Philip Morris Companies and Kraft, Inc.

John M. Richman, the chairman and chief executive officer of Kraft, Inc., concluded his October 23, 1988, letter to shareholders as follows:

> We deeply regret the dislocation and hardships that the [restructuring] plan we contemplate will cause, and we will seek to ameliorate these hardships as much as possible. We know that our shareholders, employees, customers, suppliers and communities recognize that today's situation is not of our making. Rather it is the product of current era investment policies and financial attitudes that favor short-term financial gratification over steady, long-term growth and the need to provide a sound economy for future generations.
>
> It will take several years, but with the history and traditions of Kraft and the dedication of Kraft people, we are confident that we will rebuild Kraft to the leading position it occupies today.

The letter announced a radical restructuring of Kraft in response to a hostile tender offer by Philip Morris Companies: $90 per share in cash for all of Kraft's outstanding common stock. The offer had been announced just five days earlier, on October 18, 1988.

Kraft, Inc.

In 1987, Kraft was known for such brand names as Miracle Whip, Seven Seas, and Kraft salad dressings; Kraft mayonnaise; Velveeta cheese; Parkay and Chiffon margarines; Lender's Bagels; and Breyers ice cream. Net sales from continuing operations were $9.9 billion in 1987, an increase of 27% over 1986. Net income from continuing operations rose 11%, to $435 million. Exhibit 1 presents operating and stockholder information for Kraft from 1982 through 1987. Exhibit 2 presents balance sheet information for 1986 and 1987.

Kraft's strategy was focused on food. Its 1987 annual report stated:

> The food industry offers such diverse and rewarding opportunities that we see no purpose in running the risk of diluting our efforts or our focus with other lines of business.

This all-food strategy was in sharp contrast to its earlier diversification program. Most of the diversification occurred when Mr. Richman engineered the September 1980 merger between Kraft and Dart Industries, a $2.4 billion consumer products manufacturer. Mr. Richman, who had been promoted to chairman and CEO less than 1 year before the merger, noted that the merger brought "diversification in one fell swoop to Kraft." Dart's products included Tupperware containers, Duracell batteries, and West Bend appliances. The merger was accomplished by exchanging one share of the merged company, Dart & Kraft, for each outstanding share of the two preexisting companies. Dart & Kraft was the twenty-seventh-largest company in the United States at the time of the merger. Six months later, in March 1981, Dart & Kraft acquired Hobart Corporation, the manufacturer of KitchenAid and other food-related equipment, for $460 million.

Mr. Richman reversed direction and began pursuing the all-food strategy in 1986. Kraft spun off most of its nonfood businesses acquired in the Dart & Kraft merger into Premark International, Inc., on October 31, 1986. Each shareholder of Dart & Kraft received one share of Kraft common stock and a quarter share of Premark. Kraft, with sales of about $9.9 billion after the spin-off, retained its food businesses and Duracell batteries. Premark's share of Dart & Kraft included Tupperware and Hobart food service equipment, with combined sales of $1.8 billion.[1]

Kraft sold its last nonfood asset, Duracell, to Kohlberg, Kravis, Roberts & Co., a leveraged buyout firm, for $1.8 billion in June 1988. According to Kraft's 1987 annual report, the proceeds of the sale were to be used to repurchase shares and to repay debt obligations. In October 1987, Kraft authorized the repurchase of 10 million shares, and 6 million were repurchased under the authorization by year-end.

In 1987, Kraft was organized into three business segments: U.S. Consumer Food, U.S. Commercial Food, and International Food. In 1987, U.S. Consumer Food had sales of $4.5 billion and an operating profit of $593 million. U.S. Commercial Food, which included Kraft Foodservice, the second-largest U.S. food service distributor, had sales of $3 billion and an operating profit of $86.4 million. International Food had sales of $2.3 billion and an operating profit of $229.8 million. Exhibit 3 presents a financial summary of Kraft by business segment.

The Philip Morris $90-per-Share Tender Offer

On the evening of October 18, 1988, Philip Morris offered to purchase all Kraft common stock at $90 per share in cash. The offer represented a 50% premium over the $60.125 closing price on October 18. At $11 billion in total value the bid, if successful, would have been the second-largest acquisition ever completed, exceeded only by Chevron Corporation's $13.3 billion acquisition of Gulf Oil Corporation in 1984.[2]

Most Philip Morris sales and profits came from its Marlboro, Benson & Hedges, and Virginia Slims cigarettes. The company's tobacco sales increased by 15%, to $14.6 billion, in 1987. Philip Morris increased its domestic share of the cigarette market to 38% in 1987, from 37% in 1986, and 1987 operating profits were $3.3 billion. Nevertheless, consumption of cigarettes in the United States had been declining from its 1981 peak of 640 billion cigarettes. Estimated U.S. consumption for 1988 was 563 billion cigarettes. Increases in exports offset the decline in U.S. consumption, as new markets were entered, especially Japan and Taiwan. Overall, cigarette exports were predicted to increase by 15%, to 115 billion cigarettes in 1988.

1. KitchenAid had been sold in February 1986 for $150 million.

2. Kraft had 119,285,155 shares outstanding and outstanding employee stock options on 2,396,808 shares. The total number of Kraft shares purchased under the offer was therefore 121,681,963.

