| MC | 1.85 | 1.41 | 0.97 | 0.52 | 0.45 |
| SS | 0.73 | 0.59 | 0.52 | 0.50 | 0.45 |

## QUALITY AUDIT CRITICAL HARD PACK DEFECTS
1991 - 1995 PLAN




| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| COMP | 1.10 | 0.91 | 0.75 | 0.58 | 0.54 |
| CAB | 0.47 | 0.43 | 0.40 | 0.38 | 0.36 |
| LVL | 0.88 | 0.77 | 0.70 | 0.65 | 0.60 |
| MC | 1.60 | 1.29 | 1.00 | 0.65 | 0.60 |
| SS | 0.70 | 0.56 | 0.51 | 0.50 | 0.45 |

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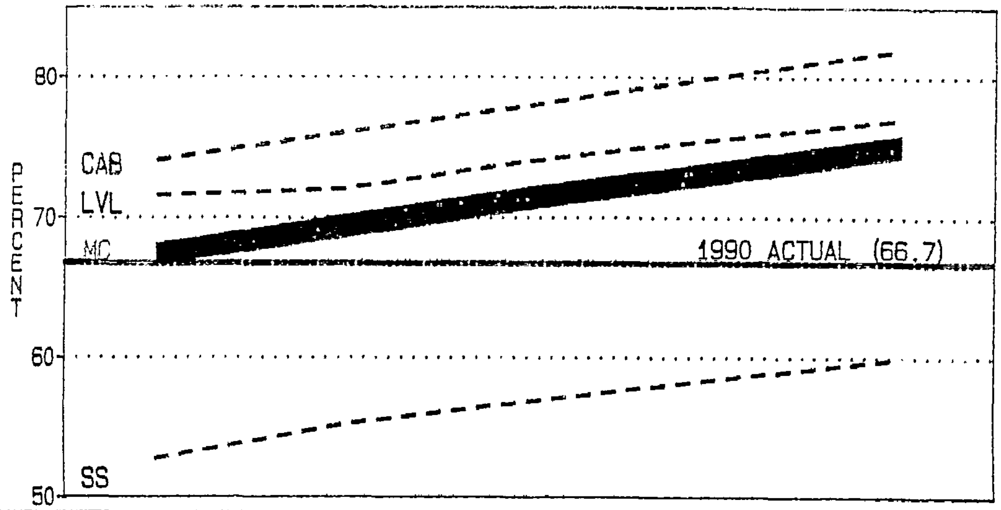
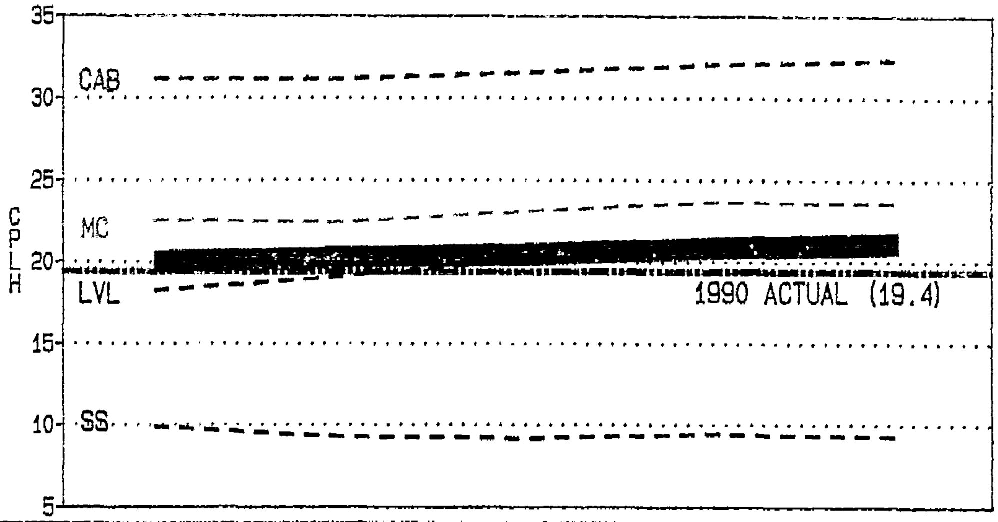
## FACTORY UTILIZATION




| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| COMP | 67.4 | 69.4 | 71.4 | 73.2 | 75.1 |
| CAB | 74.0 | 76.0 | 78.0 | 80.0 | 82.0 |
| LVL | 71.5 | 72.0 | 74.0 | 75.5 | 77.0 |
| MC | 66.8 | 68.8 | 70.9 | 72.9 | 75.0 |
| SS | 52.8 | 55.3 | 56.9 | 58.5 | 60.0 |

