PHILIP MORRIS U.S.A.

INTER-OFFICE CORRESPONDENCE

120 PARK AVENUE, NEW YORK, N.Y. 10017

DATE: June 11, 1993

TO: Mr. W. I. Campbell

FROM: B. A. Reuter

SUBJECT: Domestic Canadian Export Business Sales Soft Due to P.M. Inter-Company Competition

For Your Information

We have just completed a series of marketing meetings with selected sales units along the Canadian border to prepare for the Summer Distribution Drive for both Imperial and Rothmans products. The meetings went well, with considerable enthusiasm expressed for the opportunity to market full margin units to Canadian visitors.

However, in Region 1, where more than 60% of our projected volume resides, we discovered a disturbing deterioration of the business. The problem is centered in Unit 1202, the Buffalo, New York market where an Indian reservation straddles the border. As you can see in the attached chart, after loading the pipeline in December and January, the business has softened considerably.

This change was primarily due to the availability of duty free product from Philip Morris International at a lower price point in March.

While we have asked the PM USA sales force to focus on domestic Canadian Export Sales, the inter-company competition between the PM USA sales force and PMI Duty Free special market customers is a problem. As long as the two operating companies remain rivals in the Canadian export business, where Duty Free has a price advantage, there is little incentive for PM USA Sales to take this business opportunity seriously.

I, therefore, recommend that the business be consolidated within PM USA under one management, enabling the PM USA Sales organization to support and receive credit for total USA regional sales gains -- both duty paid and duty free. The attached brief summarizes the reasons why it is in the best interest of Philip Morris Companies Inc. to house domestic duty free in PM USA.

Attachments:
- Unit 1202 Canadian Player's Sales Trends
- Rationale for Moving US. Duty Free Sales into PM USA
- Incremental Volume/Income Potential for PM USA

cc: H. Steele

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UNIT 1202 CANADIAN PLAYER'S

CANADIAN PLAYER'S SALES TREND IN BUFFALO AREA

	CURRENT MONTH	YEAR - TO - DATE	6M-CASE PER MONTH
Dec-92	4,794,000	4,794,000	799
Jan-93	13,896,000	13,896,000	2,316
Feb-93	1,308,000	15,204,000	218
Mar-93	1,908,000	17,112,000	318
Apr-93	96,000	17,208,000	16

*All figures are in units except 6m case size.

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Canadian Export Business Development

1993 Business Development

During the first four months of 1993, the Canadian cigarette export market reached 4.3 billion units, considerably more than the 1992 level of 1.7. As a result, Imperial is estimating a 12 billion unit market for the full year. Duty Free Canadian sales are strong, reaching 308 million for Player's year-to-date, and 460 million for Rothmans year-to-date. In fact, both Imperial and Rothmans are pressuring Duty Free to increase sales. Imperial, in particular is urging PMI to push sales along the Western border. PMI, to date, has been holding back in deference to PM USA, but it is likely that with time, their sales efforts will be increasing and under-cut our sales even more than what has been experienced in the Buffalo market.

PM USA Opportunity

The growth of the Canadian Tobacco Export business in the United States provides at least short term volume growth for Philip Morris Companies. I think we can maximize this opportunity and minimize our investment if we move the business under a single management in PM USA. This would mean reversing the 1967 decision that transferred USA duty free business from PM USA to PMI. In the 1960's, PM USA was in a growth spurt, PMI needed the volume and income more than PM USA, and duty free volume was used to seed export markets. In 1993, these three reasons are no longer valid.

The magnitude of the domestic duty free market, including all USA territories in PMI, is expected to reach 4 billion units worth $56 million in operating income in 1993. (See attachment). Three reasons have been given for including this business in International. First, the pricing for duty free sales is influenced by pricing in similar outlets around the world. Second, the brand offerings are international, rather than limited to U.S. brands. Third, the customer is generally a non-American.

However, there are a variety of compelling reasons why it makes more sense to move the management of domestic duty free sales to PM USA. First of all, the actual sales are made in the United States and its territories. This is volume and income that PM USA can readily use. There is precedent in all other regions of the world, as the management responsible for a geographical area oversees both the duty free and duty paid businesses. Presumably, this has been done to realize the synergies available in management people/time, warehousing, marketing materials and sales support. But we are not currently realizing these synergies in the American Region of Philip Morris. In addition, the Canadian Export business adds to the rationale for consolidating all U.S. duty free business in PM USA. The contractual arrangements with both Imperial and Rothmans are with Philip Morris USA. In addition, the marketing activity and retail presence for the Canadian brands for promoting the business resides with the PM USA sales organization. The product and packaging design work, as well as the manufacturing for domestic duty free already are all done in PM USA.

I hope I have presented a compelling argument for the consolidation of the Canadian Export business within PM USA as part of a duty free/duty paid entity. Please let me know if you have any questions or concerns.

POTENTIAL INCREMENTAL DOMESTIC VOLUME AND INCOME CURRENTLY UNDER PMI MANAGEMENT

1993	UNITS (BILLIONS)	OPERATING INCOME (MILLIONS)
USA Duty Free	2.44	$39.0
Puerto Rico	.60	$ 0.9
Virgin Islands	.11	$ 1.5
Guam	.58	$13.9
Bahamas	.02	$ 0.3
American Samoa	.04	$ 0.7
	3.79	$56.3

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