DRAFT 2

PROJECT UMPIRE

SKELETON BUSINESS PLAN

SECTION 1. Executive Summary

The Uzbek Cigarette market is estimated to be 22 billion cigarettes although domestic production at Tashkent Tobacco Factory (TTF) is currently only able to supply 4 billion. Imported brands from both the West and other Eastern and Central European countries supply the shortfall.

Uzbekistan grows around 45 thousand tonnes of semi-oriental tobacco each year. A small proportion of this is used to satisfy domestic cigarette manufacturing requirements and the remainder is sold or bartered to other CIS countries by the state.

Following signature of a Memorandum of Understanding on 5th October 1993 with the Uzbek authorities, and in addition signature of a Protocol of Intent on 16th December 1993 by Sir Patrick Sheehy and First Deputy Prime Mininster Mr Ismail Jurabekov supporting the MOU, NBD have conducted an in depth review of the Uzbek tobacco industry.

These studies are now substantially complete and have been used to formulate this BAT business plan covering the first ten years of operations. The plan will be used as the basis for the negotiation and agreement of a Joint Venture incorporating all aspects of the Uzbek tobacco industry.

The BAT objective is to dominate the local cigarette market and where possible, export cigarettes to neighbouring countries. A rapidly growing population and future improvements in the economic situation of the region should create the opportunity for the JV to sell 25 billion cigarettes by 1999.

An investment of $44mn will be made in the existing cigarette factory in Tashkent to bring capacity up to 10 billion cigarettes by 1996 and to improve product quality and safety standards.

Further expansion of the Tashkent factory is limited by the small factory site and construction of a new cigarette factory in Samarkand, at an estimated cost of $147mn, is planned to commence in year 1. The new factory will be designed to have a capacity of 20 billion cigarettes with future expansion capability to 30 billion cigarettes. However, capacity will initially be restricted to 15 billion cigarettes, Full production levels will be reached in 1998 and at this time moves

while TTF is still in operation.

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will be made to close down the Tashkent factory and for/equipment and staff to be transferred to the new factory.

A leaf extension programme to improve the existing semi-oriental tobaccos and to introduce flue cured and burley tobaccos, together with a $33mn investment in Urgut fermentation plant to improve existing facilities and for the installation of a Green Leaf Threshing plant, will improve the quality of leaf for domestic use and add value to leaf exports. #37.4

Resolve this ¶. with Paul.

The development of flue cured and burley tobaccos is intended for domestic use only and exports will be restricted to semi-oriental style tobacco. The overall quantity of leaf to be exported will reduce from a current total of 25 million kg to 23 ~~22~~ million kg *[check this figure]* by 2003, but revenues will increase from an estimated $18mn*[check this figure]* to $49 mn.

It will be ~~a political necessity~~ necessary for both competitive and political reasons to include the Samarkand fermentation plant in the JV although the plant is a liability because of the very poor condition of some of the facilities. The intention will be to close it down within three years and to transfer the employees to the new cigarette factory. Notwithstanding, investment of $?mn will be necessary to extend the life of the main production building and to rectify the more dangerous defficiencies.

#2.5

Continued operation of the Samarkand plant in the short term is necessary because the Urgut plant will not have sufficient capacity to ferment all the 1/3 bak semi-oriental leaf crop.

[para on JV structure]

[para on financial analysis]

SECTION 2. Business Objectives and Strategies

2.1 Cigarettes & Leaf

<u>Cigarettes</u>

Satisfy domestic demand and explore export opportunities

Maintain and develop local brands/eventual manufacture of IFB's

Distribution- - relationship with Bakalea
- develop private distribution networks

The opportunity lies in exploiting the severe defficiency in domestic production (3.2 billion in 1993) against significant and growing market potential; 22 billion cigarettes today rising to 32 billion cigarettes in 1999. There are also opportunities to export cigarettes to neighbouring countries not all of which have a local cigarette industry.

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(b) *Fermentation*

Refurbish and increase production at Urgut - installation of GLT

Eventual closure of Samarkand - wish to utilise employees at GFS if possible

(c) *Leaf*

Improve quality and value of oriental

Commence growth of FCV and Burley

Leaf extension programme

2.2 Essential elements in any BAT investment

[Schroders note: these conditions fall into three groups:

- *those which are absolute pre-conditions for investment: I suggest freedom to price and distribute, termination of the State Order, freedom to contract with farmers, access to brands, hard currency, environmental indemnification (subject to any environmental survey and excise (subject to David Bishop's report);*
- *those which are disireable but not mandatory: I suggest that these might be freedom to export, freedom to barter, certain of the tax exemptions, freedom to advertise; and*
- *those which would simply confirm in detail the privileges available to foreign investors.]*

There may be other liabilities against which we would seek indemnification rather than a price adjustment.]

1. **Freedom to price.** At present, there is a legal freedom to price tobacco products in Uzbekistan *[Confirm]*. However, in practice the legal freedom is reduced by the dominant role of the state in the form of UPP in the purchasing of leaf and tobacco products; UPP is responsible for the purchase of some 50 per cent of the current tobacco leaf crop and all of current cigarette and other tobacco products produced at TTF. Whilst the leaf farmers can sell separately they must meet the "State Order" requirements; TTF have no legal alternative. The State Order system is addressed below.

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Nonetheless, BAT would require absolute freedom to price its products and not to be subject to any preferential pricing policy for the state's requirements outside any agreement about the State Order. BAT would also require confirmation that the Uzbek Anti-Monopolies committee did not deem that any part of BAT's investment would be subject to regulation.