NOTE: Effect of Cabarrus Expansion Not Included

## CPLH




| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| COMP | 20.0 | 20.3 | 20.5 | 20.9 | 21.2 |
| CAB | 31.1 | 31.1 | 31.5 | 32.0 | 32.3 |
| LVL | 18.2 | 19.1 | 20.1 | 21.0 | 21.6 |
| MC | 22.5 | 22.4 | 23.1 | 23.7 | 23.6 |
| SS | 9.9 | 9.3 | 9.2 | 9.5 | 9.3 |

NOTE: Effect of Cabarrus Expansion not included



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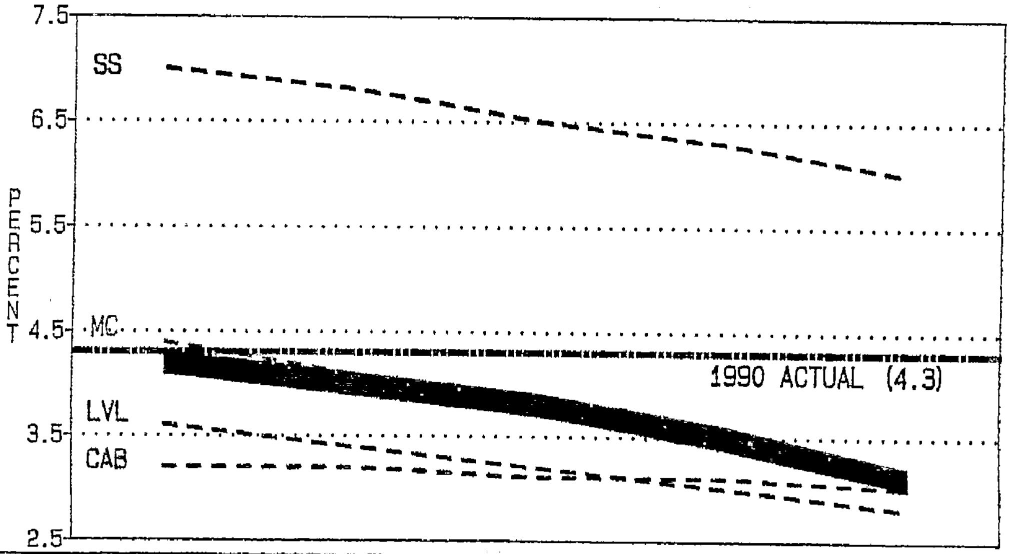
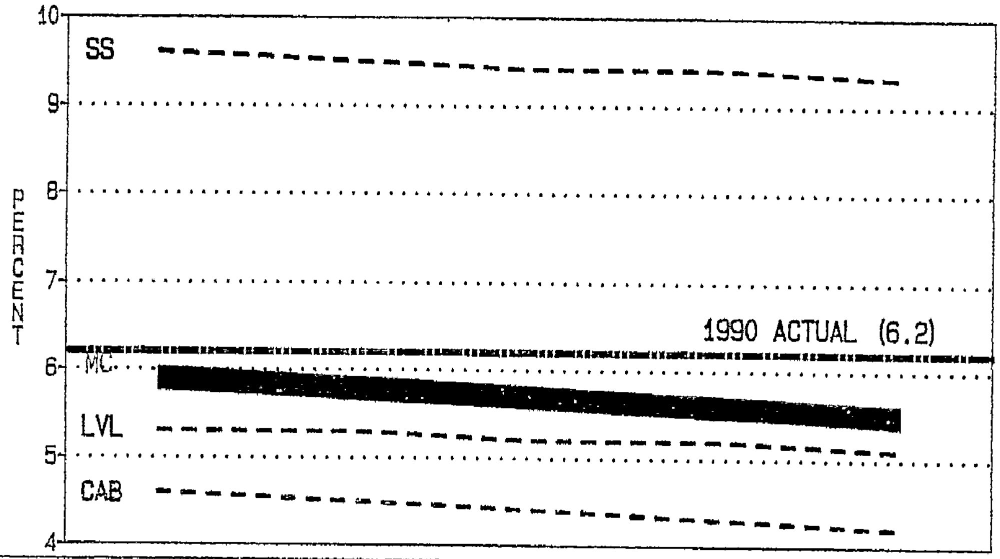
## CIGARETTE REJECTS




| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| COMP | 4.2 | 4.0 | 3.8 | 3.5 | 3.1 |
| CAB | 3.2 | 3.2 | 3.1 | 3.1 | 3.0 |
| LVL | 3.6 | 3.4 | 3.2 | 3.0 | 2.8 |
| MC | 4.4 | 4.1 | 3.8 | 3.4 | 3.1 |
| SS | 7.0 | 6.8 | 6.5 | 6.3 | 6.0 |

## MATERIAL WASTE




| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| COMP | 5.9 | 5.8 | 5.7 | 5.6 | 5.5 |
| CAB | 4.6 | 4.5 | 4.4 | 4.3 | 4.2 |
| LVL | 5.3 | 5.3 | 5.2 | 5.2 | 5.1 |
| MC | 5.9 | 5.8 | 5.7 | 5.6 | 5.5 |
| SS | 9.6 | 9.5 | 9.4 | 9.4 | 9.3 |

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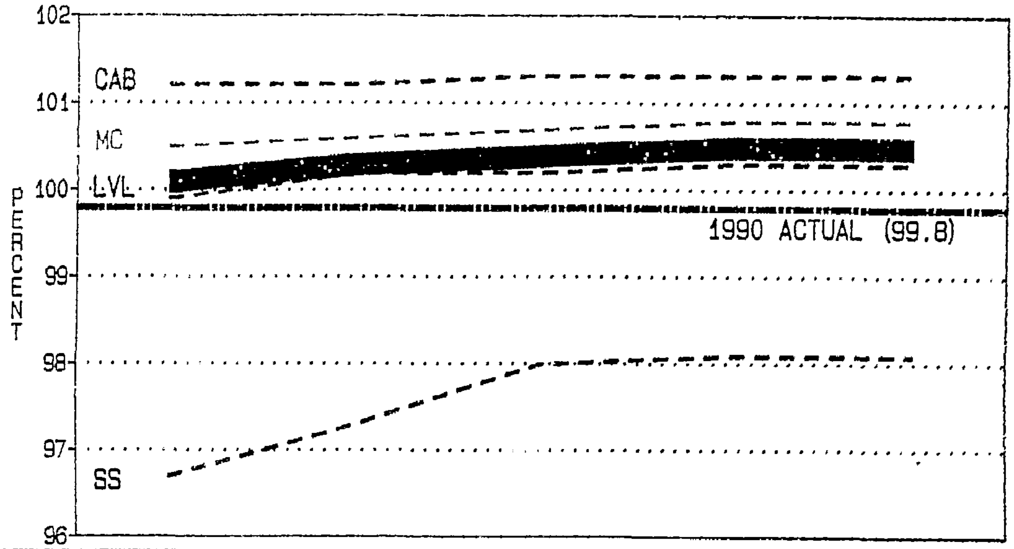


| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| COMP | 100.1 | 100.3 | 100.4 | 100.5 | 100.5 |
| CAB | 101.2 | 101.2 | 101.3 | 101.3 | 101.3 |
| LVL | 99.9 | 100.2 | 100.2 | 100.3 | 100.3 |
| MC | 100.5 | 100.6 | 100.7 | 100.8 | 100.8 |
| SS | 96.7 | 97.3 | 98.0 | 98.1 | 98.1 |