Philip Morris had been pursuing a strategy of diversifying out of the tobacco business since 1969, when it acquired 53% of the Miller Brewing Company's common shares, the remainder of which it acquired in 1970. With brands like Miller, Lite, and Matilda Bay Wine Coolers, the brewing division generated sales of $3.1 billion in 1987. Philip Morris also purchased Seven-Up Company in May 1978 for $520 million. Its largest food acquisition by far was General Foods, which Philip Morris purchased in 1985 for $5.6 billion. Like Kraft, General Foods was based on brand-name products such as Maxwell House coffee, Birds Eye frozen foods, Jell-O, Oscar Mayer meats, Ronzoni pasta, and Post cereals. It had 1987 sales of $10 billion.

Philip Morris's acquisitions had mixed results. See Exhibit 4 for operating and stockholder information from 1982 through 1987. Exhibit 5 presents balance sheet information for 1986 and 1987. Exhibit 6 presents the consolidated changes in financial position, and Exhibit 7 reports line-of-business information.

Philip Morris sold its Seven-Up operations in 1986 for about book value after a $50 million write-off in 1985. General Foods' operating profit declined from $624 million in 1986 to $605 million in 1987. The 1987 operating profit represented a 9.3% return on Philip Morris's $6.5 billion investment in the food industry, including additional postacquisition investments of $868 million. Speculation was that Philip Morris might use Kraft's management team to revitalize General Foods, which had been without a chief executive officer since July 1988, when Philip L. Smith left to become chairman of Pillsbury.[3] Smith, a 22-year veteran of General Foods, had been president and chief operating officer before its merger with Philip Morris.

The acquisition of Kraft would have made Philip Morris the world's largest food company, and it would have been a major step in the firm's strategy of reducing its dependence on tobacco and moving into the food business. As Hamish Maxwell, the chairman and CEO of Philip Morris, said in his October 21, 1988, letter to John Richman:

> Our goal is to have Kraft combine with Philip Morris to create the leading international food company. . . . Our intention is to keep Kraft's present businesses intact and for the company to be managed by Kraft executives, using your present headquarters and facilities.

Exhibit 8 contains excerpts from the letters between the two companies throughout the takeover contest.

Philip Morris proposed to finance the acquisition with $1.5 billion in excess cash and its available bank credit lines of up to $12 billion.

Kraft's Response

On October 23, 1988, Kraft's board of directors rejected the Philip Morris bid:

> We strongly believe the $90 takeover bid . . . undervalues Kraft, for these important reasons: first, after careful analysis, our investment banker, Goldman, Sachs & Co., has advised us that the bid is inadequate; and second, our stock has been trading above the $90 offer, a clear signal that investors see the bid as low.

3. The combination also would have increased leverage with grocery stores and advertisers. In 1987, Philip Morris spent $1.5 billion and Kraft $400 million on advertising.

Kraft's response occurred when the food industry was undergoing a major restructuring and revaluation. Grand Metropolitan PLC began a hostile tender offer for Pillsbury on October 4, 1988. Grand Met was a diversified British company that brewed and distributed beer, ale, and lager; produced and distributed alcoholic beverages; and owned and operated pubs and restaurants. Pillsbury was a diversified food and restaurant company, with popular brands such as Pillsbury Doughboy bakery items, Green Giant vegetables, and Häagen-Dazs ice cream in its food business, and Burger King in its restaurant group. Like Kraft, Pillsbury had just completed a major restructuring that focused the company on the food business. The $5.2 billion Grand Met bid was a 53% premium over the previous market price—about 25 times Pillsbury's net earnings and about four times the book value of common equity.[4] Pillsbury opposed the bid, and its outcome was uncertain.

The developments at RJR Nabisco were more startling. Management, in partnership with the investment banking firm of Shearson Lehman Hutton, had proposed a $17 billion leveraged buyout of RJR Nabisco on October 20, 1988. Like Philip Morris, RJR Nabisco was a tobacco and food company, with brand names such as Winston and Salem cigarettes, Oreo cookies, Ritz crackers, Planters nuts, LifeSavers candies, Royal gelatin, and Del Monte fruit and vegetables. At $75 per share, the buyout offer was a 34% premium over the previous market price of RJR Nabisco, $55.875. The $75 offer was about 16 times RJR Nabisco's 1987 earnings per share of $4.70 and about three times the book value of common equity. Analysts speculated that a higher offer for RJR Nabisco was likely: its stock closed above the offer price.

Taken together, the Philip Morris bid for Kraft, Grand Metropolitan's bid for Pillsbury, and the RJR Nabisco leveraged buyout attempt by its management involved about $34 billion—an amount unprecedented in the history of the industry. Exhibit 9 examines this history, with statistics on mergers and acquisitions for food and beverage firms as well as a listing of transactions of more than $1 billion. Exhibit 10 contains historical stock prices and return-on-equity information for the food and tobacco industries.

Kraft proposed a restructuring plan as an alternative to the Philip Morris tender offer. For each share of common stock, shareholders would receive a cash dividend of $84 and a high-yield debt valued at $14, and they would retain their now highly leveraged equity interest. Kraft valued the postrestructuring stock at $12 per share and the total restructuring package at $110 per share.

Under the plan Kraft would sell some businesses for cash proceeds of about $2.1 billion after taxes. The businesses to be sold represented 45% of estimated 1988 revenues and 19% of estimated 1988 operating profits. Kraft would also reduce operating expenses. It would finance the $10.2 billion in dividend payments to shareholders with $6.8 billion in bank borrowings at a 12% annual interest rate and the $3 billion in debt with rates ranging from 12.5% to 14.75%. The $2.1 billion from asset sales would be used to pay down the bank debt.

The company planned to retain $904 million of existing debt at an average annual interest rate of 8.65%.