2. **Freedom to distribute.** At present, there is a legal freedom to distribute leaf and tobacco products although Uzbakalaya, the state distributor *[Confirm]*, is understood to be the exclusive distributor of tobacco products for TTF. BAT would require discretion as to whom it used for domestic and international distribution , subject to any agreement on the future of the State Order.

3. **Managing down of the State Order system.** It will be extremely important for the freedom to price and to distribute that the State Order system is terminated. It is probably unreasonable to expect its immediate abolition given the government's economic interest in it. Therefore, it might be appropriate to make proposals for the managing down of the system until improved economic circumstances, and increasing availability of tobacco products removes the need for it:

- Leaf. The government purchases tobacco leaf for processing as well as for international barter. It is believed that the government may have pledged significant amounts of leaf for future barter deals, so any scheme to manage down the State Order for leaf may have to reflect these commitments. It is proposed that for 1994 the State Order for leaf is accepted *[specify absolute amount and percentage of crop]* and thereafter on an annual basis reduced by a third of the 1994 amount so as to be reduced to zero in 1998 although the government would be able to purchase leaf from the farmers in free competition with other purchasers. The State Order would be agreed in advance but farmers would be under no obligation to offer a preferential price. The State Order would not *[would have limited]* access to leaf grown by those farmers contracted to BAT under the leaf extension programme, once BAT's orders had been satisfied.

- Processed leaf. Subject to the commitments already made by the government for the barter of processed leaf, the State Order would be reduced on the same ~~[different]~~ basis from that proposed for leaf so that by the beginning of ~~1998~~ year 4 BAT would have absolute discretion as to the fulfilment of orders from ~~UFP~~ UPP. *[Schroders note: this timetable for the managing down of the State Order should also reflect the timetable for*

Pricing — same as for cigarettes. See next page.

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investment in production so that BAT retains as much discretion as possible over the use of the product of the new investment]

- Tobacco products (principally cigarettes). It is understood that the government's economic interest in tobacco products may be more limited in relation to cigarettes and smoking tobacco which may be used as payment in kind for government employees. Logically, as the new currency is introduced and the economic position stabilises and as the domestic supply of low cost/VFM cigarettes improves, payment in cigarettes should decline. However, in order to promote this process and to avoid the State believing it can simply increase the State Order to improve its hard currency earning potential through barter and export, it might be appropriate to require the following:

    - 1994 State Order is an absolute ceiling for the remainder of the State Order system's life;
    - the 1994 State Order volume will be reduced in even amounts on an annual basis so that by the beginning of 1998 it has been terminated; and
    - ~~prices will be agreed annually [/quarterly in advance to address inflation/be subject to adjustments for inflation] in advance~~.

Volumes will be set annually on the basis of an indicative price, and delivery will be conditional on agreement on a final price (reflecting inflation and market conditions).

An important part of agreeing the termination of the State Order will be convincing the government that improved quality and supply will allow it to satisfy its requirements on the open market. Moreover, the government will need to be persuaded that its principal economic interest lies in the pre-tax profitability of TTF, UFP, SFP and the greenfield site.

4. **Freedom to contract with leaf farmers.** BAT would require absolute freedom tc contract with any leaf farmer it wishes to do so on an equal basis with the state should the State Order system still be in existence. In addition, it would be a term of participation in the leaf extension programme that BAT had priority access/ right of first refusal for the product of participating leaf farmers. *[Schroders note: it is highly likely that the govemment will seek some access to improved quality leaf for use for barter therefore BAT may need to consider ceding access for an appropriate percentage of the leaf produced as part of the extension programmes.]*

BAT to have priority after state order for leaf grown under extension program.

5. **Freedom to import the capital equipment, raw materials and other goods necessary for the implementation and maintenance**

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• all such imports would have to be free of duties or taxes, including VAT.

of the investment. BAT will require the appropriate licenses to import:

- capital equipment necessary for investment *[Schroders note: it would be appropriate to specify this in as much detail as possible for that if specific licenses are needed they can be obtained as soon as possible. Clearly, it would be appropriate to secure discretion to import other capital goods.]*

- raw materials necessary for the leaf extension programme, leaf processing and the production of cigarettes. *[Schroders note: it would be appropriate to specify in detail.]*

~~[Any other goods and services?]~~

6. **Freedom to export.** BAT would require to be licensed so that it has freedom to export leaf, processed leaf and tobacco products at its discretion. It would be appropriate to emphasize BAT's commitment to improving the supply of tobacco products in the domestic market. but freedom to export is necessary to generate hard currency for wrapping materials, spare parts, etc.

7. **Freedom to barter.** BAT would require to be licensed to barter with any goods (not necessarily tobacco or tobacco products) or services ~~it owns~~ for both domestic and export purposes. It is expected that involvement in barter should diminish over time as the currency becomes internally and externally convertible.

8. **Access to brands.** BAT would require untrammelled access to local brands existing and dormant and an undertaking ~~that~~ by UPP that no local or international brands have or would be registered by them from *[date]* without prior consultation with BAT.

9. **Freedom to advertise.** BAT would require freedom to advertise its domestic and international tobacco products both generally and at the point of sale. BAT would require an undertaking from the government not to impose restrictions on the advertising of tobacco products for a period of [seven] years from the agreement to invest.

Do we really want to go for this?

