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August MONTHLY OPERATIONS LETTER
Issued September 18, 1996

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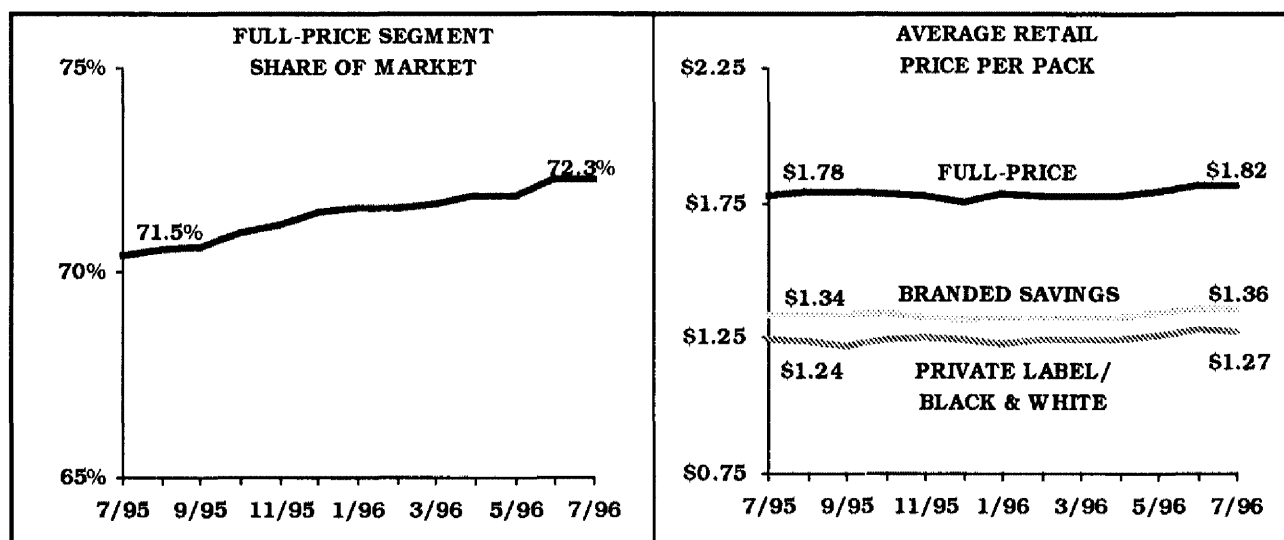


AUGUST MONTHLY OPERATIONS LETTER
Issued September 18, 1996

EXECUTIVE SUMMARY

- **RETAIL SHARE:** Full-Price Segment share was flat in July; **RJR** held SOM versus June and **PM** declined .1 point
- **YEAR-TO-DATE SHIPMENTS:** **RJR** 1.6% behind Plan and 3.7% below year-ago through August; **industry** shipments up .7% versus 1995 with consumption holding about flat
- **OPERATING COMPANY CONTRIBUTION:** Above Plan by \$13 million through August; forecast under Plan by \$2 million in **Third Quarter**, over Plan by \$25 million for **Full Year**
- **CASH FLOW:** Projected at \$1,410 million for 1996, \$129 million below Plan
- **KEY ACTIVITIES:**
 - In-market testing at record level; **RED KAMEL** expansion underway
 - Negotiations yield savings on inbound freight, employee travel expenses

RETAIL SHARE PERFORMANCE



Full-Price Segment share stabilized at 72.3% of the market in July.