The debt received by shareholders would accrue interest at a 15.25% annual rate (paid semiannually), with no cash payments in the first 5 years. Interest would be paid

4. Pillsbury's 1988 net earnings per share were $2.45, excluding unusual items, and $.81, including unusual items. The difference was due to a restructuring charge of $1.64 per share. Its 1987 net earnings per share were $2.24, excluding unusual items, and $2.10, including unusual items.

in cash at the 15.25% semiannual rate after the fifth year. Exhibit 11 presents pre-bid sales and profit forecasts for Kraft through 1989. Exhibit 12 presents earnings and cash flow forecasts for the restructuring plan proposed by Kraft's management.

The Stock Market Response

The price of Kraft common stock rose $10 per share, to $102, in response to the restructuring announcement. Philip Morris criticized the restructuring plan and reiterated its offer to negotiate with Kraft, which responded that "if Philip Morris or another company truly wishes to negotiate with Kraft, a simple phone call proposing a price of more than $110 is all that is necessary." Philip Morris did not increase its bid.

Uncertainty about the market value of food assets grew as Kohlberg, Kravis, Roberts entered the bidding for RJR Nabisco, with a $20.6 billion offer on October 24, 1988.

On Thursday, October 27, Kraft's common stock closed at $94.50. On Friday, October 28, Kraft's stock rose $2, closing at $96.50. Exhibit 13 contains the closing stock prices for Kraft and Philip Morris throughout the takeover contest.

EXHIBIT 1

Condensed Operating and Stockholder Information for Kraft, 1982–1987 (millions of dollars except per share data)

	1982	1983	1984	1985	1986	1987
Revenues	$7,041	$6,660	$6,831	$7,065	$7,780	$9,876
Cost of goods sold[a]	5,350	4,928	4,969	4,963	5,393	6,912
Depreciation	103	80	74	74	79	103
Delivery, sales, and administrative expenses	1,183	1,157	1,238	1,391	1,620	2,068
Interest, net	24	(8)	22	26	31	91
Other income (expense)[b]	(38)	23	43	37	37	86
Income from continuing operations before taxes	343	526	571	648	694	788
Income taxes	164	225	252	286	300	353
Income from continuing operations	179	301	319	362	394	435
Income from discontinued operations[c]	171	134	137	104	19	54
Net income	$ 350	$ 435	$ 456	$ 466	$ 413	$ 489
Earnings per share	$ 2.13	$ 2.65	$ 3.17	$ 3.24	$ 3.06	$ 3.73
Dividends per share	1.20	1.28	1.38	1.52	1.68	1.84
Closing stock price[d,e]	22.83	22.21	28.04	43.38	49.38	48.25
Price-earnings ratio[e]	11	8	9	13	16	13
Number of shares (millions)[e]	164	164	144	144	135	131
Beta[f]	.72	.55	.69	1.12	1.18	.74

Sources: Company reports and casewriter's estimates.

a. Cost of goods sold does not include annual depreciation.

b. Includes the cumulative effect of a change in method of accounting for income taxes of $45 million in 1987 and a nonoperating item of –$91 million in 1982.

c. Discontinued operations include Duracell, the sale of which was announced in 1987, and the business of Premark International, which was spun off on October 31, 1986. Also included in discontinued operations is a $41 million gain on the sale of KitchenAid in 1986.

d. Adjusted for a 3-for-1 stock split in 1985.

e. Year-end.

f. Calculated by ordinary least-squares regression using daily stock price data.

EXHIBIT 2
Consolidated Balance Sheets for Kraft, 1986–1987 (millions of dollars)

	1986	1987
Cash	$ 321.5	$ 189.0
Accounts receivable	637.6	763.6
Inventories	1,061.1	1,283.4
Investments and long-term receivables	236.2	178.3
Prepaid and deferred items	127.5	161.5
Property, plant, equipment, net	1,087.7	1,424.2
Intangibles	419.0	888.3
Net assets of discontinued operations	600.7	598.4
Total assets	$4,491.3	$5,486.7
Accounts payable	$ 492.1	$ 544.8
Short-term borrowings	596.4	645.9
Accrued compensation	148.9	151.2
Accrued advertising and promotions	113.7	132.8
Other accrued liabilities	188.4	245.4
Accrued income taxes	335.3	399.3
Current portion of long-term debt	108.5	37.2
Current liabilities	1,983.3	2,156.6
Long-term debt	237.7	895.3
Deferred income taxes	286.4	282.7
Other liabilities	185.9	253.7
Total liabilities	2,693.3	3,588.3
Shareholders' equity	2,798.0	1,898.4
Total liabilities and net worth	$4,491.3	$5,486.7

Source: Company reports.

EXHIBIT 3
Financial Summary for Kraft by Business Segment, 1983–1987 (millions of dollars)