[Schroders note: this has not been discussed in any detail and Murray Marr may wish to consider what is necessary. The legal position and practice in relation to advertising appear to be inconsistent.]

10. **Licensing for the domestic processing of leaf and manufacture of tobacco products.** BAT would require that for a period of

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Now Available.

15. **Excise.** [To await paper from David Bishop].

16. **Other indemnification?**

SECTION 3 Cigarette Marketing and Sales Strategy

3.1 The Uzbek Market

Accurate market data is not available and the best estimate, based on on figures quoted by BAKALEA, the state distribution agency, is that current consumption is 22 billion cigarettes. Of this, only 3.2 billion cigarettes were produced in Uzbekistan in 1993. Imported cigarettes from F.S.U., Bulgaria, the subcontinent, "the west" and other 3rd country imports make up the balance of 18.8 billion cigarettes. all of which are relatively expensive compared to local brands.

~~Expensive 3rd country and western~~ Imports, are estimated to account for ~~50%~~ 80% of the present market. If a more affordable mix of cigarettes were made available to consumers then increased demand and consumption is likely to result.

Historically, TTF has been able to produce in greater quantities, and in 1985 manufactured 7 billion cigarettes, an estimated 33% of the local consumption of 21 billion cigarettes. Output since then has gradually declined due to the familiar F.S.U. problems of raw materials supply shortages and lack of investment in equipment.

Move to 3.2

With a current population of 20.5 million, and an estimated market of 22 billion cigarettes, annual per capita consumption is calculated at approximately 1100 units, which is considerably lower that the F.S.U. average of 1700 units. In part this may be explained by the fact that Uzbekistan is an Islamic state (non-fundamental) with correspondingly less conspicuous consumption amongst women. In addition, given the harsh economic climate, there is a severe shortage of the more affordable low cost locally produced cigarettes.

Cigarettes from TTF are ~~only~~ principally sold through the state distribution agency BAKALEA, ~~who~~ which decides allocations, and ensures the physical distribution of cigarettes in rural areas through a network of 12 regional warehouses. A small quantity of cigarettes are imported by the state to make up the "state order", and the remainder are brought in by private importers and businessmen. There is no smuggling as such because import duties have been removed in response to the domestic shortages.

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Insert A from previous page.

The four principal assumptions underlying this forecast are:

3.2 Market Trends

The domestic market segment trend forecast up to 2003 is shown below:

Billions	(%MS) 1993	1994	1995	1996	1997	1998	(%MS) 2003
Papirossi	0.5 (3%)	0.0	0.0	-	-	-	-
Plains	5.5 (25%)	6.0	6.0	4.8	4.3	3.8	2.5 (8%)
Economy	4.5 (20%)	4.6	5.2	7.0	8.2	10.1	12.0 (38%)
VFM	7.5 (34%)	7.7	8.3	8.8	9.4	10.1	10.8 (34%)
Low (IFB3's)	2.4 (11%)	2.5	2.7	3.0	3.4	3.3	3.5 (11%)
Med (IFB2's)	0.6 (3%)	0.8	1.0	1.2	1.3	1.3	1.5 (5%)
High(IFB1's)	1.0 (4%)	1.0	1.1	1.2	1.2	1.2	1.4 (4%)
Total volume	22 (100%)	22.6	24.3	26.0	27.8	29.8	31.7 (100%)

- High inflation coupled with low disposable income will prevail for several years, although economic conditions will gradually improve over the plan period. Consequently, consumers will be very price-conscious with correspondingly high demand for inexpensive cigarettes.

- Better supply of cigarettes can be expected in the future as capacity in F.S.U. increases and distribution infrastructure yields more efficiency in reaching the consumer.

- Most smokers are used to the flavour of semi-oriental tobaccos, but the longer USB styles remain in the market due to shortages, the more the trend will be towards the latter. This will be reinforced by the impact of high birth rates in the 1980s and starters adopting USB styles.

- Dramatic growth will occur in the market during the first 6 years of the plan driven by:

  a) rapid population growth (+ 2.5 % p.a)
  b) increased per capita consumption levels as economy improves
  c) increased availability of inexpensive cigarettes
  d) growth in incidence amongst women as cultural stigma on smoking recedes.

It is estimated that the market will grow from 22 billion cigarettes presently to approximately 32 billion in 1999 after which it will stabilise. Correspondingly, per capita consumption will rise from 1100 to 1300 over the same period.

Papirossi will cease to exist as machinery becomes obsolete, whilst plain cigarettes will experience a temporary resurgence compensating for Papirossi

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demise, before a long term decline to 8% of the market in 2003, from 25% currently. The reasons for this rapid decline are:

a) small franchise at present, relative to F.S.U. (35%)
b) increasing smoking and health issues
c) competitive "economy" filter offers
d) no "starter" consumers, old franchise will get older

Economy segment will experience dramatic growth in early years as supply increasingly meets demand for better quality inexpensive filter cigarettes with Uzbek pedigree.

"Value for money" segment will maintain its segment share over the plan period, but its present fragmented nature, with a myriad of cheap, pseudo-western imports, will rationalise down to a few dominant brands with a quasi-western imagery e.g. Apollo Soyuz, as the major manufacturers become more proactive in this segment. These segments will account for 72% of market by the end of the period. **<u>These are the opportunity segments.</u>**

<u>IFBs</u>, presently over-represented at 18% of the market due to imbalanced mix of cigarettes available, will experience gradual growth to 20% of market by 2003. Image will become important to an increasingly large proportion of consumers as disposable income levels increase.