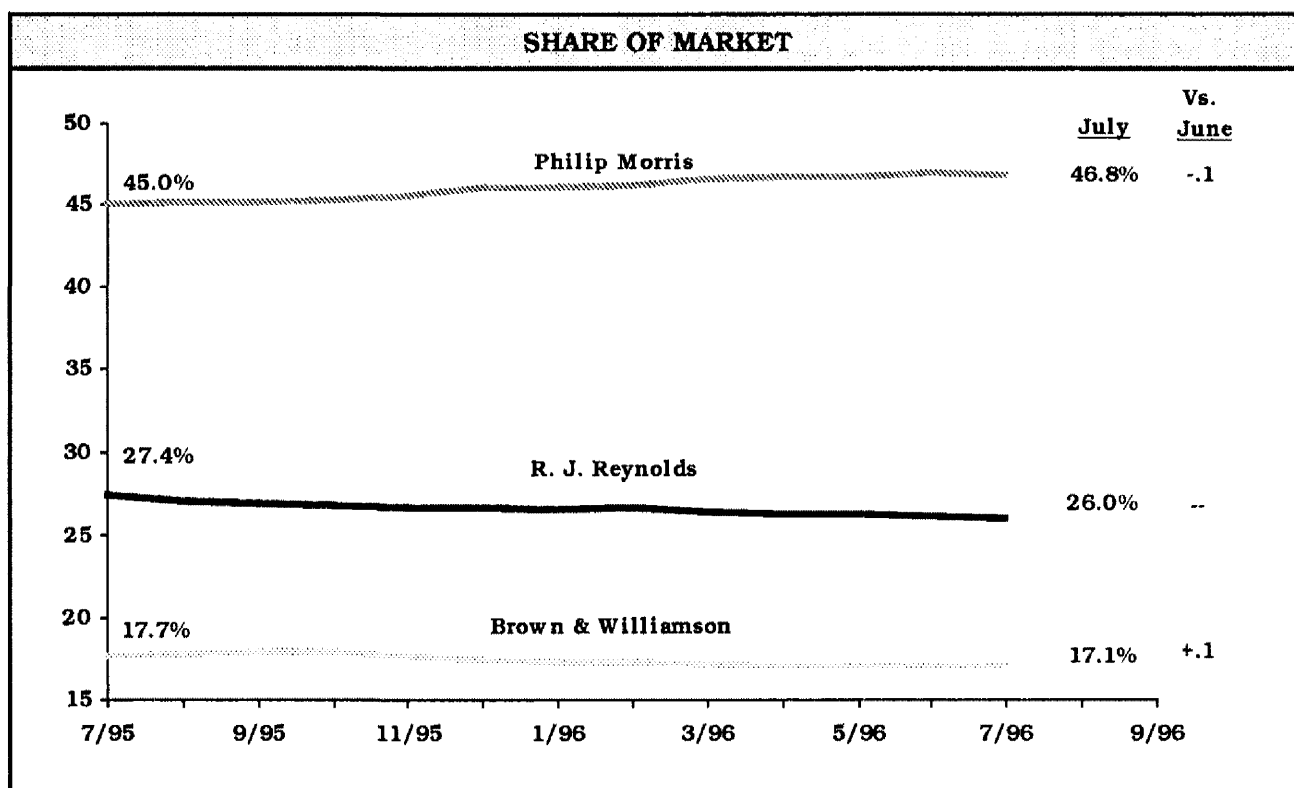
- Marlboro's growth slowed to +.1 share point despite continued \$2 carton buydowns
- **WINSTON** and **Newport** also gained .1 each, while other Full-Price brands were flat or slightly lower

Most Savings Segment brands held share in July, but B&W's GPC posted a .1 point gain.

	July SOM	Vs. June	Vs. July '95		July SOM	Vs. June	Vs. July '95
Full-Price Segment	72.3%	--	+1.9	Savings Segment	27.7%	--	-1.9
Marlboro	30.9	+1	+2.8	DORAL	5.5	--	+2
WINSTON	5.9	+1	-.4	GPC Approved	5.3	+1	+2
Newport	5.1	+1	+5	Basic	4.5	--	--
CAMEL	4.8	--	+2	RJR PL (Forsyth)	2.3	--	-.4
SALEM	3.9	--	-.1	Misty	1.5	--	+1
Kool	3.5	--	+1	Cambridge	1.4	--	-.2
Merit	2.8	--	-.1	Montclair	1.0	--	-.3
Virginia Slims	2.7	--	--	Liggett PL	.9	--	-.2
Benson & Hedges	2.5	-.1	--	Brown & Wmson PL	.8	--	-.2
Carlton	1.5	--	--	PM PL (Famous Val.)	.8	-.1	-.4

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RETAIL SHARE PERFORMANCE



RJR's Share of Market was stable from June to July.

