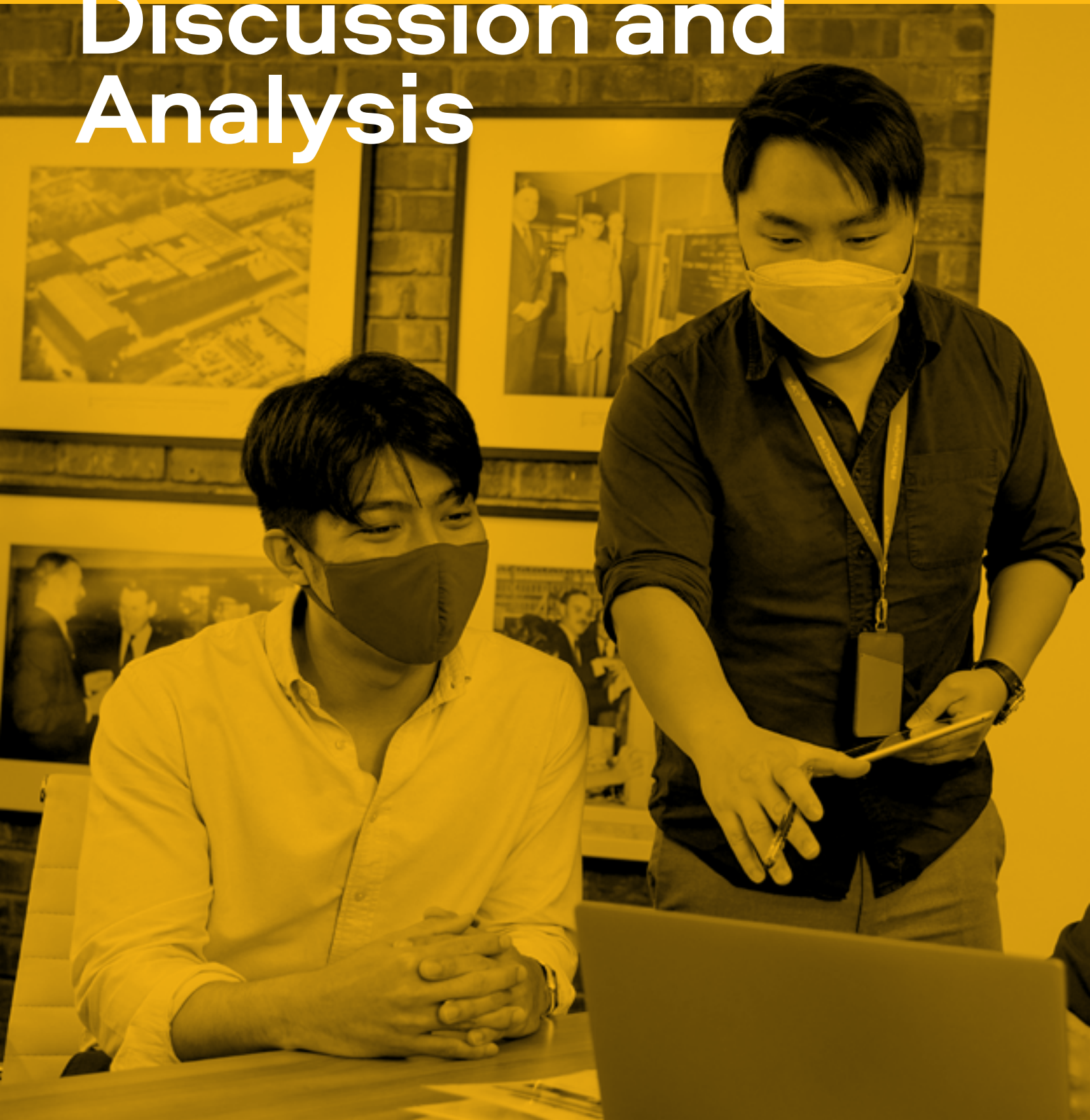


Management Discussion and Analysis



BAT Malaysia will continue growing its revenue through combustibles. This will enable us to allocate sufficient investments to develop New Category products that will fulfil our aim of providing greater choice and less risky products to reduce harm to our consumers.