	1983	1984	1985	1986	1987
U.S. Consumer Food[a]					
Sales	$3,718.0	$3,781.2	$3,911.3	$4,016.1	$4,518.9
Operating profit	388.1	446.0	527.3	545.9	593.3
Identifiable assets	1,450.9	1,615.4	1,309.1	1,807.6	2,509.3
Depreciation	54.0	50.0	37.6	36.6	47.4
Capital expenditures	58.0	71.7	63.1	93.7	151.2
Operating profits/identifiable assets	26.75%	27.61%	40.28%	30.20%	23.64%
U.S. Commercial Food					
Sales	$1,172.7	$1,349.3	$1,421.0	$1,755.8	$3,022.0
Operating profit	na	na	61.7	79.5	86.4
Identifiable assets	na	na	291.4	558.9	914.6
Depreciation	na	na	7.6	8.0	15.3
Capital expenditures	na	na	5.2	17.6	33.7
Operating profits/identifiable assets	na	na	21.17%	14.22%	9.45%
International Food					
Sales	$1,769.7	$1,707.2	$1,733.0	$2,007.7	$2,334.8
Operating profit	165.4	169.4	145.9	182.8	229.8
Identifiable assets	680.9	701.1	793.7	861.1	1,000.5
Depreciation	19.2	18.9	20.6	27.5	34.0
Capital expenditures	37.3	36.2	39.2	41.7	48.3
Operating profits/identifiable assets	24.29%	24.16%	18.38%	21.23%	22.97%
Direct Selling[b]					
Sales	$ 825.1	$ 776.9	—	—	—
Operating profit	189.3	138.8	—	—	—
Identifiable assets	462.7	488.0	—	—	—
Depreciation	36.0	28.9	—	—	—
Capital expenditures	40.7	62.8	—	—	—
Operating profits/identifiable assets	40.91%	28.44%	—	—	—
Consumer Products[c]					
Sales	$1,181.0	$1,244.8	$ 962.5	—	—
Operating profit	104.7	118.4	66.9	—	—
Identifiable assets	828.0	958.8	849.6	—	—
Depreciation	26.9	42.9	34.2	—	—
Capital expenditures	43.0	67.9	47.4	—	—
Operating profits/identifiable assetes	12.64%	12.35%	7.87%	—	—
Commercial Products[d]					
Sales	$1,047.5	$ 899.3	—	—	—
Operating profit	104.8	101.0	—	—	—
Identifiable assets	727.6	556.9	—	—	—
Depreciation	30.4	23.9	—	—	—
Capital expenditures	25.4	28.1	—	—	—
Operating profits/identifiable assets	14.40%	18.14%	—	—	—

Source: Company reports.

na = not available.

a. Figures for 1983 and 1984 include both U.S. consumer foods and U.S. commercial foods.

b. Includes Tupperware, which was spun off to Premark International in 1986.

c. Includes Duracell, West Bend, Health Care, and KitchenAid. All assets except Duracell were sold or spun off to Premark International in 1986.

d. Includes Hobart, which was spun off to Premark International in 1986.

EXHIBIT 4
Condensed Operating and Stockholder Information for Philip Morris, 1982–1987 (millions of dollars except per share data)

	1982	1983	1984	1985[c]	1986	1987
Revenues	$11,586	$12,976	$13,814	$15,964	$25,409	$27,695
Cost of goods sold[a]	5,046	5,028	5,170	5,926	10,495	10,664
Excise taxes	2,615	3,510	3,676	3,815	4,728	5,416
Depreciation and amortization	281	327	375	424	655	704
Selling, administrative, and research expenses[b]	2,125	2,377	2,467	3,244	6,061	7,004
Equity in net earnings of unconsolidated subsidiaries	71	83	54	82	111	126
Interest	246	230	273	308	770	685
Other expense	44	—	300	—	—	—
Income before taxes	1,300	1,587	1,607	2,329	2,811	3,348
Income taxes	518	681	718	1,074	1,333	1,506
Net income	$ 782	$ 906	$ 889	$ 1,255	$ 1,478	$ 1,842
Earnings per share	$ 3.11	$ 3.58	$ 3.62	$ 5.24	$ 6.20	$ 7.75
Dividends per share	1.20	1.45	1.70	2.00	2.48	3.15
Closing stock price[d]	30	35.875	40.375	44.125	71.875	85.375
Price-earnings ratio[d]	9	10	11	8	11	11
Number of shares (millions)[d]	252	250	243	239	238	237
Beta[e]	1.04	.77	.94	.88	1.24	.88

Sources: Company reports and casewriter's estimates.

a. Cost of goods sold does not include annual depreciation.

b. Selling, administrative, and research cost includes corporate expenses.

c. General Foods was acquired on November 1, 1985.

d. Year-end.

e. Calculated by ordinary least-squares regression using daily stock price data.

EXHIBIT 5
Consolidated Balance Sheets for Philip Morris, 1986–1987 (millions of dollars)

	1986	1987
Cash	$ 73	$ 189
Receivables	1,878	2,083
Inventories	3,836	4,154
Other current assets	127	146
Property, plant, equipment, net	6,237	6,582
Investments in unconsolidated subsidiaries and affiliates	1,067	1,244
Goodwill and other intangibles	3,988	4,052
Other assets	436	695
Total assets	$17,642	$19,145
Notes payable	$ 864	$ 691
Accounts payable	813	803
Current portion of long-term debt	103	465
Accrued liabilities	1,967	2,277
Income taxes payable	557	727
Dividends payable	178	213
Current liabilities	4,482	5,176
Long-term debt	5,945	5,222
Deferred income taxes	994	1,288
Other liabilities	566	636
Total liabilities	11,987	12,322
Stockholders' equity	5,655	6,823
Total liabilities and net worth	$17,642	$19,145

Source: Company reports.