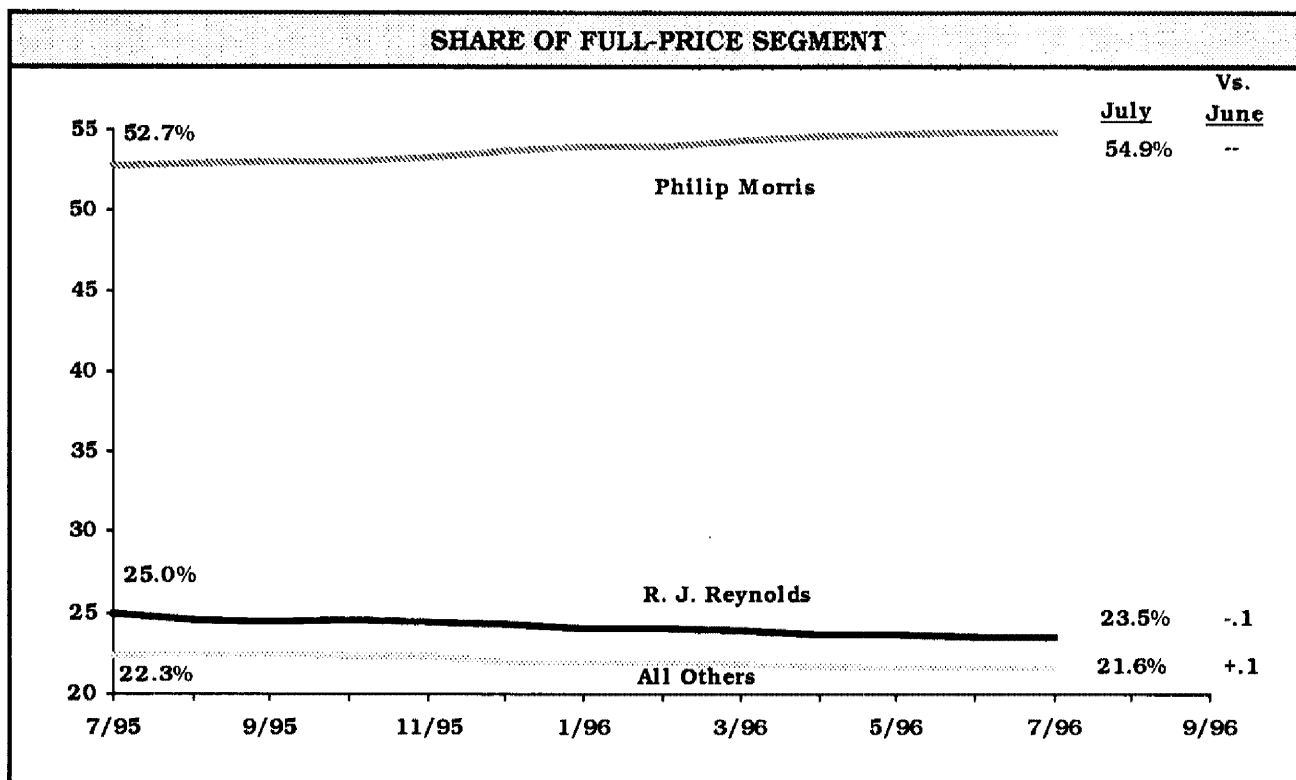
- WINSTON's .1 point gain was offset by small declines on several other Full-Price brands
- Shares of each of our Savings brands and Private Labels were flat versus June

Philip Morris' total share slipped .1 point as Marlboro's modest gain was outweighed by losses on Benson & Hedges and Private Labels