18	Our Strategic Priorities
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	- Aspirational Premium Segment
	- Value for Money Segment
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	- Optimising Our Supply Chain
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I am pleased to present the Management Discussion and Analysis (MD&A) of BAT Malaysia for the financial year ended 31 December 2021. This MD&A provides insights into BAT Malaysia's business operations, how we navigated challenges, our financial performance for the year under review as well as our expectations going into 2022."

Nedal Salem
Managing Director



Our strategic priorities



Combustible Value Growth



Step-Change in New Categories



A Simpler & Smarter Company



Key Enablers:



Marketplace

The Tobacco Black Market

The Company's efforts to draw attention to the seriousness of Malaysia's tobacco black market through our **"STOP THE BLACK MARKET"** platform continue to yield success. Nielsen's Illicit Cigarettes Study (ICS) in Malaysia 2021 reported that the incidence of illegal cigarettes decreased by 6.1ppt, from 63.8% in 2020 to 57.7% in 2021.



However, criminal syndicates have changed their modus operandi to circumvent the measures introduced in Budget 2021 by shifting their operations and moving to small private jetties and unofficial landing spots along Malaysia's coast. The Marine Police seized more than RM220 million worth of smuggled items from January to June 2021, compared to RM55.75 million over the same period last year. More than 70% of the items seized were illegal cigarettes and liquor, followed by drugs.

Numerous initiatives were undertaken to amplify the cigarette black market crisis. One example was a digital campaign titled **A Smuggler's Story**. This interactive story, housed on the **STOP THE BLACK MARKET** website, sheds light on how smugglers evolve and change their operations to mitigate new enforcement actions.

BAT Malaysia expects the tobacco black market to remain at crisis point in the coming years. Therefore, the Company was pleased when the government made the decision to maintain the excise moratorium during Budget 2022. As the tobacco black market crisis is mainly attributed to affordability pressures, the Company is of the opinion that any further increase in prices will drive more consumers to cheaper illegal alternatives.

BAT Malaysia believes that more can be done to stop the black market. Therefore, it is vital to remain steadfast in enforcing the measures outlined by the government, accompanied by enhanced enforcement and an effective fiscal measure that addresses the affordability issue.

Illegal Vapour Products

As noted previously, BAT Malaysia was encouraged by the government's intention to legalise nicotine vapour products. However, given that over one million Malaysians are currently using these products illegally, any new revenue, regulatory and enforcement regimes must be science-backed, considered and specific. If not, BAT Malaysia fears that the mistakes of the black market cigarette crisis will be repeated. BAT Malaysia has placed itself at the government's disposal to discuss this matter.

Regulatory Developments

As we operate in a highly regulated industry, the Company places great importance on robust processes and strict governance to ensure that we are fully compliant with all existing legislation governing our products and business.

In terms of regulations, the Company has always been clear that they should be based on robust evidence and thorough research, deliver on the intended policy aims and, at the same time, allow businesses to operate and be competitive in the marketplace.

In view of the current operating landscape of the Malaysian tobacco industry, in which the tobacco black market dominates more than half of the total marketplace, BAT Malaysia strongly believes that the government must introduce regulations that will not further exacerbate the tobacco black market.



A Smuggler's Story

A story of deceit, terror and billions lost.

Contents

- The ICS Cigarette Study
- A Closer Look At The Black Market
- The Amazing True Story
- How They Operate
- Stop Smuggling

[Download
"Stop The Black Market"](#)

[Read the story](#)



Scan Here

for the full version of
A Smuggler's Story

Performance Portfolio

COMBUSTIBLE VALUE GROWTH

We will deliver long term sustainable growth by deploying our winning Global brands to meet the evolving needs of the adult nicotine consumers.

In 2021, our combustible business continued to deliver a strong share growth. This was achieved via a strategic and well-positioned portfolio across all key consumer segments. Our brands recorded share growth across all segments, and thus reinforcing our leadership position in Malaysia.