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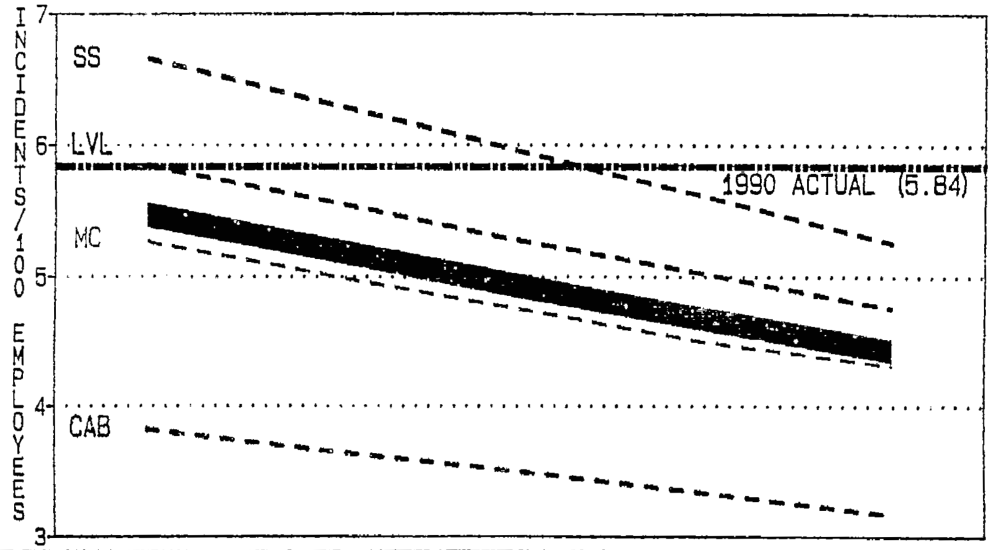
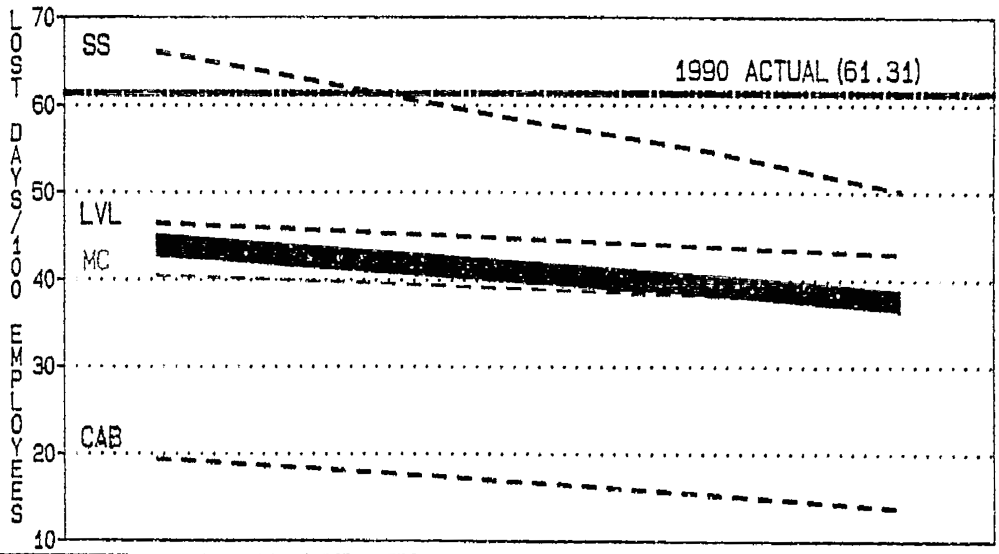
## INCIDENT RATE




| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| COMP | 5.47 | 5.20 | 4.93 | 4.68 | 4.44 |
| CAB | 3.83 | 3.66 | 3.50 | 3.34 | 3.17 |
| LVL | 5.85 | 5.56 | 5.27 | 5.02 | 4.76 |
| MC | 5.26 | 5.00 | 4.75 | 4.50 | 4.32 |
| SS | 6.65 | 6.30 | 5.95 | 5.60 | 5.25 |

## LOST WORKDAY RATE




| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| COMP | 44.04 | 42.44 | 40.85 | 39.36 | 37.63 |
| CAB | 19.46 | 18.07 | 16.68 | 15.29 | 13.76 |
| LVL | 46.50 | 45.60 | 44.70 | 43.80 | 42.90 |
| MC | 40.46 | 39.73 | 38.92 | 38.12 | 37.37 |
| SS | 66.00 | 62.00 | 58.00 | 54.50 | 50.00 |