EXHIBIT 6
Consolidated Statements of Changes in Financial Position for Philip Morris, 1985–1987 (millions of dollars)

	1985	1986	1987
Funds Provided by			
Net earnings	$ 1,255	$ 1,478	$ 1,842
Depreciation and amortization	424	655	704
Deferred income taxes	159	133	338
Equity in undistributed net earnings of unconsolidated subsidiaries and affiliates	(63)	(52)	(95)
Total funds from operations	1,775	2,214	2,789
Increase in accrued liabilities and other payments	1,467	226	505
Working capital from sales of operations	169	487	20
Currency translation adjustments affecting working capital	18	77	139
Other, net	211	210	—
Total funds provided	$ 3,640	$ 3,214	$ 3,453
Funds Used for			
Increase (decrease) in			
Cash and receivables	$ 1,005	$ (2)	$ 321
Inventories	1,174	9	318
Other current assets	74	14	19
Capital expenditures	347	678	718
Dividends declared	479	590	749
Increase in property, plant, and equipment from income tax election	—	508	—
Investment in General Foods Corp. exclusive of $718 million working capital acquired	4,864	—	—
Other, net	—	—	301
Total funds used	$ 7,943	$ 1,797	$ 2,426
Net funds provided (used)	$(4,303)	$ 1,417	$ 1,027
Financing Activities			
Increase in current notes payable	$ 149	$ 289	$ 189
Long-term debt financing	4,666	1,788	492
Reduction of long-term debt	(326)	(3,385)	(1,534)
Purchase of treasury stock	(216)	(140)	(200)
Issuance of shares	30	31	26
Funds (used for) provided from financing activities	$ 4,303	$(1,417)	$(1,027)
Increase (decrease) in working capital	$ 637	$ (494)	$ (36)
Working capital (year-end)	1,926	1,432	1,396

Source: Company reports.

EXHIBIT 7
Financial Summary for Philip Morris by Business Segment, 1982–1987 (millions of dollars)

	1982	1983	1984	1985	1986	1987
Tobacco						
Sales	$7,821.8	$9,094.9	$9,802.0	$10,539.0	$12,691.0	$14,644.0
Operating profit	1,475.7	1,647.0	2,141.0	2,441.0	2,827.0	3,273.0
Identifiable assets	5,070.7	5,114.3	5,149.0	5,622.0	5,808.0	6,467.0
Depreciation	97.7	124.7	151.0	166.0	200.0	214.0
Capital expenditures	498.0	319.9	163.0	151.0	191.0	256.0
Operating profit/identifiable assets	29.10%	32.20%	41.58%	43.42%	48.67%	50.61%
Food Products						
Sales	—	—	—	$ 1,632.0	$ 9,664.0	$ 9,946.0
Operating profit	—	—	—	95.0	624.0	605.0
Identifiable assets	—	—	—	7,974.0	8,629.0	9,129.0
Depreciation	—	—	—	29.0	167.0	201.0
Capital expenditures	—	—	—	71.0	395.0	402.0
Operating profit/identifiable assets	—	—	—	1.19%	7.23%	6.63%
Beer						
Sales	$2,935.5	$2,935.5	$2,940.0	$ 2,925.0	$ 3,054.0	$ 3,105.0
Operating profit	159.0	227.1	116.0	136.0	154.0	170.0
Identifiable assets	2,113.7	2,138.9	1,892.0	1,779.0	1,736.0	1,680.0
Depreciation	122.3	130.5	144.0	134.0	136.0	137.0
Capital expenditures	286.3	174.6	94.0	87.0	80.0	57.0
Operating profit/identifiable assets	7.52%	10.62%	6.13%	7.64%	8.87%	10.12%
Other[a]						
Sales	$ 822.9	$ 945.5	$1,072.0	$ 868.0	—	—
Operating profit (loss)	(2.4)	(10.9)	23.0	14.0	$ (9.0)	$ 19.0
Identifiable assets	979.4	1,007.3	1,018.0	643.0	—	—
Depreciation	—	—	—	—	—	—
Capital expenditures	—	—	—	—	—	—
Operating profit/identifiable assets	-.25%	-1.08%	2.26%	2.18%	—	—

Source: Company reports.

a. Includes the Seven-Up Company, which was sold in 1986.

EXHIBIT 8
Correspondence During Takeover Bid Between Kraft and Philip Morris, October 1988

October 20, 1988

Mr. Hamish Maxwell
Chairman and Chief Executive Officer
Philip Morris Companies Inc.
120 Park Avenue
New York, NY 10017

Dear Hamish:

In addition to your letter requesting "negotiations" following your commencing, on Monday, a tender offer without talking to me beforehand, your lawyers and investment bankers have been barraging our advisers with similar requests. You did not see fit to discuss your takeover attempt when we were together at the Grocery Manufacturers of America meeting last Wednesday and Thursday, nor did you see fit to tell me that you were planning on filing a bizarre and baseless law suit against me and our Board of Directors on Monday.

You must have been planning your takeover bid for a long time. We intend to take our time and study the situation very carefully. We have a fiduciary duty to our shareholders and an obligation to our employees, customers, suppliers, and communities to do so. Following our study, the Board of Directors will consider the situation and determine Kraft's response. If at that time there is a purpose to be served by our meeting, we will so advise you.

Sincerely,
JOHN M. RICHMAN
Chairman and Chief Executive Officer
Kraft, Inc.

October 21, 1988

Mr. John M. Richman
Chairman and Chief Executive Officer
Kraft, Inc.
Kraft Court
Glenview, IL 60025

Dear John:

I understand and sympathize with your reaction to the events of this week. I would have preferred to discuss our offer with you prior to taking the actions we commenced. However, in the current legal environment in which we live, I accepted the advice to proceed as we did as a business decision. Our actions were designed to minimize uncertainties and delays in addressing the main issue—the economic benefits and other factors favoring the merger of Kraft with Philip Morris.

I hope you understand that any discussion of our interest in Kraft would have been premature and inappropriate when we saw each other last week at the Grocery Manufacturers of America meeting. At that time we had made no final decision to proceed with an offer and our Board had not yet approved our actions. In any event, I am hopeful you and we can now move forward in a positive and constructive manner.