Our focus is to continue share growth momentum in combustibles in order to drive revenue growth. This revenue growth will ensure we are able to re-invest in the development of New Category products in order to satisfy ever-evolving consumer needs by offering a greater choice of enjoyable and less risky products.

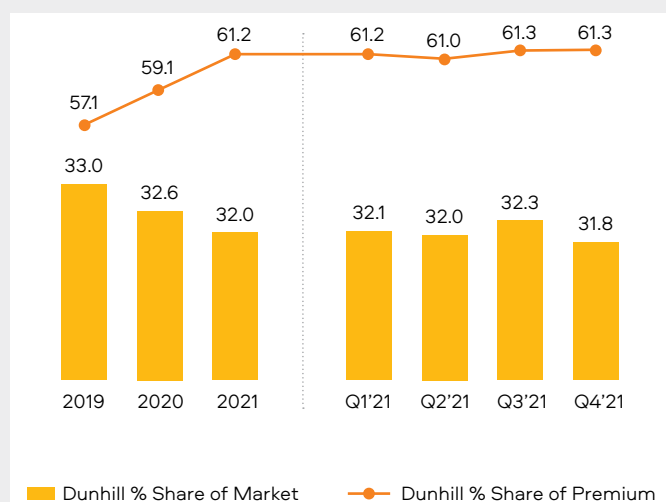
Strengthening Premium Segment Leadership

Dunhill continues to strengthen its position as the leading Premium brand in Malaysia, delivering a growth of 2.1ppt in the Premium segment. This was accomplished by reinforcing Dunhill's position as the benchmark brand for taste, quality, modernity and innovation.

DUNHILL



DUNHILL SHARE PERFORMANCE



Performance Portfolio

Resilience in Aspirational Premium Segment

Our brands in the Aspirational Premium segment grew 0.6ppt share of segment in 2021.

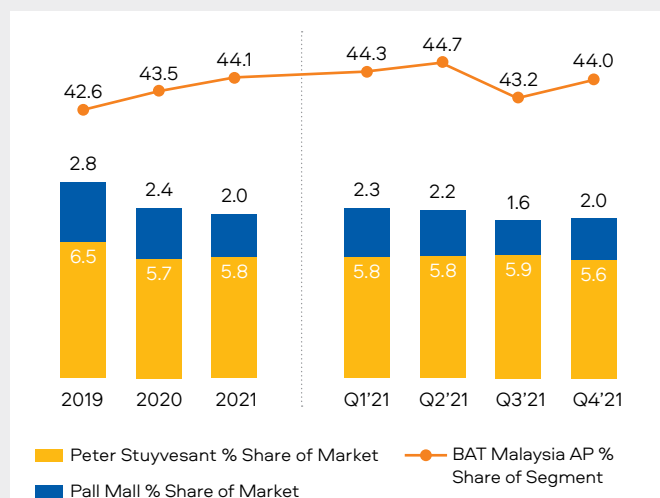
*Peter
Stuyvesant*



PALL MALL



PETER STUYVESANT AND PALL MALL SHARE PERFORMANCE

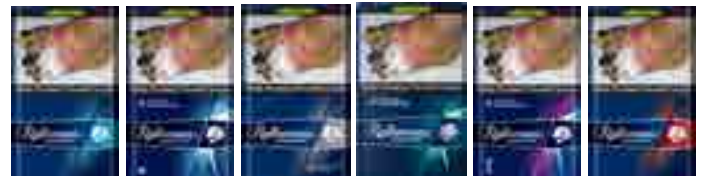


Continuous Growth in Value-For-Money Segment

Our Value-For-Money (VFM) portfolio continued to be a key growth driver for the company in 2021, with a total of 1.4ppt growth in share of market compared to the previous year.

This was achieved through the focus on two key brands in our VFM portfolio.

Rothmans



Rothmans was re-staged to a new progressive expression of the brand to drive growth.