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PRODUCTIVITY SAVINGS

(1990 Constant Dollars - Millions)

| VARIABLE COSTS<br>Manufacturing Performance | OB<br>1991 | 1992 | 1993 | 1994 | 1995 | TOTAL<br>5-YEAR<br>PLAN |
|---|---|---|---|---|---|---|
| Factory Utilization | 5.4 | 7.3 | 9.3 | 11.2 | 13.2 | 46.4 |
| Leaf Yield | 2.7 | 4.7 | 6.3 | 7.3 | 7.3 | 28.3 |
| Material Waste | 3.8 | 4.4 | 5.2 | 5.8 | 6.6 | 25.8 |
| Processing Plants | 8.3 | 8.3 | 8.3 | 8.3 | 8.3 | 41.5 |
| MC - Bay 1 | 4.7 | 9.8 | 9.8 | 9.8 | 9.8 | 43.9 |
| MC - Bay 2 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 12.0 |
| Other - W/E maint/Prim OT | (2.8) | (2.2) | (2.2) | (1.5) | (1.5) | (10.6) |
| **Total** | **$24.5** | **$34.7** | **$39.1** | **$43.3** | **$46.1** | **$187.7** |
| **Capital Programs** | | | | | | |
| MC - Bays 3, 4, 5 | -- | 0.3 | 1.4 | 2.3 | 2.3 | 6.3 |
| LVL - Productivity | -- | 0.2 | 2.6 | 6.3 | 10.5 | 19.6 |
| SS - M8/Repl | -- | 1.0 | 2.1 | 2.1 | 2.1 | 7.3 |
| Merit Plug Relocation | 1.0 | 1.5 | 1.5 | 1.5 | 1.5 | 7.0 |
| Cabarrus Expansion | -- | -- | -- | 17.3 | 21.7 | 39.0 |
| **Total** | **$1.0** | **$3.0** | **$7.6** | **$29.5** | **$38.1** | **$79.2** |
| **Productivity Initiative** | | | | | | |
| Matl's Price - Vol/Tandem | 5.2 | 5.2 | 5.2 | 5.2 | 5.2 | 26.0 |
| Supply Chain | 11.1 | 21.2 | 32.1 | 37.4 | 37.4 | 139.2 |
| Cambridge Blend Change | 2.5 | 7.9 | 8.7 | 9.4 | 10.1 | 38.6 |
| Specification Consolidation | | | | | | |
| Triacetin to 7% | -- | 1.0 | 1.0 | 1.0 | 1.0 | 4.0 |
| Eliminate Tyvek Bags (ET) | -- | 0.6 | 0.6 | 0.6 | 0.6 | 2.4 |
| Va. Slims FF to 98.6mm | -- | 0.3 | 0.3 | 0.3 | 0.3 | 1.2 |
| **Total** | **$18.8** | **$36.2** | **$47.9** | **$53.9** | **$54.6** | **$211.4** |
| **TOTAL VAR. PROD. SAVINGS**<br>*(EXCLUDING OVERTIME)* | **$44.3** | **$73.9** | **$94.6** | **$126.7** | **$138.8** | **$478.3** |
| **FIXED COSTS** | | | | | | |
| Volume | (5.0) | 45.8 | 65.6 | 80.3 | 92.0 | 278.7 |
| Supply Chain Project | | | | | | |
| URC Contract | (13.1) | (13.1) | (6.5) | -- | -- | (32.7) |
| Savings | 3.0 | 5.5 | 7.9 | 9.2 | 9.2 | 34.8 |
| Other Cost | 3.7 | 3.7 | 3.7 | 3.7 | 3.7 | 18.5 |
| York Rebuild | (6.4) | (11.1) | (14.2) | (16.7) | (19.2) | (67.6) |
| Additional Training Cost | -- | (6.7) | (6.7) | (9.5) | (9.5) | (32.4) |
| Cabarrus Expansion | -- | (5.3) | (5.8) | (18.4) | (14.8) | (44.3) |
| Depreciation | -- | (2.6) | (7.3) | (22.9) | (38.3) | (71.1) |
| General Growth | -- | (8.0) | (9.0) | (10.0) | (11.0) | (38.0) |
| Other | -- | (6.4) | (6.4) | (6.4) | (6.4) | (25.6) |
| **TOTAL FIXED SAVINGS**<br>*(EXCLUDING OVERTIME)* | **($17.8)** | **$1.8** | **$21.3** | **$9.3** | **$5.7** | **$20.3** |
| **PRODUCTION OVERTIME** | | | | | | |
| Variable | 8.6 | (5.0) | (11.0) | 12.7 | 17.2 | 22.5 |
| Fixed | 3.9 | (9.2) | (14.4) | 6.1 | 10.1 | (3.5) |
| **Total** | **$12.5** | **($14.2)** | **($25.4)** | **$18.8** | **$27.3** | **$19.0** |
| **GRAND TOTAL** | **$39.0** | **$61.5** | **$90.5** | **$154.8** | **$171.8** | **$517.6** |



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