

Q & A -- (THIRD DRAFT - 2/7/96)

JIM MORGAN PMI SPEECH -- 2/18/96

- 1. We as retailers are "carding" young adults to comply with the minimum age requirements for buying cigarettes, but how can we avoid liability when a legal-age buyer purchases cigarettes for minors?**

When retailers suspect that this situation may be occurring they have two courses of action:

- 1) Explain that you, the retailer, are required by law to ask if this transaction is an other-party purchase for a minor.
- 2) Explain that it is illegal for you to make the sale. Be polite and informative.

When in doubt, do not make the sale!

- 2. What is the status of the proposed FDA regulations, and do you think all or part of them will become law?**

In January of this year, the public comment period (five months' in duration) ended. Hundreds of thousands of letters were received by the FDA from concerned citizens and interested trade groups expressing their dislike for the plan. By law, the FDA must now review all the submissions before proceeding with its plan. The various lawsuits filed against the agency remain pending. We are confident that our positions will be upheld.

- 3. What is the Philip Morris position concerning the situation with the ex-Brown & Williamson employee, Jeffrey Wigand?**

We do not have a position on this situation.

- 4. Does Philip Morris believe that the current industry trend toward premium products will continue for the foreseeable future?**

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The current market dynamics are such that consumers continue to demonstrate their preference for premium brands that provide image at a perceived value. We will continue to reinforce these values through our marketing efforts and believe that we will be successful.

5. What is the future of the Private Label segment of the industry?

Private label products grow when the economy is in recession or when the prices of brand name products become too high. Prior to mid-1993, private label cigarette sales grew because the price difference between Premium brands and low-priced cigarettes was too large.

Private label sales peaked at 10.4% of industry sales in May, 1993 and have been declining since then. According to Nielsen data, the private label segment of the industry was 5.7% as of the end of December 1995.

We believe that smokers will continue to shift away from these brands toward premium-priced products.

6. Does PM plan to continue its Private Label brands?

We participate in all segments of the business. Ignoring a segment that accounted for 5.7% of industry sales as of December 1995 would not be good business.

The private label business is one means of establishing valuable partnerships with the trade. Refusal to accommodate trade customers seeking private labels would force them to go to our competition.

7. Some of your competitors have launched niche brands in the marketplace. How does PM view the viability of these brands?

These products make up less than 1% of the market. We will continue to monitor the consumer's reaction toward these products and react accordingly.

8. Please explain the state Medicaid class action suits. What is the legal strategy behind them and how do these cases differ from each other?

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This is proprietary information.

9. Can you (PM) do anything to prevent state excise taxes (SET) from pricing cigarettes out of the reach of our customers?

Revenue-hungry states raise tobacco excise taxes knowing that kind of tax hike will have the acquiescence, if not the support, of roughly 70% of their constituents -- the non-smokers, who won't have to pay it. We make sure that legislators in those states are aware of the impact of these taxes on our customers and seek to elicit grassroots efforts in opposition.

10. What has been the impact on cigarette sales in the states with the highest tobacco excise taxes?

Many people in high-excise-tax states cross state lines to lower-tax states for tobacco products if they live near enough to the border or commute there regularly. Unfortunately for the high-tax state's retailers in border areas, sales revenues have declined dramatically.

High-excise-tax states' retailers also report higher theft rates and costs for increased security measures. In some areas, tobacco products are being kept under lock and key. Michigan, a state with one of the highest cigarette excise taxes, 75¢ per pack, is reporting alarming increases in contraband product smuggled in from low-tax states.

Washington State, which hiked its tax 17.5¢ in July to the highest in the U.S., 81.5¢ a pack, (!) is a perfect illustration. Idaho's tax is 25¢; Oregon's 38¢. As a result, the state estimated in December that one in four cigarettes in Washington is purchased out of state. In the past 10 years, cigarette taxes in Washington have risen more than 350%. Their tax will go up another 1¢ per pack next summer. Just since July, the amount of money estimated lost to tax evasion also climbed, state officials say. Tax evasion on cigarettes is expected to jump from \$44.2 million this year to \$81.8 million next year.

