

Q & A -- (FIRST DRAFT)

JIM MORGAN PMI SPEECH -- 2/18/96

1. What, if any, is Philip Morris doing about legislative issues that deal with "stings?" Is PM backing them as a corollary to its Action Against Access Program, or trying to help the retailer not get unfairly prosecuted?

Legal & Corp Affairs

2. Retailers are very concerned with the issue of a legal buyer purchasing cigarettes and then giving them to his minor-aged friends. What can retailers do? Where is the liability?

Legal & Corp Affairs

3. How does Philip Morris envision the tobacco industry five, ten or twenty years from now in light of potential regulation? We see ourselves as being destroyed by legislative and litigation issues.

4. What are the chances of the FDA gaining regulatory control over tobacco?

5. What is the status of the proposed FDA regulations?

[LEGAL]

6. Does PM expect cigarettes to continue to be a legal product?

Yes - legal

7. Does Philip Morris see the cigarette retail market as overwhelmingly premium based in five or ten years?

8. Why has there been an increasing number of new private label brands on the market over the last few years?

Private label brands first appeared in the early 1980s from Liggett after the federal excise tax doubled; this was a price play. This was a desperate effort by Liggett to remain afloat.

Initial consumer and trade acceptance in the '80s was poor, primarily because of concerns about quality and packaging. In the '90s, private label as a commodity did enjoy some success, primarily because of the pricing vs. standard brands, improvements in quality and package design, as well as real interest by retailers.

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 big.

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 6 7/8% as of end of December 1995.

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9. **Why does PM-USA sell private label brands?**

We participate in all segments of the business. Ignoring a segment that accounted for 6 7/8% of industry sales as of December 1995 would not be good business.

PM 1995 = 1.2 share of industry

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.

Consumer attracted ---

10. **How do retailers compete price-wise against megavolume outlets and Indian reservations?**

private big brands w/ value/equty incentives

individualized service, convenience or commodities / etc.

11. **How do we build up business against discount sales?**

12. **Is the trend in category sales negative or is it stabilizing?**

[Reassurance that it's stabilizing.]

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- 13.. Many retailers complain that Marlboro Unlimited catalogues are still not in their stores, while customers are asking for them. Why can't PM more closely match the availability of its in-store materials to its ads and promotions?

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14. How does PM view the future of all the new niche brands, such as Natural American Spirit or the seven from Moonlight?

15. Will Philip Morris produce an "all-natural" cigarette to compete?

- Legal -

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

[LEGAL]

17. 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.

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

much 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, is reporting alarming increases in contraband product smuggled in from low-tax states.

Wash state

add Washington State
if

- ✓
19. **Isn't there a point at which the price is so high due to the exorbitant excise tax that people can't pay it and the state therefore doesn't gain the revenue that was the purpose of the tax?**

Yes, the law of diminishing returns. We are very concerned that our products continue to be affordable to our customers.

20. **Has there been an impact on local businesses in towns that have adopted strict smoking regulations?**

Smoking bans have caused some hospitality establishments to lose up to 30 percent of their sales; some have gone out of business.

21. **What is the price gap now between premium and discount cigarettes, and is it widening or narrowing? Do you include the price of private label brands in calculating the price gap?**

The price gap is the differential between the price of Marlboro vs. that of the lowest-priced Discount product in the store. According to Nielsen figures, the pack price gap has narrowed to from approximately ____% in September 1993 to roughly ____% today

- ✓
22. **What strategies affect the price gap? If it widens too much, do you raise the price of your discount brands?**

We don't answer questions about pricing.

- ✓
23. **What if your competition raise their prices?**

We cannot discuss future pricing intentions.

- ✓
24. **Retail share for Marlboro has risen quarter over quarter since Marlboro Friday. Do you envision sustained share and volume growth for Marlboro?**

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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 ours. 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 growth stems from Marlboro's consistent quality, appealing imagery and favorable demographics.

25. What would you do if Marlboro began to lose share?

✓ We would not accept sustained losses.

26. ~~What is the retail breakdown of PM's sales?~~ *Politically correct* I've read that there's a movement among drug stores to get out of the business of selling cigarettes. How much effect will that have on sales?

PM data
Using Nielsen data, of the four major trade classes, convenience stores account for 44.6 % of PM's retail sales; supermarkets for 18.9 %; drug stores 4.1 %; and mass merchandisers 5.1 %.

As you can see monthly
Drug stores have traditionally accounted for only a small percentage of retail tobacco sales.

27. ~~How much are you spending on the Marlboro Unlimited programs as compared to your other marketing efforts?~~ ** long & PUs absorbed (no more)* Do you expect Unlimited to go over as well as the previous two (MAT and Country Store)? Better? Why?

28. What can you tell us about your new brand, Dave's, that is currently in test market? ~~Is it a Discount segment brand?~~

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.

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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.

29. **Is Dave's being introduced to compensate for Basic's relatively flat share performance? Won't Dave's cannibalize Basic or any of your other brands? Who is the target market? When will Dave's complete testing and be launched nationwide?**

We believe it complements Basic, and that together they will create a more uniform geographic reach for PM-USA within the Discount segment.

We believe this brand will establish its own constituency and carve out its own niche in the Discount category.

30. **Why does Philip Morris introduce new brands, spend the money for a moderate-to-big build-up, and then stop supporting them? I'm thinking of Alpine, Bucks, and especially Cambridge -- which had sort of found a market? What's the strategy behind this? Is it just a way to gain more shelf space?**

31. **What other products are in test markets right now?**

We do not discuss that for competitive reasons.

32. **Does PM intend to totally automate the cigarette ordering process by taking advantage of the new technologies?**

That is proprietary information we cannot discuss.

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33. **What kind of value-added information is PM going to be able to deliver to wholesalers, using the data that we are providing through the program?**

Among the many uses for the data, we plan on providing a series of Category Management services to our customers that will help them grow their businesses toward maximum overall profitability.

34. **How will the program be changing in the future, if at all?**

35. **Does PM see B&W becoming the second-biggest player in the industry, moving RJR into third place? What would this mean?**

36. **I've heard that RJR has come out with a smokeless cigarette with no tar or nicotine that is only available by mail order called "Smoker's Option." What is this product, how does it work, and why do you think RJR isn't selling it at retail?**

The message on the back panel of the Smoker's Option pack says that it is a "smokeless, non-tobacco alternative for situations when you can't or choose not to smoke." You don't light it up, though you draw on it like a cigarette. Its package says it has a menthol/cinnamon taste.

We haven't any idea why they're choosing to sell it via mail order only.

37. **How can I "partner" with PM when my store sells too few cartons per week to be eligible for your Retail Masters program?**

38. **How can I increase my profitability when my store is in a lower-demographic, overwhelmingly-discount-priced neighborhood? I've had to sign deals with RJR and B&W to make a living -- making me ineligible for Retail Masters.**

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39. There seems to be a trend toward consolidation in both the c-store and supermarket trade classes. Do you foresee an eventual "super-C-store" segment of the largest chains with special deals for them? What would this consolidation mean for the smaller chains or "Mom & Pop" c-stores?
40. Philip Morris' stock is trading in the mid-90s; what would it have to reach before the company would consider a stock split?

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