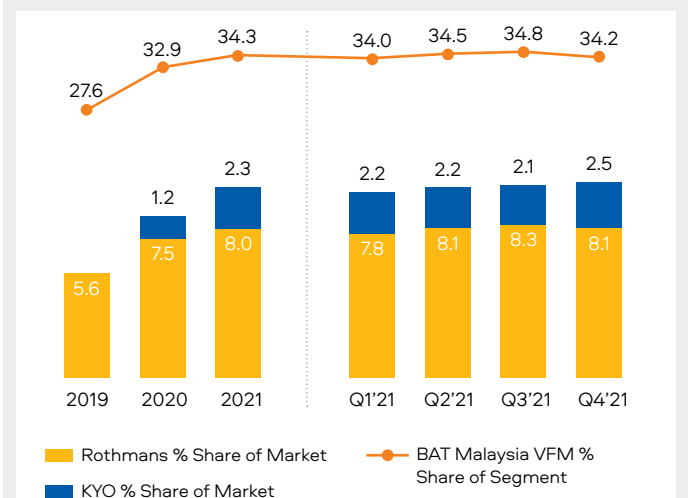
Since its debut in 2020, KYO has established itself as the fastest growing brand in the moderation space. In 2021, the brand continued to build its presence with the range expansion in the Fresh & Stimulation and Full Flavour segments.

The brand debuted in 2020 with two Stock Keeping Units (SKUs), KYO Original and KYO Silver which feature a charcoal filter. There was an addition of two SKUs in 2021, KYO Switch (Mint Capsule) and KYO Red (Full Flavour).

KYO



ROTHMANS AND KYO SHARE PERFORMANCE



Shape and Lead New Categories

Reduced-Risk Products*

Our corporate purpose is to build A Better Tomorrow™ by reducing the health impact of our business through offering a great choice of enjoyable and potentially reduced-risk products* to our consumers. We will evolve our growth model through the development of our portfolio in new categories meeting our consumers' evolving need for enjoyment and satisfaction.

While combustible tobacco will be at the core of our business for some time to come, we aim to generate an increasingly greater proportion of our revenues from products other than cigarettes, thereby reducing the health impact of our business. We intend to build on our strong foundations in tobacco, to build a better tomorrow for consumers, employees, shareholders, and society.

Our ambition is to deliver long-term sustainable growth with a range of innovative and potentially reduced-risk products* that stimulate the senses of new adult generations. We believe that by providing a range of high quality, innovative products, many millions of smokers will make the choice to switch.

We welcome the announcement in Budget 2022 on the Government's intention of legalising nicotine vaping with the introduction of excise on vaping products. A robust regulatory framework with clear quality controls is needed for the entire vape industry, including nicotine e-liquids. This would ensure that Malaysian consumers have access to products of known quality and facilitate government access to significant revenue. We will continue to support and encourage clear and practical regulations in relation to nicotine vaping by the Malaysian Government.

* Based on the weight of evidence and assuming a complete switch from cigarette smoking. These products are not risk-free and are addictive.



Simpler and Smarter Organisation

To remain competitive in a changing environment we have utilised new technologies and innovative ways of working to drive our ongoing transformation.

EMBRACING DIGITAL TRANSFORMATION

In 2021, BAT Malaysia continued on its digital transformation journey to include solutions to collaborate with law enforcement authorities and to adapt to changes in the sales and distribution environment.

Anti-Illicit Trade Automation

In the year under review, we, working together with law enforcement, leveraged on automation and artificial intelligence to combat the scourge of the tobacco black market which enabled the authorities to obtain in-depth intelligence about the black market instantly.

This further enhances our efforts to support law enforcement and to reduce the supply of illicit cigarettes in the market from 63.8% in 2020 to 57.7% in 2021.

Enhancing our Distribution Model

The market environment remains dynamic with an evolving retail environment on a backdrop of sustained levels of the tobacco black market, acceleration of digital capabilities amongst retailers as a result of COVID-19 and a diversifying consumer preference. With that, BAT Malaysia has designed a new route-to-market (RTM) model to capitalise on the opportunities.