I quite appreciate your need to study our offer carefully before responding to it. We have, however, seen press reports that Kraft may consider other possibilities including highly leveraged transactions that could encumber the company, operationally and financially, and which also might lead to the dismemberment of Kraft. From what I know of you and some public statements you have made, I feel sure that this is not the route you would prefer to take.

(continued)

EXHIBIT 8 *(continued)*

As we have said, our goal is to have Kraft combine with Philip Morris to create the leading international food company. I repeat that our intention is to keep Kraft's present businesses intact and for the company to be managed by Kraft executives, using your present headquarters and facilities.

I believe it to be in the best interests of your shareholders and other constituencies that we avoid a prolonged struggle that could disrupt Kraft's business without adding to the value that would be realized by your shareholders.

I also believe that a meeting between us could only be helpful to you in understanding our purposes and positive thoughts concerning a combination of our two companies. . . . I want to emphasize that we are prepared to discuss all aspects of our offer.

I would be available to meet with you in Chicago at any time on short notice. I can be reached through my office if, as I hope, you see the benefits of such a meeting.

Yours sincerely,
HAMISH MAXWELL
Chairman and Chief Executive Officer
Philip Morris Companies Inc.

October 23, 1988

To: Shareholders of Kraft, Inc.

Dear Shareholder:

Kraft has an outstanding record of profitability and growth. It is a great company with great traditions, great brands, a great future, and great people who have devoted their lives to making your company what it is today.

Kraft's record of success—an increase in shareholder value, without regard to recent events, at a compound annual rate of more than 20% over the past 5 years—has been based on a strategy of balancing significant short-term returns and continued investment for long-term growth. This strategy has been working, but—frustratingly—the stock market has long been undervaluing companies which, like Kraft, sacrifice short-term profit in order to invest in long-term growth.

Last Monday, Philip Morris Companies, seeking to take advantage of this undervaluation, announced an unsolicited tender offer for Kraft at $90 per share.

We strongly believe the $90 takeover bid also undervalues Kraft, for these important reasons: first, after careful analysis, our investment banker, Goldman, Sachs & Co., has advised us that the bid is inadequate; and second, our stock has been trading above the $90 offer, a clear signal that investors see the bid as low.

Your Board of Directors has unanimously rejected the offer, and we strongly recommend that you do not tender your Kraft shares to Philip Morris.

At the same time, both your Board and company management recognize that, as a practical matter, the Philip Morris bid makes it impossible for us to go back to the situation that existed prior to the bid. Under the circumstances, your Board believes that we should take action to maximize shareholder value rather than accept an inadequate offer. Together with Goldman, Sachs we are developing a potential recapitalization plan that we believe will have a value of significantly more than $90 per share.

(continued)

EXHIBIT 8 *(continued)*

The plan we are working on is intended to result in a total value estimated to be in excess of $110 per share, with a distribution in cash and securities totaling approximately $98 per share and the retention of your common stock interest, the price of which will be adjusted by the market to reflect the cash and securities distribution. Under the plan, you will receive a cash distribution and new securities, and retain your Kraft common stock. Most shareholders will have less tax to pay as a result of the distribution than if Kraft were to be acquired by Philip Morris (or anyone else) at a price that is equal to the value of the restructuring plan.

Your Board believes that this plan will enable you as a shareholder to realize present value for your shares and also continue to participate in the future of Kraft, including some exciting new product lines we have been developing.

The plan will involve the sale of some of our businesses, bank borrowings of more than $6.8 billion, and the sale of $3.0 billion of debt. We have already begun to implement some of these transactions. Goldman, Sachs has advised us that it is highly confident with respect to the placement of the debt under current market conditions. We will retain our core businesses, together with the key brands which have provided Kraft's historic strength and currently account for approximately 80% of its profitability.

Because the restructured Kraft will have more than $12.4 billion in debt and require herculean efforts by our employees, the plan will replicate the structure currently in use in sponsored leveraged buyouts by providing significant equity incentives for employees in the form of stock options and an employee stock ownership plan. This very important link between employee compensation and company performance will, we believe, ensure the enormous efforts required to make the recapitalization a complete success.

We expect that the plan will be fully developed and our Board will be able to approve it in the very near future, at which time we will announce the details. Because the plan involves very significant restructuring of our businesses and financial structure, the Board also believes you should have the opportunity to vote upon it at a special meeting of shareholders.

For your further information, on Friday, October 21, there was a series of communications with Philip Morris. Philip Morris renewed their request for immediate negotiation, stating that all aspects of their offer, including price, are open for discussion. Philip Morris said that there would be real value to them if they could conclude the agreement with us over the weekend and asked for a meeting on Saturday. We responded that if Philip Morris were prepared to offer a realistic price, we would meet on Saturday. We told Philip Morris that their $90 bid is substantially below our valuation and Goldman, Sachs's valuation and that there would be no purpose served by a meeting unless Philip Morris were prepared to start the negotiations from a price substantially greater than $90. We asked Philip Morris to tell us where they stood and told Philip Morris that if they were in the range of value that we and Goldman, Sachs believe is obtainable, we would meet with them on Saturday. Philip Morris replied that they completely disagree with our opinion of their $90 price, that they believe $90 represents full value, and they would not tell us what price they are prepared to offer. Given this attitude on the part of Philip Morris, it was clear that a meeting would not have served any purpose of Kraft and its shareholders, and we so advised Philip Morris. We also advised Philip Morris that we were not foreclosing negotiations and that if they were to offer a price that reflects the full value of Kraft, we would negotiate with them.