A general consumer survey and a trade mark survey will be carried out to obtain further confirmation of the above trends and assumptions. A trademark survey has now been completed.

3.3 Marketing Strategy

The JV volume and segment share forecast up to 2003 is shown below:

		1993	1994	1995	1996	1997	1998	1999	2003
Plains	Vol	*2.7	3.3	5.1	4.4	3.9	3.4	3.2	2.2
*(inc Papirossi)	%SS	45	55	85	92	90	90	90	90
Economy	Vol	0.5	1.2	1.2	1.6	4.0	8.5	9.4	10.2
	%SS	11	26	23	23	49	85	85	85
Value	Vol			1.0	2.5	5.6	8.1	8.6	8.6
	%SS		5	12	28	60	80	80	80
Low	Vol		0.2	0.9	0.8	2.4	2.4	2.5	2.6
(IFB 3)	%SS			30	27	70	70	70	70
Medium	Vol			0.5	0.5	0.8	0.8	0.8	0.9
(IFB 2)	%SS			50	42	60	60	60	60
High	Vol			0.2	0.2	0.6	0.6	0.7	0.7
(IFB 1)	%SS			18	17	50	50	50	50
Total BAT/TTF	Vol	3.2	4.7	8.9	10.0	17.3	23.8	25.2	25.2
	%MS	14.5	25.7	36.2	38.5	62.2	79.8	79.8	79.8

[N.B. Sales figures are the latest available as at 28/1/94 but the segment share figures need to be updated by M.Marr]

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Sales are currently constrained by production capacity limitations. The plan therefore demands that overall production capacity in excess of 25 billion cigarettes be developed in the most rapid time scale possible, and that a manufacturing monopoly be granted for a five year period following the signing of the JV. It is assumed that production constraints will be overcome by 1998 and the objective will then be to secure a dominant position in the market and achieve 80% share.

because they are priced free of excise and import duties.

Imported cigarettes currently have a fiscal ~~tax and duty advantage~~ over locally manufactured cigarettes. It is essential that this situation be remedied by the time the local JV is able to produce substantial quantities of cigarettes and at the very least a "level playing field" be created.

Formulation of a strategic portfolio of our brands for the Uzbekistan market is an immediate key objective because:

i) it provides clear focus ~~points~~ for the allocation of marketing spend, and resource and most importantly

ii) it prepares the ground, in terms of building a consumer franchise for those of our trademarks which will ultimately be domestically manufactured under licence by the joint-venture.

The overall portfolio of brands must cover the entire spectrum of market demand (with the exception of Papirosi, which will disappear), particularly in relation to low price offers. The core will be as follows:

Plains	70mm	Astra or Equivalent
Economy	KS SC Filters	Uzbekistan or Equivalent
Value for Money	KS HL or SC Filter	Hilton or Equivalent
IFB 3	~~as above~~ KS HL	Hollywood or Equivalent
IFB 2	~~as above~~ KS HL	Pall Mall or Equivalent
IFB 1	~~as above~~ KS HL	Lucky Strike or Equivalent

N.B. *Brand Choice to be confirmed by consumer research*

It is believed ~~assumed~~ that TTF have no trademarks of their own, nor any which are protectable under international law. Whilst the Uzbekistan brand might be unique to TTF, because it is a geographical reference it is not exclusive to TTF. This is an inherent weakness and therefore new, protectable trademarks need to be developed that can serve as brands in a joint-venture scenario, particularly for the "Economy" and "Value for money" offers.

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The following brand initiatives will to undertaken in two phases:

Phase I - Immediate

- Astra oval plains will be relaunched as 70mm ~~pmd~~ round cigarettes in a Latin pack. Existing pack design graphics to be adhered to.

- Uzbekistan Filter 80mm SC will be relaunched in 84mm SC and HL versions, both of which will carry the same design. It will be positioned as cheapest filter cigarette on the market.

(Taj Hirji)

[It is estimated by T Hirji of BATCO that change in physical specification of cigarette from 80mm/18mm to 84mm/21mm will not readily alter smoking characteristic, which under present circumstances are hugely variable in any case. A trial production at the new specification will be analysed by BATCO terminal to check if any modification to product construction are required in order to ~~7~~ closely match present cigarettes.]

Phase 2 - for action in 1995, subject to consumer research:

- Development and introduction of new plain trademark either alongside or as ultimate substitute for Astra. Blend would be identical for both brands.

- Development and introduction of Economy brand (protectable trademark) to complement Uzbekistan, and act as long-term defensive measure. Possible Central Asian positioning to accommodate export potential to neighbouring republics ("Blue Dome"). new blend specification will be required.

- Local ~~Regional~~ brand variants of UZBEKISTAN product (1 or 2) e.g. Samarkand, Bukhara, to satisfy ethnic differences.

- Introduction of value for money ~~HL~~ filter brand, probably modified U.S. Blend, quasi-western imagery.

- Preparation of 70mm filter offer, to be held in reserve in case of price attack from competitor (PMI ex Almaty) or another competitor in the region

Distribution strategies need to be confirmed for a combined portfolio of domestic and licensed trademarks using State (Bakalea) and private independent operators. With reference to Bakalea, the JV will seek to establish ~~an exclusive~~ a privileged distribution arrangement by which the JV has the right of first refusal on all Bakalea cigarette orders. ~~for an unlimited period~~. This should not preclude the use of other distribution partners, whilst it would offer an immediated means of channelling cigarettes to all distribution points, rural and urban.