The new model includes a tailored approach in both taking and receiving orders via multiple channels, traditional face to face, tele sales, online and supported by our third-party logistics providers.

This newly designed RTM model leverages on digital technology platforms to further drive efficiencies and real time insights, builds capabilities to be in readiness to deliver a multi-category business and drives a fit-for-purpose sales and distribution model to best serve of our customers. The deployment of the model was done during the times of pandemic demonstrating BAT Malaysia's commitment towards driving long-term value and a testament of the resilience of the business.

Simplifying Further

BAT turned to digitalisation to further improve operational efficiency and optimise spending, all part and parcel of becoming a Simpler, Smarter Organisation. As part of this overarching goal, in 2021, we simplified our procurement procedures for lower value quotations below the RM100,000 threshold. We also implemented digital signatures to simplify and expedite our processes, which had the additional benefit of reducing costs and easier tracking for audit purposes. The use of digital signatures was an especially important initiative to ensure business continuity considering that many of our employees were working from home during the pandemic. In addition, we also introduced a new tool to analyse our spending which leverages on machine learning and artificial intelligence to produce accurate reports that helps in performing spend analysis and strategy.

OPTIMISING OUR SUPPLY CHAIN

Reducing Cost

2021 saw supply-chain related savings of RM5.4 million. The savings were indirect in nature and achieved by identifying new ways of working and process improvements. Some notable achievements included:

- Consolidating the Dunhill call centre with the new customer service call centre.
- Consolidating merchandising production from six vendors to one.
- Transitioning away from purchasing of vehicles to fleet leasing.

Accelerating Innovation

In understanding that the innovation process is a collaborative one, BAT Malaysia invited our suppliers to present their ideas, products and services that would help support our marketing initiatives. Held in August 2021, the inaugural Virtual Supplier Innovation Day saw three suppliers showcasing their ideas. We found it to be a constructive exercise as we discovered that our suppliers were aligned with our own ambitions, and we believe the innovation process can be accelerated through these kinds of collaborations.

Successfully Navigating the Movement Restrictions

In 2021, our Supply Chain team played a critical role in ensuring business continuity during the pandemic. The lockdowns led to the closure of our factory in Johor Bahru for a period of three months and this threatened to disrupt our ability to supply the market. To mitigate this, we obtained supply from our Singapore facility.

The sales team also leveraged on technology and a differentiated trade programme to minimise operational complexities in the marketplace due to the lockdowns.

Finance Director's Review

REVENUE

Total revenue for BAT Malaysia increased by 14% (RM322 million) when compared to 2020. The increase was driven by a higher volume of 10%. Our volume grew for the first time since 2002, as a result of a reduction in the tobacco black market incidence by 6.1ppt compared to 2020, as well as a one-off benefit from our new route-to-market implementation. Duty-free sales continued to be impacted due to regional and international travel restrictions.

Consistent with the volume growth trajectory, the Group's total market share was 52.4%, registering an increase of 0.8ppt when compared to 2020.

COST OF SALES

The Group's cost of sales increased by 14% (RM244 million) when compared to 2020, primarily attributed to higher sales volume as a result of the reduction in the tobacco black market. The Group continued to drive cost optimisation initiatives across its value chain to deliver a competitive product cost and to ensure that we were not impacted by any disruptions caused by the pandemic.

OPERATING EXPENSES

In 2021, the Group's operating expenses were higher by 5% (RM12 million) as the Group invested in various strategic initiatives to support our journey to A Better Tomorrow™. We established a future-fit, technology-driven route-to-market model that will support a multi-category business and deliver cost savings. We continued to invest in our strategic brands to deliver our traditional combustibles growth. Additionally, we made initial investments in preparation for the legalisation of nicotine vapour products as per the announcement in the Malaysian National Budget 2022.

Furthermore, during the year, the Group continued to invest in the "STOP THE BLACK MARKET" campaign, which highlights the severity of the tobacco black market and its impact on Malaysia.