Since we believe that the restructuring plan will create greater shareholder value and opportunity than the Philip Morris bid or any other known alternative, it is our intention to proceed with the restructuring on an exclusive basis. However, if someone comes forward with a transaction that would be more desirable than the restructuring plan, we will negotiate and your Board will give full consideration to such a transaction.

We deeply regret the dislocation and hardships that the plan we contemplate will cause, and we will seek to ameliorate these hardships as much as possible. We know that our shareholders, employees,

(continued)

EXHIBIT 8 *(continued)*

customers, suppliers, and communities recognize that today's situation is not of our making. Rather it is the product of current era investment policies and financial attitudes that favor short-term financial gratification over steady, long-term growth and the need to provide a sound economy for future generations.

It will take several years, but with the history and traditions of Kraft and the dedication of Kraft people, we are confident that we will rebuild Kraft to the leading position it occupies today.

On behalf of the Board of Directors,
JOHN M. RICHMAN
Chairman

October 24, 1988

Calvin J. Collier, Esq.
Senior Vice President and General Counsel
Kraft, Inc.
Kraft Court
Glenview, IL 60025

Dear Mr. Collier:

In light of the announcement yesterday of Kraft, Inc.'s proposed recapitalization plan, Philip Morris believes that Kraft is required to take all necessary steps to ensure that Philip Morris is given an opportunity to analyze fully Kraft's contemplated recapitalization transaction and any other proposed transaction for the sale of Kraft or any of its assets to a third party. . . .

We have a number of questions that bear on the feasibility and value to Kraft's shareholders of the announced recapitalization plan. . . .

We request that Kraft immediately supply to us specific information concerning the details of Kraft's recapitalization plan, all information concerning Kraft which may assist us in evaluating the company, and any information supplied to other third parties with respect to the sale of the company or any parts of the company.

We also request that, consistent with the responsibilities of your Board of Directors to your shareholders, Kraft not enter into, or agree to enter into, any extraordinary transaction, including a recapitalization plan, a sale of assets or securities of Kraft, or a sale of the company, or take any steps to implement any of the foregoing, until Philip Morris is given a full and fair opportunity to develop its response, and that Kraft not take any action which may diminish the value of Kraft. To that end we are today filing a motion in the Federal District Court.

Philip Morris continues to believe that, if our companies work together, a transaction can be negotiated which will achieve maximum value for Kraft's shareholders speedily and without the extraordinary disruptions to Kraft's businesses which Kraft acknowledges would be inherent in the contemplated restructuring plan.

Sincerely,
MURRAY H. BRING
Senior Vice President and General Counsel
Philip Morris Companies Inc.

(continued)

EXHIBIT 8 *(concluded)*

October 25, 1988

Mr. Hamish Maxwell
Chairman and Chief Executive Officer
Philip Morris Companies Inc.
120 Park Avenue
New York, NY 10017

Dear Hamish:

I have previously advised Philip Morris of Kraft's position on your tender offer. The letter your general counsel sent to our general counsel yesterday, and the papers your lawyer filed in court yesterday, indicate that Philip Morris does not understand what Kraft is doing—or more likely, Philip Morris is pretending not to understand in order to increase its pressure tactics. Obviously it is in your interest to try to pressure Kraft and the Kraft shareholders into a transaction that benefits you at their expense. Kraft will not permit this.

Let me again make clear Kraft's position.

Kraft was not "for sale" and is not "for sale." This is no "auction" of Kraft. Philip Morris made a unilateral tender offer for Kraft. The Kraft Board of Directors rejected your tender offer. Your price is too low. Kraft has a recapitalization plan that creates far greater value for the Kraft shareholders than your inadequate offer. Kraft is submitting the recapitalization plan to Kraft shareholders for their consideration. The recapitalization will take place only if our shareholders approve it. Kraft will not pressure its shareholders, nor will Kraft permit you to stampede them. The Kraft Board is not taking action to "entrench" itself. Just the opposite, it is proceeding expeditiously to provide Kraft shareholders with a choice between your inadequate $90 bid and a better than $110 recapitalization.

As frequently happens—witness the RJR Nabisco situation—new bidders appear and old bidders raise their bids. The Kraft Board recognizes that another company or Philip Morris may offer more than $110 per share to acquire Kraft. Accordingly, the Kraft Board said that Kraft would negotiate with that company, or you, and if it, or your company, has a better transaction than the recapitalization plan, Kraft will enter into that transaction.

In other words, if Philip Morris or another company truly wishes to negotiate with Kraft, a simple phone call proposing a price of more than $110 is all that is necessary.

Please give a copy of this letter to your general counsel as our answer to his letter, and ask him to give copies to your other lawyers and financial advisers, and instruct them to stop mischaracterizing our position.

Sincerely,
JOHN M. RICHMAN
Chairman and Chief Executive Officer
Kraft, Inc.

EXHIBIT 9
Mergers and Acquisitions in the Food Processing and Beverage Industries, 1981–1987

	Number and Dollar Value of Mergers in the Food and Beverage Industry	
	Number of Transactions	*Amount Paid ($ billions)*
1981	88	$ 4.55
1982	83	4.96
1983	85	2.71
1984	79	7.95
1985	105	12.86
1986	127	8.43
1987	97	7.75

Mergers in the Food and Beverage Industry over $1 Billion ($ millions)

Bidder	*Target*	*Year*	*Target's Sales*	*Amount Paid*	*Premium Percent*	*Price-Earnings Ratio*	*Multiple to Book*
Philip Morris	General Foods	1985	$9,022.4	$5,627.5	35.2%	18.7	3.5
RJ Reynolds	Nabisco Brands	1985	5,985.0	4,906.4	31.5	16.7	4.1
Nestlé S.A.	Carnation Co.	1984	3,370.0	2,885.4	9.9	14.4	2.7
Beatrice Foods	Esmark Inc.	1984	4,120.0	2,508.6	39.5	15.7	2.5
RJ Reynolds	Heublein, Inc.	1982	2,140.0	1,302.6	36.5	13.1	2.7
Bond Corporate Holdings Ltd.	G. Heileman Brewing Co.	1987	1,173.8	1,083.6	21.6	23.0	3.2

Source: W. T. Grimm and Co., *Mergerstat Review*, 1981–1987.