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Add a section on Competition.

[Independent of completion of successful joint-venture, a commercial team should be set up with the appropriate trade marketing and consumer marketing individuals, to implement the marketing strategies, given the market potential and competitor proximity. As a matter of urgency core brand portfolio and support priorities across the group's range of trademarks should be immediately established, together with a distribution strategy].

3.4 Brand Strategy

The background to these strategies is an anticipated threat from PMI out of Kazakhstan - specifically, aggressive positioning of their L&M and Apollo Soyuz brands in IFB2 and VFM segments respectively. Additionally, the possibilty of an ultra cheap filter offer cannot be ignored.

The overall objective is to develop locally produced IFBs to account for approximately 65% segment share by the end of the plan period, and to develop "economy" and "value for money" domestic filter offers with an image premium which will drive BAT/TTF share of this potentially dominant sector above 82%.

A reserve 70 mm filter SC brand should be "on the stocks", should our "economy" offer come under threat from a cheaper competitor.

IFB brand mix will conform to group strategic brand priorities.

IFB 1 - Main Strategies:

- Segment share objective 50%
- Manage retail selling price to remain at parity with other IFB 1s.
- Highly selective distribution in early years to reach "opinion leaders".
- Move to local production only when assured that imagery and perception of product quality will not be compromised.
- Highly targeted communcations support programme arrived at Y.A.U.S. High quality point of sale materials.

IFP2 - Main Strategies:

- Segment share objective ~~0~~60%
- Manage retail price position to achieve parity with L+M.

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- Move to local production to remain competitive with competitor IFB2s (L+M from Almaty)

- Employ above and below-the-line support to build awareness at point of sale and brand imagery.

- Selective distribution policy in early years, assuring availability in appropriate trade channels.

IFB3 - Main Strategies:

- Segment share objective 70%

- Retail selling price should reflect "authentic" western imagery. Slight price advantage (10%) over competitor IFB3s should be achieved due to import duty agreement, whilst maintaining value position to attract other IFB3 consumers and those trading up from non-IFB.

- Commence local production as soon as quality, price and quantity can be assured.

- Establish broad distribution base supported by point of sale, image communications and trade incentives.

- Menthol variant to be considered for female market.

Value for Money - Main Strategies:

- Segment Share objective 80%.

- Position against Apollo Soyuz as international quality "value for money" offer, reinforced with clear imagery (suitable trademark to be confirmed by consumer research).

- Initially price at parity with Apollo Soyuz, but with the objective over time of achieving a slight price premium and bridging the gap between IFB 3 and economy domestic filter, which will open up as cheap imports are rationalised.

- Comprehensive, widespread distribution from day 1 is essential in making the brand <u>widely available</u>, to encourage up-trading from plains and switching from economy.

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- Intensive below-the-line, point of sale promotion, trade incentives should be complemented by heavy media communication.

- Develop immediately line extensions, e.g. Menthol, 100s.

Economy - Main Strategies

- Segment share objective 85%.

- Develop economy brand (Uzbekistan and/or new proprietary brand) with domestic values, traditional smoking characteristics, that facilitiates trading up from plains. (Consumer research needed to establish trademark.)

- Enhance packaging quality, through more efficient sourcing and purchase of wrapping matterials.

- Ensure consistent product and smoking quality.

- Ensure widespread distribution though all channels, urban and rural.

- No marketing support programme, except point of sale communication in early years 1-2 to reinforce packaging/product enhancement and consistency.

- Ensure it is lowest priced filter brand in the market., by having in reserve a 70mm SC version.

Other Brands - Main Strategies:

- Papirossi will be discontinued at the earliest opportunity to provide factory space and capacity for filter cigarettes.

- Plains should be made a consistent offer in terms of packaging and product charateristics. The strategy will be to move this category into a conventional round cigarette in a latin pack or in a soft cup pack with a paper bundle.
  i.e.

- Development of a proprietary trademark instead of Astra should be tested as a possible long-term defensive measure (Astra from Kazahkstan). No support necessary in either case.

3.5 Product/Packaging Strategy

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Product consistency against laid down specifications is critical for all cigarette styles:

•Development work, should be initiated on Menthol, 100s and "lights" variants.

•Packaging materials quality needs to be enhanced for plains and domestically produced filter e.g. quality of board, consistency of inks, construction and assembly of 20s packs.

•All filter products should be 84mm in length in line with international trends, with the exception of reserve 70mm offer.

•HL ~~box should~~ be the standard ~~packaging~~ format for all filter ~~cigarettes~~, except economy as this has perceived ~~premium~~ over SC ~~versions~~

•Polypropylene wrap for all filter 20s packages should be standard, as a means of aiding product quality and consistency, especially in present distribution environment. Paper bundle wrap should be minimum requirement for all filter products.

3.6 Communication Strategy

In light of the Central Asian customs union, investment levels will be as if operating in a free market, with no "monopoly" guarantees extant, as there remains the need to build brands in advance of possible advertising restrictions, and the continuing existence of D.N.P. imports.

Initially all creative printed matter and POS material will need to be sourced offshore for both IFB's and non-IFBs.

The future situation regarding the advertising environment remains unclear in terms of restrictions and this will affect the mix of communcations spend. Presently, cigarette advertising on billboards at major road intersections, whilst not illegal, is not recommended ~~"are no restrictions"~~ With reference to strategies listed above investment levels will be as per Exhibit 4.