	Latest Month				Latest Quarter	
	July 1996 Share	Share Point Change Versus June	Share Point Change Versus July '95	Percent Change Vs. July '95	July Quarter Share	Annualized % Chg. Vs. Apr. Qtr.
Philip Morris	46.8%	-.1	+1.9	+4.2%	46.8%	+2.9%
Full-Price	39.7	--	+2.6	+6.9	39.6	+7.0
Savings	7.1	-.1	-.7	-8.9	7.2	-16.4
R. J. Reynolds	26.0%	--	-1.4	-5.2%	26.1%	-4.0%
Full-Price	17.0	--	-.6	-3.5	17.0	-4.0
Savings	9.1	--	-.8	-8.0	9.1	-4.0
Brown & Williamson	17.1%	+.1	-.6	-3.3%	17.1%	-2.5%
Full-Price	7.6	--	-.2	-2.4	7.6	-2.8
Savings	9.5	--	-.4	-4.0	9.5	-2.2
Lorillard	7.9%	+.1	+3	+4.0%	7.8%	+2.1%
Full-Price	7.4	+.1	+2	+2.9	7.3	+0.2
Savings	.5	--	+1	+22.0	.5	+32.8
Liggett	1.7%	--	-.4	-17.0%	1.7%	-8.7%
Full-Price	.5	--	-.2	-24.2	.5	-15.5
Savings	1.2	--	-.2	-16.4	1.2	-5.4

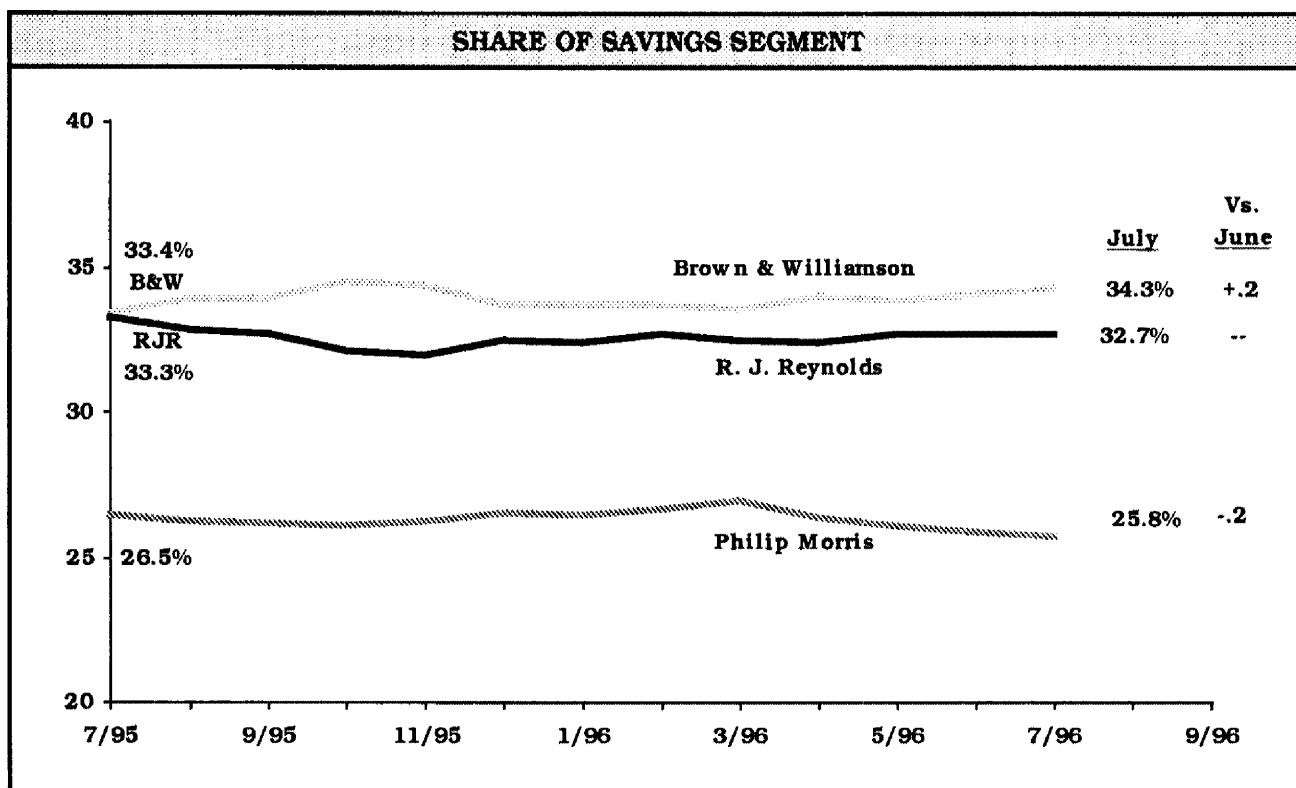
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RETAIL SHARE PERFORMANCE



RJR's July Share of Full-Price was .1 point below June.