11. What has been the impact on local businesses in towns that have enacted strict smoking regulations?

Smoking bans have caused some hospitality establishments to lose up to 30 percent of their sales; many have been forced to lay off employees, and some have gone out of business.

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12. What are your future intentions on pricing?

We cannot discuss future pricing intentions.

13. How long do you believe Marlboro can sustain its share and volume growth?

Since our Premium price reduction in March 1993, Marlboro's share performance has returned to its long-term growth trend. Immediate share gains after the Premium price reduction were a recovery of share that was previously Marlboro's. We lost it to low-price discounts and we were getting back what we lost.

Now that Marlboro's price is lower and it has recaptured smokers lost to Discount, the brand has returned to its previous steady growth trend. That continuing growth stems from Marlboro's consistent quality, appealing imagery, favorable demographics and creative promotions.

14. There seems to be a trend among drug stores to discontinue selling cigarettes; potentially, what effect will that have on PM's sales?

Using PM data, of the four major trade classes, convenience stores account for 44.6% of PM's retail sales; supermarkets for 18.9%; mass merchandisers 5.1%; and drug stores 4.7%. As you can see, drug stores currently account for only a small percentage of retail tobacco sales, and our analyses indicate that volume would be absorbed by the other trade classes.

15. Why "Marlboro Unlimited," and what do you project the impact of this promotion to be?

Marlboro Unlimited is the third generation of our continuity programs on behalf of Marlboro. Building on the success of the Marlboro Adventure Team and the recent Marlboro Country Store programs (which have made us one of the largest catalog enterprises in the world), Marlboro Unlimited will be our biggest and boldest effort to date. Thus far, smokers have identified with the image and value of Marlboro and we believe that Marlboro Unlimited will further enhance the brand's success.

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- 16. What can you tell us about your new brand, Dave's, that is currently in test market?**

Dave's is designed to meet consumer demand among discount smokers looking for quality taste and character in a discount brand. Dave's has strong and unique imagery ("Different Smokes") and provides price-sensitive smokers with a quality product.

The strategy behind Dave's is consistent with PM-USA's overall strategy announced on April 2, 1993, which is to inject brand equity into the discount category and develop trademarks that consumers ask for by name. Dave's was developed to ensure that PM captures a share of the discount category.

- 17. Marlboro Ultra Lights has been in test market for some time. Why has it not been released nationally?**

We do not discuss that for proprietary reasons.

- 18. What impact has the new B&W brand portfolio had on PM and the industry?**

B&W is a more formidable player due to its' overall market share (16.5% Nielsen, 12/95) and its large share of the discount price segment (34.8% MSA, 12/95) but we don't foresee their materially altering the marketplace, because doing so would not be in their long-term interest. B&W's U.S. market represents 14% of B.A.T.'s worldwide volume, yet it contributes 34% of total B.A.T. profits, thereby making the U.S. market the most profitable profit center for B.A.T. Our concentration is in the premium category, where we have built brand equity and positioned ourselves to counteract any competitive inroads. We believe B&W's brand portfolio will have minimal impact on our business.

- 19. RJR has recently introduced a mail order product called "Smokers Option." Does PM have any plans in this direction?**

That is proprietary information.

- 20. What has been the impact of the mega-volume cigarette outlets?**

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Mega-volume outlets are, in fact, the fastest growing trade class today. Comparing year-end 1995 to 1994 sales data, mega-volume retail accounts have increased their share of industry sales from about 1.4% to 4.4%, just under the drug category's 4.7%.

Their success can be attributed to their ability to create a smoker friendly environment with low cigarette prices.

21. **Philip Morris' stock is trading in the mid-90s; what would it have to reach before the company would consider a stock split?**

This is proprietary information.

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