

January 31, 1994

To : Ulrich Herter
Nick Brookes, Edouard Ertegui

From : François de Combret

Re : your meeting with J.D. Comolli on February 3d

This memo summarises the main background elements we believe may be of use in view of your scheduled meeting with J.D. Comolli on February 3d.

1) Privatisation policy of the French government

. Seita within the privatisation policy

We have been in touch with all senior decision makers in the French administration involved with Seita's privatisation. They have all made it clear that Seita's privatisation is not on the government's priority list, and that the government has not yet defined its policy regarding this issue.

A number of significantly less controversial large scale privatisations are already scheduled in 1994 so that the government can meet its targets as regards the privatisation program without needing to include Seita in this year's program.

It is our understanding that the government would rather postpone Seita's privatisation to after the next French presidential election, scheduled to take place in May 1995, than run the risk of any controversy with any of Seita's main constituencies (tobacconists, leaf farmers, smokers, employees of the firm) or on the political level.

. Specifics of Seita's privatisation

Among the specifics of Seita's privatisation, the following will have a major influence on how the process is handled :

- Seita is a company with two major fields of activity - cigarette production and cigarette distribution - plus a number of side activities (matches, cigars are the main). Neither the government nor the company's management are considering creating distinct legal entities for these various activities, so that an investment in Seita will have to be - for the time being - an investment in the company as it is.

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- Defense of the tobacconist monopoly vs EEC has been strongly endorsed by the French Government, giving an indication of SEITA importance to the French authorities.
- It is most likely that the government will want the State and/or State owned entities to initially retain a very substantial shareholding in the Company (at least a blocking minority of 1/3d, possibly a majority).
- A foreign investor should not hope to gain more than a limited minority stake at the outset. Although the law does not set a limit for EC investors, nor for any foreign investor when the privatisation is organised within the framework of a business cooperation agreement, our experience with recent privatisations has made it clear to us that the French government will be very reluctant to sell a large stake to a foreign investor, particularly in a case as sensitive politically speaking as Seita is bound to be;

2) Suggested approach

We believe B.A.T should envisage a two step approach to Seita's privatisation if it wants to achieve something within the next year or so :

- B.A.T would initially acquire a minority stake in Seita (possibly about 20 % but most likely less than 33 1/3 %), on the basis of a business cooperation agreement that would reflect both parties' managements' views ;
- it would then, after the Presidential election, be in a position to reach over time its ultimate goal, i.e. control of Seita's cigarette activities.

These will, in our view, be the key issues in the initial stage :

- from the government's point of view :

- . B.A.T should be Seita's management's preferred choice
- . B.A.T's involvement should not put the retail monopoly at increased risk,
- . B.A.T should bring production volume to Seita plants. In recent years, Seita has very substantially cut its workforce and diminished the number of plants it operates without creating major social unrest ; B.A.T's involvement should be viewed as a plus in this approach, and not as a source of increased tension on production jobs.

- from Seita's management point of view :

- . Seita's management sees the merits of co-operating with a major tobacco company - but does not feel its survival depends on such a cooperation - it will thus not be ready to sacrifice too much of its independence to establish such a cooperation - all the less since its financial situation is sound ;
- . B.A.T's cooperation with Seita should enhance the development perspectives of B.A.T brands such as Lucky Strike on the French market, and of Seita brands on international markets ; it could also include extensive cooperation in Spain, Italy and Africa ;
- . B.A.T should contribute some production volume (see above).

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- from B.A.T's point of view :

. B.A.T will want to limit its risks in case it does not ultimately reach its final goal i.e. controlling Seita's cigarette activities. This means that it should have as clear a vision as possible on the conditions in which it could sell its stake, and that the business agreements be conceived so that they should be a strong incentive for Seita to further cooperate, whilst not entangling B.A.T with it in case the second step fails.

. even if B.A.T's stake is limited, it can aim at an agreement including substantial governance issues (B.A.T board members, involvement in the management of tobacco activities).

In addition to B.A.T, the government might want other investors to buy a stake in Seita. We believe that B.A.T could participate, with Seita's management, in the discussions about such potential partners, so as to contribute to the design of a suitable group of core shareholders. We have already suggested a few possibilities in this respect, but do not recommend that this issue be addressed with Comolli during the February 3d meeting, unless he brings up the topic himself. Even in that case, we would recommend not to mention the Française des Jeux possibility yet.

We thus recommend that B.A.T's initial contacts with J.D. Comolli be focused on the business vision B.A.T and Seita can share, and on what cooperation with B.A.T could bring to Seita. B.A.T should not hesitate going again through the hearts and minds stages it initially went through with B. de Gallé. B.A.T's priority should be to build a personal, confident relationship with Comolli.

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