- WINSTON's Share of Segment gain was outweighed by declines on several other brands



RJR held Share of Savings from June to July.

- All of our Savings brands were stable month-to-month
- Philip Morris' Share of Segment declined for the fourth consecutive month

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RETAIL SHARE PERFORMANCE

Progress Toward Key 1996 Share Goals

	YEAR-TO-DATE		GOALS	
	July YTD	Vs. YTD Goal	Full Year 1996	Vs. 1995
Share of Market				
WINSTON	5.90%	-.20 pt.	6.10%	Stable
CAMEL (Ex. Reg.)	4.07%	+.03 pt.	4.10%	+.32 pt.
SALEM	3.99%	-.06 pt.	4.05%	Stable
RJR Full-Price	17.11%	-.21 pt.	17.32%	Stable
Share of Savings				
DORAL	19.64%	+.31 pt.	19.70%	+1.96 pt.

SHIPMENT PERFORMANCE

RJR's August Year-To-Date shipments were below Plan by 1.3 billion units or 1.6%.

- Full-Price volume was 2.3% above Plan level despite trade inventory reductions in January
- Savings brands softness (-7.6% versus Plan) reflects January trade cutbacks and reduced demand against aggressive Plan assumptions
- Volume gains versus year-ago were achieved on CAMEL (Total +4.1%, Ex. Regular +6.0%) and DORAL (+3.8%)

Industry shipments were up .7% versus year-ago, and consumption is about flat.

- Year-ago volume comparisons are distorted by early 1995 trade inventory reductions, the May 1995 PM product recall and the impact of one additional trading day in 1996
- Lorillard and Philip Morris posted volume increases of 5.6% and 4.9% respectively
- RJR shipments were 3.7% below year-ago, while Brown & Williamson's were off 3.6% and Liggett's were down 16.8%
- Current estimates continue to show overall consumption about even with last year

R. J. REYNOLDS SHIPMENTS			INDUSTRY SHIPMENTS		
Full-Price	Savings	Total	Full-Price	Savings	Total
50.3 29.8 80.1 -.4% -.4% -.4% +2.3% -7.6% -1.6% -2.8% -5.2% -3.7%			August YTD 1996	231.8 92.4 324.2 +.8% -.8% +.4% +3.1% -6.8% +.1% +3.4% -5.4% +.7%	
			Actual		
			Vs. Latest Estimate*		
			Vs. Plan		
			Vs. 1995		
19.4 11.7 31.1 -2.5% +.8% -1.3% 19.3 12.9 32.2 -3.2% +11.1% +2.0%			Third Qtr. 1996	89.1 36.6 125.7 +3.9% -1.4% +2.3% 88.4 38.8 127.2 +2.9% +4.7% +3.5%	
			Latest Estimate*		
			Vs. 1995		
			Plan		
			Vs. 1995		
74.8 44.7 119.5 -3.2% -3.3% -3.3% 73.5 48.7 122.2 -4.9% +5.5% -1.0%			Full Year 1996	342.5 139.4 481.9 +1.7% -3.6% +.1% 336.6 148.2 484.8 -- +2.5% +.7%	
			Latest Estimate*		
			Vs. 1995		
			Plan		
			Vs. 1995		

*Latest Estimate issued 7/8/96

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FINANCIAL FORECAST

Third Quarter 1996 (\$MM)	Forecast	Vs. Plan		Vs. 1995	
		Units/\$	%	Units/\$	%
Volume (Billions)					
Full-Price	19.3	--	--	(0.6)	(3.0)%
Savings	<u>11.6</u>	<u>(1.3)</u>	(10.1)%	--	--
Total	30.9	(1.3)	(4.0)%	(0.6)	(1.9)%
Net Sales	\$1,196	\$(8)	(0.7)%	\$40	3.5%
Operating Company Contribution	\$375	\$(2)	(0.5)%	\$10	2.7%
Operating Margin	31.4%	+0.1 pt.		-0.2 pt.	
Cash Flow	\$320	\$(2)	(0.6)%	\$(159)	(33.2)%