Uzbekistan or propriety or economy offer will receive marketing support only for the relaunch period.

1994 costs include packaging development costs, adaptation of films for IFB's and production of a film for the value for money offer which will be renewed every two years.

Investment in some corporate advertising and public relations excerises will be necessary to reinforce credibility of locally manufactured IFB quality, i.e. new machinery , methods, standards and transfer of technology will bring domestic manufacture up to international levels

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3.7 Distribution

The JV will adopt a proactive stance in developing a distribution system which meets the requirements of a growing market, diverse brands and brand availability for the consumer. Both the state organisation (BAKALEA) and selected private enterprises will play a role in the short to medium term. not in BLOCK CAPS

Investment in a network of 4 to 6 depots to ensure regional coverage and channel penetration will be considered. Additionally, investment in transport to guarantee physical distribution of cigarettes and merchandising materials to regional distribution warehouses may be required. [This might require a fleet of approximately 6 x 15 tonnes trucks at $30,000 cash, total $180,000].

Trade marketing requirements will rerquire a total staff of 100 people, divided amongst the 6 depots:

- 50 field force (including 6 Sales Managers)

- 50 administration staff.

Bain Link Central Asia distribution study will assist in determining appropriate strategy. This study will be available around the end of June.

Distribution Price Build-Up

(1) National

	Tax/Mark Up	Sell Out Index
Ex-Factory	N/A	100
VAT	30%	130
Excise	20%	150
Distributor	20% (max)	180
Wholesaler	20% (occassional)	216
Retailer	20%	260

(2) Imports

CIF	**Tax/Mark Up**	**Sell Out Index**

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Factory	N/A	100	100
Import Tax	0.15	100.13	100
VAT	20	120.12	100
Distributor	25 (20 to 40)	150.2	125
Wholesaler	20	180.25	150
Retailer/Wholesaler2	20	216.3	180
Retailer 2	20	260	216

In both instances, distribution/trade margin as a percentage of retail price is very high (40% - 55%), which needs to be revised to more reasonable levels (20% - 25%) as the distribution infrastructure develops over time. Hence the interest for BAT to be proactive in this area.

3.8 Pricing Strategy

Status at 15.10.93

	AverageRetail US$ per Packet 20	Average Retail US $ Per Mille net	Approx. Ex-factory Price net of Tax and Distribution Cost US$ Per Mille
Papirossi	US $0.04	$2.00	US $1.14
Plains	US $0.10	$5.00	US $2.86
Economy {	US $0.20	$10.00	US $5.71
	US $0.28	$14.00	US $8.00
Value {	US $ 0.32	$16.00	US $9.14
	US $ 0.36	$18.00	US $10.3
IFB 3	US $0.48	$24.00	US $13.71
IFB 2	US $0.60	$30.00	US $17.14
IFB 1	US $0.76	$38.00	US $21.71

Update using data from financial analysis.

~~N.B. Distribution tables shows price build up on indexation basis. Para 7.~~

- Real price increases should be applied in Year 1 to Plains and Economy, the former to a greater degree due to its relatively very low price.
- [Caveat: these brands must remain cheaper than competitor imports.]
- Prices should be inflated at the agreed rate of real price increases.
- The retail price of Value offer should progressively move upward over years 3 through 7, reflecting increasing brand equity.
- The retail price of BAT's IFB 3 should be positioned at 10-20% below other IFB 3's in year 1 with a progression to IFB 3 level in year 5.

3.9 Product Development Strategy

Add info on recent price increases versus inflation.

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The following projects would be initiated immediately

- Improvement of blend quality on all brands.
- Improvement of secondary manufacturing and packaging process including the redesgin of all case packaging to fit in with international standards.
- The introduction of bundle packaging in 200s.
- Development of new and existing trademarks and packaging for the overall plan.
- Development of enhanced packaging for Astra (not withstanding above).
- Development of new enhanced packaging for Uzbekistan.
- Development of new"value for money" brand in full flavour and menthol variants (Hilton?) using consumer research findings.

3.10 Excise Strategy

Input from David Bishop, due 31/1/94

SECTION 4. Production Strategy Cigarettes

4.1 Introduction

The Marketing Plan requires the development of an overall production capacity in excess of 25 billion cigarettes in the most rapid timescale possible.

~~The existing factory in Tashkent,~~ TTF, occupies a very small site (2.6 hectares) with limited opportunity for further expansion. Even when developed to its full potential, capacity will be limited to 10 -12 billion cigarettes. A new factory ~~of 20-30 billion cigarettes capacity~~ is therefore required to exploit the market opportunities.

Construction and commissioning of a new factory will take 2.5-3 years and it will not reach full production until the 4th year. In the interim, TTF will play a key role and appropriate development is planned to obtain output levels of 10 billion cigarettes from it.

The long term intention is to close TTF and to concentrate all manufacturing in the new factory. This cannot be discussed openly at present but it is inherent in

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the investment proposals and will result in the new factory having less than its full complement of SMD equipment to begin with.

