

Q & A -- (SECOND DRAFT - 1/31/96))

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?**

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

[LEGAL]

- 3. Does Philip Morris believe that the current trends toward premium product ~~shares~~ will continue for the foreseeable future?** *growth*

- 4. 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 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 5.7% as of end of December 1995.

- 5. 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.

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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.

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

These products ~~still~~ make up less than 1% (?) of the market, but we ~~know they do have strong followings in certain areas.~~ We're watching this situation closely so as not to have a repeat of what occurred in the beer industry.

Call Karen Eisen

7. **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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8. **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.

9. **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.

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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.

10. 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; some have gone out of business.

11. What are your future intentions on pricing?

← We cannot discuss future pricing intentions.

12. 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 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 continuing growth stems from Marlboro's consistent quality, appealing imagery, favorable demographics and creative promotions.

carrying **13. There seems to be a trend among drug stores to discontinue their cigarette business; 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

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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 that volume would be absorbed by the other trade classes.

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

15. **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.

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.

16. **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.

17. **What impact will the new B&W brand portfolio have on PM and the industry?**

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

That is proprietary information.

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19. Trade consolidation in the industry continues to increase. How will this impact the market?

c-store Diamond Diamond & buy NCS.

20. What effect has NAFTA (North American Free Trade Agreement) had on PM and the U.S. tobacco industry?

[LEGAL/CORP AFFAIRS]

21. What has been the impact of the megavolume cigarette outlets?

~~Megavolume outlets have not yet been broken out into a separate trade class, so at present they're mixed in with the traditional tobacco shops in the "Other" category, because there isn't a good scanning process that would provide representative data. Indian reservation sales have decreased as states have become more vigilant in collecting tax on sales to non-Indian consumers.~~

then share of industry sales from

~~However, comparing year-end 1995 to 1994, megavolumes have increased about 1.4% to 4.4%, just under the drug category's 4.7%. Megavolumes are, in fact, the fastest growing trade class. There is continued trade class shifting in the industry. The rate of supermarket losses to c-store growth has slowed, and the megavolumes may be picking up the difference.~~

sales data, retail acct, acct

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