- **Third Quarter Operating Company Contribution** forecast \$2 million below Plan
 - Favorable pricing and product mix are more than offset by lower volume
- **Cash Flow** projected \$2 million lower than Plan
 - Reduced OCC, higher work-in-process inventories and increased pension contribution partially offset by lower leaf inventories

Full Year 1996 (\$MM)	Forecast	Vs. Plan		Vs. 1995	
		Units/\$	%	Units/\$	%
Volume (Billions)					
Full-Price	74.7	0.9	1.2%	(2.6)	(3.4)%
Savings	<u>44.5</u>	<u>(4.2)</u>	(8.6)%	<u>(1.7)</u>	(3.7)%
Total	119.2	(3.3)	(2.7)%	(4.3)	(3.5)%
Net Sales	\$4,561	\$ 4	0.1%	\$81	1.8%
Operating Company Contribution	\$1,450	\$25	1.8%	\$30	2.1%
Operating Margin	31.8%	+0.5 pt.		+0.1 pt.	
Cash Flow	\$1,410	\$(129)	(8.4)%	\$(81)	(5.4)%

- **Full Year Operating Company Contribution** forecast \$25 million above Plan at \$1,450 million
 - Favorable pricing and product mix are partially offset by lower volume
- **Cash Flow** expected to be \$1,410 million, \$129 million below Plan
 - Higher leaf inventories, increased merchandiser purchases and unfavorable timing of marketing payments, partially offset by increased OCC

NOTE: 1995 Restructuring Reserve of \$100 million not reflected in prior year comparisons

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KEY ACTIVITIES

BRAND MARKETING

RJR In-Market Testing at Record Level.

- RJR has introduced an unprecedented array of new products into test or lead markets in the past year
- Performance of these initiatives is being closely monitored to identify the best opportunities for building competitively advantaged brands which can provide meaningful share growth in 1997 and beyond

	<u>4Q95</u>	<u>1Q96</u>	<u>2Q96</u>	<u>3Q96</u>
Moonlight Tobacco				
• Seven brands; New York, Chicago, Seattle	→			
• Added two brands, Portland, OR			→	
• Expanded to North Carolina, Cleveland				→
HOGSHEAD				
• Austin Test Market	→			
• Expanded within Austin				→
CAROLINA GOLD				
• Pittsburgh Test Market	→			
RED KAMEL/KAMEL MENTHE				
• New York, Dallas, Los Angeles, San Francisco		→		
• Expanded in new and original markets				→
ECLIPSE				
• Chattanooga Test Market			→	
WINSTON "No Bull" Positioning				
• Florida Test Market				→
CAMEL Menthol				
• Chicago, Buffalo Region Lead Markets				→

RED KAMEL Expansion Underway in New and Original Markets.

- Based on RED KAMEL's performance in its original markets, the brand was expanded into Denver and Seattle via CAMEL's established bar programs in August
- Retail sales in selected high-opportunity outlets in those cities as well as Boston, Philadelphia and Portland, Oregon began in September
- Also beginning in September, RED KAMEL's retail availability in its four original markets is being expanded to the full metro areas and certain trendy pockets outside the metros

COST/PERFORMANCE MANAGEMENT

Negotiations Yield Favorable Terms on Inbound Freight and Employee Travel Expenses.

- Through the combined efforts of Distribution and Purchasing, transportation costs for incoming filter tow from Eastman Chemical and cigarette paper from Miquel Y Costas have been reduced \$140,000 on an annual basis; these savings will be reflected in reduced unit prices for the materials
- The Travel Department has renegotiated a three-year contract with our travel partner, American Express; the new contract became effective July 1, and provides RJRT with an annual savings of

approximately \$75,000 and an increase of annual revenue of approximately \$42,000, improvements which benefit RJRT by 23.3% as compared to our previous contract

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