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The planned growth in production will therefore be as follows:

Billions	1993	1994	1995	1996	1997	1998	1999	2003
Tashkent	3.2	4.7	9.1	10.9	10.8	10.5	10.3	10.3
New Factory	-	-	-	-	7.8	15.7	15.7	15.7
Total	3.2	4.7	9.1	10.9	18.6	26.2	26.0	26.0

In terms of types of cigarette the combined capacities of TTF and the new factory will be as follows:

	1993	1994	1995	1996	1997	1998	1999	2003
Papirosi	0.2	-	-	-	-	-	-	-
Oval -Plain	2.5	3.3	4.1	1.1	-	-	-	-
SC -Plain	0.1	0.0	1.1	4.1	4.7	3.1	2.3	2.3
SC -Filter	0.4	1.2	2.3	4.1	9.7	17.9	18.6	18.6
HL -Filter	0.0	0.2	1.6	1.6	4.2	5.1	5.1	5.1
Total	3.2	4.7	9.1	10.9	18.6	26.2	26.0	26.0

4.2 Tashkent Tobacco Factory (TTF)

In almost all regards TTF facilities and performance (quality, efficiency, waste, health & safety, etc) fall far below BAT standards and large amounts of money and effort will be required to put them right.

It also has the disadvantage that it is located in a prime residential area, next to a maternity hospital, and is likely to come under increasing pressure from its neighbours on environmental matters.

Total production for 1993 was 3.15 billion cigarettes plus 1 billion cigarettes equivalent of smoking tobacco which is substantially below the quoted capacity of 7 billion cigarettes. This was principally due to the lack of wrapping materials but also reflects the poor state of the production equipment.

Depite the manifold problems of TTF, its continued existence and development over the next 4-5 years is an essential part of the overall joint venture proposal. However, due to its ~~potentially~~ limited future, it is not the intention to develop TTF to full BAT standards. Notwithstanding, the proposal for TTF has the following aims:

-Increase output to 10 billion cigarettes as rapidly as possible.
-Improve product quality to acceptable standards.
-Increase Health & Safety levels to acceptable standards.

Additional cost to bring TTF fully up to BAT standards is £ ___ millions.

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An overall capital investment of $44mn is planned to meet the above. This will consist of a preliminary capital investment of $11mn to help increase capacity under the terms of the MOU, followed by a further $33mn to be invested predominantly in 1995-96.

4.2.1 Primary Manufacturing Department (PMD)

The current PMD consists of a pair of simple lamina lines and as it stands cannot be used to manufacture cut tobacco for BAT IFB or VFM brands. In addition, cut tobacco quality is poor and must be improved if we are to provide a decent cigarette for the consumer.

An investment of $2.9mn is planned in which the two processing lines are combined into one and performance improved by the installation of a bale slicer, DCC, new cutters, and a new drier. Besides the local semi-oriental tobacco, this line will also be able to handle imported flue cured and burley. In addition an add back system will be installed so that imported ready processed components such as stem can be combined with locally processed lamina to create cut tobacco for BAT brands.

limiting investment in

A stem line or a cased leaf line is not planned for TTF as in the longer term the state of the art PMD in the new factory will have sufficient capacity to supply the needs of both factories. It is assumed that the cut tobacco requirements for TTF, if it is kept running, will eventually be totally supplied by the new factory, or, at the very least blend components such as stem which cannot be processed on a simple lamina line. Besides the economic arguments for this, there are environmental arguments for TTF, bearing in mind its location, in terms of reduced dust, process waste water, and odour levels. *[The Uzbek parties are unlikely to welcome this proposal and it will have to be strongly argued in the context of the overall investment. If we are unsuccessful the only credible alternative will be to install a new PMD in TTF which will not be transferable to the new factory and, will make TTF difficult to walk away from in the future.]*

When the factory is closed there will not be a substantial requirement for the new PMD equipment installed in TTF to be transferred to the new factory. It will either have to be resold, if possible, or written off.

4.2.2 Secondary Manufacturing Department (SMD)

Planned production figures for TTF are as follows:

Billions	1993	1994	1995	1996	1997	1998	1999	2003
Papirosi	0.2	-	-	-	-	-	-	-
Oval -Plain	2.5	3.3	4.1	1.1	-	-	-	-
SC -Plain	0.1	0.0	1.1	4.1	4.7	3.1	2.3	2.3

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SC -Filter	0.4	1.2	2.3	4.1	4.5	5.8	6.4	6.4
HL -Filter	0.0	0.2	1.6	1.6	1.6	1.6	1.6	1.6
Total	3.2	4.7	9.1	10.9	10.8	10.5	10.3	10.3

An investment of $29mn is planned involving the installation of additional production capacity, and the phased replacement and, where appropriate, refurbishment of existing production equipment. By 1997 all cigarette making will be carried out on rebuilt Mk9 and Protos 70 machines, and all packing will be carried out on rebuilt HLP, Sasib 6000, and GDX1 packing machines.

The investment in rebuilt and refurbished equipment is not only neccessary to achieve the required production levels, but perhaps more importantly, it will lead to a significant improvement in product quality.

Production levels in 1994 will be increased initially through the installation of 4 refurbished machine groups (2 for soft cup filter and 2 for hinge lid) followed by a switch from single shift to double shift operation. The space occupied by the papirosi machines will be required for the new machine groups and manufacture of papirosi phased out.

The requirement for low cost cigarettes for people on low incomes is currently satisfied by papirossi and oval plains. Neither styles are convenient for modern cigarette making and packing equipment and the strategy will be to move this category into plain round-cigarette brands in either latin, or soft cup packs with a paper bundle. Manufacturing capacity for this will be provided by refurbishing Mk9 machines currently used for oval plain cigarettes and reinstalling them with rebuilt Sasib soft cup packers. It is planned that all manufacture of low cost plain cigarettes will be carried out on Mk9/Sasib groups by 1997.