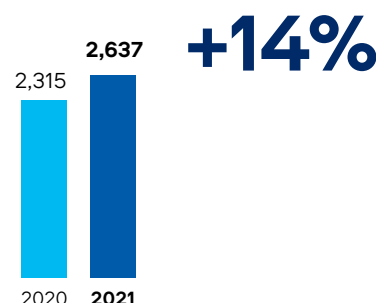
RESTRUCTURING EXPENSES

The Group incurred RM9.3 million in 2021 to restructure its business operations to become smarter and simpler. This restructuring exercise resulted in a reduction of the workforce and the creation of a new, more sustainable cost base.

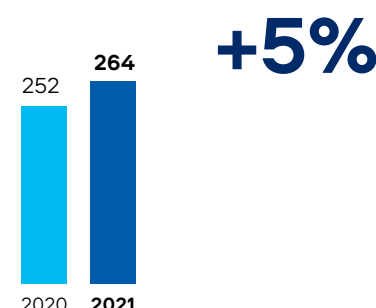
PROFIT FROM OPERATIONS

Profit from operations registered an increase of 19% (RM65 million) when compared to 2020. This growth, the first since 2015, was mainly led by higher sales volume as a result of the reduction in the tobacco black market and was partially offset by higher strategic investments.

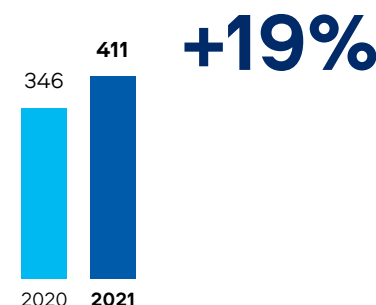
GROSS REVENUE (RM million)



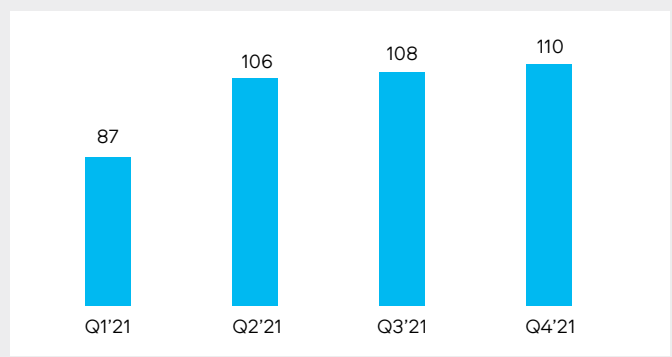
OPERATING EXPENSES (RM million)



PROFIT FROM OPERATIONS (RM million)



Finance Director's Review

PROFIT FROM OPERATIONS
(RM million)**TAXATION**

The average effective tax rate of the Group for the financial year ended 31 December 2021 was 27.7%. The marginal increase in the average effective tax rate compared to the actual tax rate of 24% was mainly due to non-deductible items and under-provision of current tax in prior years.

DIVIDENDS

Despite the challenging environment, the Group remained committed to paying dividends at a level above 90% of its earnings. In 2021, the Group declared four quarterly interim dividends amounting to 98 sen per share, an increase of 18% as compared

to 2020. This was equivalent to a 98% total earnings payout for the year and a dividend yield of 7%, based on the average share price in 2021.

DEBT STRUCTURE

As at 31 December 2021, the Group had a total debt facility of RM850 million, maintained with several licensed financial institutions in Malaysia. The Group continued to utilise revolving credits and bank overdrafts to support its short-term working capital requirements. This flexible debt structure allowed the Group to borrow at optimum levels, thereby minimising financing costs and improving interest deductibility.