EXHIBIT 10
Stock Price Indexes and Returns on Equity, 1982–1987

	1982	*1983*	*1984*	*1985*	*1986*	*1987*
Stock price index (1981 = 100)						
Kraft	144.1	148.5	200.6	321.2	397.3	409.3
Philip Morris	128.8	161.2	190.0	218.3	368.7	453.0
RJR Nabisco	114.8	144.8	192.2	220.1	357.4	337.0
Pillsbury	133.0	202.1	256.4	365.4	413.5	440.8
Food index	132.9	161.1	186.9	297.6	387.4	398.8
Tobacco index	117.7	142.4	165.7	179.2	279.7	299.0
S&P 500 index	114.7	134.5	136.4	172.3	197.6	201.5
Return on equity (ROE)						
Kraft	12.6%	14.9%	17.6%	16.2%	23.0%	25.8%
Philip Morris	21.3	22.4	21.7	26.5	26.1	27.0
RJR Nabisco	20.8	17.1	22.3	20.8	20.0	22.8
Pillsbury	16.6	15.0	17.0	17.3	16.8	13.5
Food index	14.3	17.0	17.9	18.0	12.0	12.5
Tobacco index	19.0	18.2	19.4	21.6	20.0	20.3
S&P 500 index	10.9	11.7	13.1	11.0	10.5	11.8

EXHIBIT 11
Pre-Bid Sales and Profit Forecasts for Kraft, 1988–1989 (millions of dollars)

	1987	Est. 1988	Est. 1989
Revenues	$9,876	$11,200	$12,500
Earnings before interest and taxes	834	950	1,050
Interest, net	91	95	108
Income from continuing operations before taxes	743	855	942
Income taxes	353	333	368
Accounting change	45	—	—
Income from continuing operations	435	522	574
Income from discontinued operations[a]	54	658	—
Net income	$ 489	$ 1,180	$ 574

Source: Analysts' estimates.

a. Duracell was sold to Kohlberg, Kravis, Roberts & Co. for $1.8 billion on June 24, 1988. Duracell's 1987 after-tax income was $54 million, and Kraft's 1988 gain on its sale was $658 million.

EXHIBIT 12
Projections for Kraft's Restructuring Plan, 1989–1998 (millions of dollars)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Sales	$ 6,515	$ 6,804	$7,125	$7,481	$7,855	$8,248	$8,660	$9,093	$9,548	$10,025
Earnings before interest and taxes	1,280	1,487	1,671	1,755	1,842	1,935	2,031	2,133	2,239	2,351
Interest	1,380	1,270	1,310	1,286	1,278	1,257	1,212	1,155	1,086	1,010
Taxes	(39)	89	148	192	231	278	336	401	473	550
Profit (loss) after taxes from continuing operations	(61)	128	213	277	333	400	483	577	680	791
Cash flow available for capital payments[a]	2,481[b]	496	636	630	742	334	411	500	597	728
Principal payments										
Preexisting debt	111	33	57	287	100	100	100	100	16	0
Bank debt	2,370	463	579	343	642	234	311	400	581	728
Year-end book values										
Preexisting debt	793	759	703	416	316	216	116	16	0	0
Bank debt	4,430	3,968	3,389	3,046	2,404	2,170	1,859	1,459	878	150
High-yield debt	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Cram-down debt	1,974	2,286	2,648	3,067	3,553	3,553	3,553	3,553	3,553	3,553
Total	$10,197	$10,013	$9,740	$9,529	$9,273	$8,939	$8,528	$8,028	$7,431	$ 6,703

Sources: Kraft and casewriter's estimates.

a. Cash flow available for capital payments = Net income + Depreciation, amortization, deferred taxes – Capital expenditures – Change in working capital + Net proceeds from asset sales.

b. Includes the $2,146 million in cash proceeds from the sale of businesses in 1989.

EXHIBIT 13
Stock Prices and Market Index, October 1988

Date		Philip Morris	Kraft	S&P 500	Event
Oct.	3	$ 97.000	$ 60.000	638.710	Grand Metropolitan bids for Pillsbury Company.
	4	98.000	58.500	637.010	
	5	97.375	59.375	640.020	
	6	96.875	59.375	641.360	
	7	100.875	60.625	654.830	
	10	101.125	60.750	655.320	
	11	100.750	60.375	654.680	
	12	98.875	59.500	645.470	
	13	99.250	59.250	648.480	
	14	98.625	59.500	649.230	
	17	100.000	60.125	651.460	
	18	95.500	88.250	658.560	Philip Morris bids $90 per share for Kraft.
	19	94.000	90.375	652.970	
	20	99.000	90.250	666.990	RJR Nabisco management proposes a $17 billion leveraged buyout.
	21	97.375	92.000	668.920	
	24	97.500	102.000	665.760	Kraft proposes its restructuring plan and Kohlberg, Kravis, Roberts announces its bid for RJR Nabisco.
	25	95.875	99.000	666.090	
	26	95.500	97.500	663.820	
	27	95.000	94.500	654.240	
	28	94.750	96.500	657.280	