Further increases in capacity for soft cup filter manufacture will be achieved by the installation of three Protos 70/GDX1 groups. The first group is scheduled to be installed in fourth quarter 1995, by which time substantial improvements in cut tobacco quality will have been obtained. The remaining two groups will be installed during 1996, and the existing Garant 4 and LOG groups removed from service.

No increase in hinge lid capacity is planned for TTF above the 2 rebuilt Mk9/MAX S/HLP groups to be installed in 1994. Further hinge lid manufacturing capacity will be provided by the new factory in 1997.

If the decision is taken to close TTF once the new factory has come on stream, then all of the new, rebuilt and refurbished SMD equipment in TTF can be transferred to it.

4.2.3 Upgrading of Services and Facilities

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The estimated expenditure required to bring existing services and facilities upto a reasonable standard is shown below:

Buildings & Structures	$3.24mn
Fire & Safety	$1.22mn
Mechanical & Environmental	$1.64mn
Electrical	$2.26mn
Professional Fees	$1.38mn
Total	$9.74mn

This will not result in an ergonomic 10bn cigs/annum BAT standard factory (the equivalent costs to do this are estimated at $28.5mn) but simply aims to remedy the major problem areas.

In the above there will be diversity between BAT and Uzbek standards and it is unlikely that they will expect to see so great an expenditure on these items.

When TTF is closed almost the total expenditure in this area will have to be written off.

4.2.4 Health & Safety

Some, but by no means all, aspects of Health & Safety will be covered by the expenditure on "Upgrading of Services and Facilities". Areas not covered will include machinery guarding, equipment for safe working at heights, protective clothing and equipment, etc.

It is not possible to analyse this in detail at this stage but a budget of $2mn should be set for expenditure in this area.

There is some evidence of Health & Safety activity in TTF but it is unlikely that the factory would reach double figures in a BAT audit. Besides expenditure to improve the safety of equipment plant & machinery and working procedures, considerable efforts will be required to raise levels of safety awareness and to instill a Health & Safety culture in the factory workforce.

The only way to coordinate and progress this in an acceptable manner will be to appoint an expatriate Health & Safety manager. The managers responsibilities would extend to all BAT operating sites in Uzbekistan.

4.2.5 Expatriate Production Staff

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A technical projects manager will be required for a period of three years to coordinate the various technical development projects in TTF, the new factory , and Urgut.

In TTF itself there will be the requirement for a Production manager supported by two expatriate SMD technicians and one expatriate PMD technician.

A Health & Safety manager will be required for three years to coordinate and progress activities in the various operating sites in Uzbekistan.

4.3 Green Field Site (GFS)

A new factory on a green field site is required because TTF, even if developed to its full potential, will not have sufficient capacity to satisfy market demand.

The new factory will have a design capacity of 20 billion cigarettes on 3 shifts with future expansion capability up to 30 billion cigarettes and will be able to produce the full range of international quality cigarettes.

Initially SMD equipment sufficient to produce 15 billion cigarettes only will be installed pending the closure and subsequent transfer of SMD equipment from TTF.

The overall cost of the new factory including SMD equipment to 15 billion cigarettes capacity is estimated to be $146mn.

It is planned that the new factory be built in or close to Samarkand. Compelling reasons for this include:

-It is the preferred choice of President Karimov in his effort to establish new industry outside of Tashkent.

-Closure of the Samarkand Fermentation plant will become politically acceptable.

-We will have the full support of the Regional Governor of Samarkand as opposed to his full opposition if it is located eslewhere.

All things being equal Tashkent would probably be the first choice location for a new factory, but Samarkand would certainly be the second, and a not unattractive, choice.

4.3.1 Production Plan

A realistic estimate of the time to build and commission the new factoty, taking into account the difficulties of operating in Uzbekistan, is 2.5 to 3 years. After that

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it will take a further year to bring the factory up to full production and the schedule for capacity coming on-line is as follows:

Billions	1993	1994	1995	1996	1997	1998	1999	2003
SC -Plain	-	-	-	-	-	-	-	-
SC -Filter	-	-	-	-	5.2	12.2	12.2	12.2
HL -Filter	-	-	-	-	2.6	3.5	3.5	3.5
Total	-	-	-	-	7.8	15.7	15.7	15.7

It is not planned that any equipment be installed to produce low cost soft cup plain cigarettes. These will be produced in TTF up until the old factory is closed and the equipment transferred across to the new factory; not shown on the above schedule.

4.3.2 Site Requirements

Details of the site requirements are given in Appendix (?) *[Specification prepared by OveArup]*

4.3.3 Equipment Requirements

The PMD will be a two shift state of the art installation capable of supporting a 25 billion cigarette operation with the capability to be expanded to cope with a 30 billion cigarette operation, and will be able to produce cut tobacco to support the full range of BAT brands.

Protos 70 making machines and GDX1 and GDX2 packing machines is the level of SMD technology envisaged for the new factory. This will be operated on three shifts.

4.3.4 Staff & Manning Requirements

A total workforce of around 700 employees will be required to operate the new factory when operating at 15 billion cigarettes.

In terms of expatriate staff there will be a requirement for a Production Director, Factory Manager, and Chief Engineer. There may also be an initial requirement for expatriate SMD and PMD technicians.