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Mr. P. Macadam

C.A.C. V - VICTORIA

Item L, Investment/Acquisition Strategy

The Group's Investment Strategy will be discussed by the B.A.T Industries Board in September and rather than give a presentation based on last year's paper it seemed more appropriate to discuss with you some of the key issues that will be covered in our paper this year.

Since everyone here has had experience in their own company of similar issues, I believe that hearing your views and sharing your experience will be valuable to us in preparing September's paper.

Since you may like to give some preliminary thought to these issues before Wednesday, some introductory notes are attached.

P. Macadam

12th July 1980

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Item K - Group 10 Year View

Mr. Macadam presented the Group 10 Year View, which was presented to the Board of B.A.T Industries in June 1980 and which had been circulated to delegates in advance. In highlighting the main points raised in the paper, he stressed that there was heavy reliance on the achievement of forecast profit margins and on recoveries in certain businesses. There appeared to be limited involvement in growth sectors and the returns on proposed new investment were all below the agreed 20%.

Item L - Investment/Acquisition Strategies

Mr. Macadam presented a paper which had been circulated to delegates in advance. The paper outlined five key issues which arose from the 10 Year View and which will be covered in the Investment Strategy paper to be presented to the Board of B.A.T Industries in September 1980. Conclusions resulting from discussion of the five issues were as follows:-

(1) Investment Criteria

(a) The required level of return on assets should be decided for each business separately;

(b) The minimum level of return on assets should not be below 20% for any business. With inflation levels significantly above 10%, a return of nearer 25% should be sought;

(c) A rigorous and realistic approach should be adopted in the case of currently poor performers for which no acceptable improvement can be seen to be achievable within two or three years (normally) or five years (at the most).

(2) Geographical Emphasis

(a) Despite the inherent risks, profitable growth opportunities in selected developing countries should be pursued;

(b) At the same time, sound growth opportunities in developed countries should be sought.

(3) Industrial Emphasis

(a) While not excluding the possibility of investing in new growth industries in the longer term, the main immediate concentration should be on expansion from the Group's existing industrial bases by exploiting new markets or by developing new products or concepts;

(b) Assuming that satisfactory levels of performance can be achieved in each element of the existing businesses, no major change is called for in the development of the industrial shape of the Group as outlined for 1989 in the 10 Year View (i.e. a reduction in the Trading profit contributed by Tobacco from 63% to 52% of the total). However, some increase in levels of investment in Packaging/Printing, and possibly in Home Improvements, will take place.

(4) Organisational Implications

Several differing views were expressed on the best ways of initiating and subsequently managing geographical extensions of existing businesses into countries where Group companies are already operating.

General concensus was reached on two principles:-

(a) In general, management accountability should lie with the majority shareholders, who are basically responsible for the allocation of resources and for 'bottom line' accountability. However, there must be close co-operation between the shareholding company and the company where the technological expertise lies (e.g. the BATUS/Appleton/Wiggins Teape relationships).

(b) An arrangement already exists within the Tobacco Operating Group whereby the originator (or product/industrial) company first invites the host country (or geographical) company to participate or become involved in any new venture. If agreement cannot be reached, the originator company is free to develop its business in the host country, but the host country company has no investment in, and therefore no accountability for, the venture. The principle of this arrangement should be adopted (and possibly adapted) in the case of new product/new market ventures within the Group's overall existing businesses.

Mr. Macadam suggested that in spite of basic agreement on principles, the matter is not all that simple, particularly in view of other factors such as tax advantages, optimal financing arrangements, potential for trade boycott, etc. These matters should be resolved by the Centre and it was up to the Centre to reconcile the differences, which means that the issues need to be properly defined, discussed and agreed.

(5) Resource Management

If investment proposals are agreed which cannot be financed by surplus cash, the priorities should be:-

(a) To seek short term measures to improve efficiency and utilisation of resources;

(b) To consider selective divestment of low performers, both to raise funds and improve overall performance;

(c) To consider increasing the equity of the Group, either directly by a rights issue or indirectly by acquisitions for shares (this will not be practicable until or unless ways can be found to increase the P/E of B.A.T Industries shares);

(d) To relax the current policy of maintaining the Debt:Equity ratio below 50%, provided an early return to 50% is perceived.

Mr. Sheehy said that the word 'risk' had been mentioned on several occasions and he felt that there should be no misunderstandings of what it meant and implied. It could have either of two meanings:-

(1) An investment proposal on which, if all went according to plan, the return would be acceptable, but in which there is a risk of failure to achieve the planned return. Examples could be investment in Tobacco in the Canary Islands, Thimbles, sports goods in Canada, etc.

(2) An investment proposal whose purpose is to establish a presence either for political reasons or in hopes, rather than reasoned expectations, of acceptable returns in the future. Examples could be Philip Morris' entry into Italy, BAT's possible entry into Turkey, China, etc.

In either case the element and extent of risk need to be analysed, carefully defined and deliberately accepted if the proposal is to go ahead. A higher return is usually expected where the risk is greater. An investment proposal where the return is expected to be very low or non-existent is not a 'risk-type' investment and its acceptance or rejection will be on policy grounds. Investments in welfare, anti-pollution, etc. would fall in this category.

Item M - Summary of Future Plans

Mr. McCarty, Mr. Paré, Mr. Widdup, Mr. Long and Dr. Stützer presented summaries of future plans for each of their companies. Mr. Stewart Lockhart gave a similar presentation for BAT Co. (with particular reference to BAT (UK & E) and to certain other tobacco companies), and Mr. Best for Wiggins Teape.

The presentations included opportunities for new investment, acquisitions and mergers; probable divestments and disposals; probable competitive activities; and ways of achieving productivity improvement and profit growth in the face of a difficult business environment.

Item N - Organisation Structure

Mr. Macadam reported on the current organisation of B.A.T Industries and of the Headquarters of each of the six Operating Groups.

Mr. Paré, Mr. McCarty, Mr. Widdup, Dr. Stützer and Mr. Long described, for their respective companies:

1) Their present organisation, with particular reference to organisation for diversification.

2) Their interaction with the Centre.

3) The future development of their organisational structure.

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