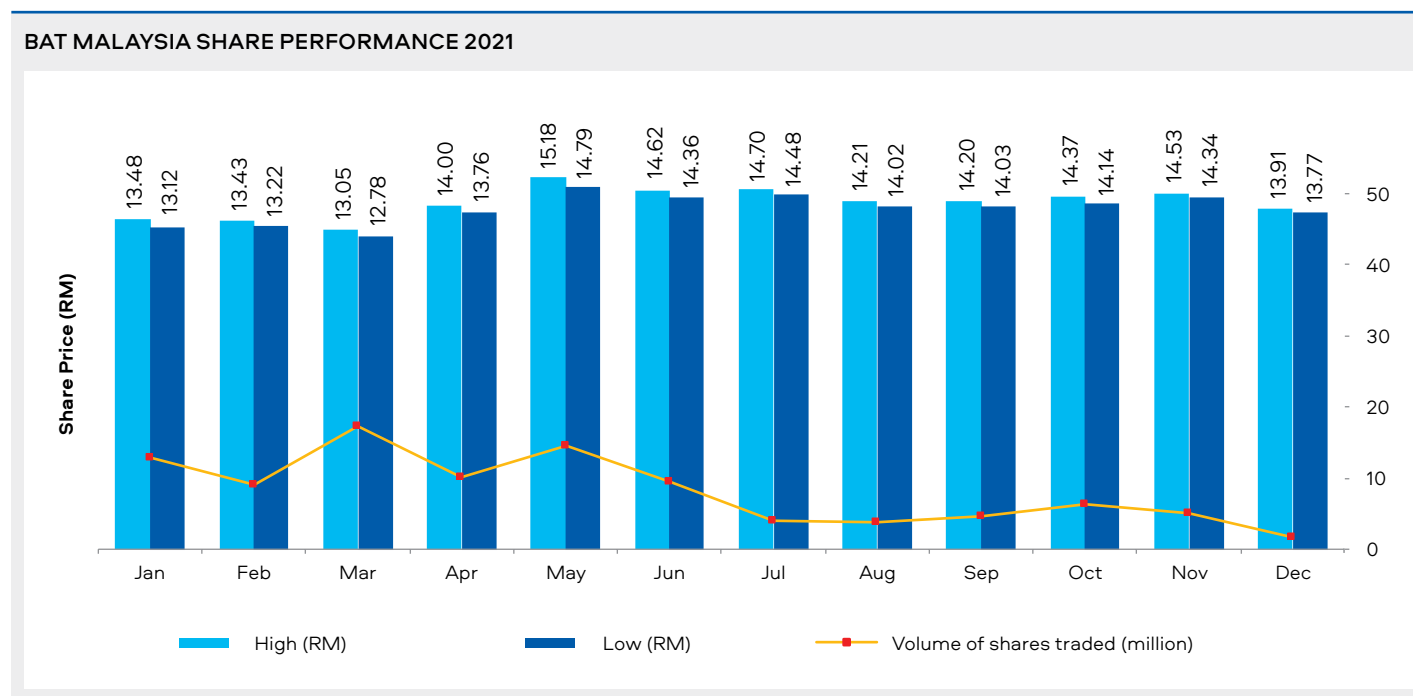
At the end of 2021, the Group had RM775 million of revolving credit with a tenure of one month, compared to RM510 million in 2020, to support higher working capital requirements due to higher sales, higher inventories and prepaid excise duties, ensuring that we were well insulated against any potential supply chain disruptions impacting the business during the unprecedented times of the COVID-19 pandemic.

WORKING CAPITAL AND LIQUIDITY

In 2021, cash from operations recorded a decline of 46% (RM122 million) as compared to 2020. The decrease in cash inflow was mainly due to increase in sales and prepayment of excise duties in view of the pandemic situation to ensure business continuity.

	2020 RM million	2021 RM million
Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA)	359	423
Profit from Operations	346	411
Cash from Operations	264	141
Cash Conversion	73%	34%
Increase/(decrease) in cash and cash equivalents	9	(7)

Finance Director's Review



SHAREHOLDERS' RETURN

The share price of BAT Malaysia was mainly impacted by external factors such as the tobacco black market. The share price saw a stabilisation in 2021 after consecutive years of decline reflecting the improved performance of the company.

Market capitalisation for the Group closed at RM4.0 billion in 2021. The annual dividend yield that the Group generated was estimated at 7%.

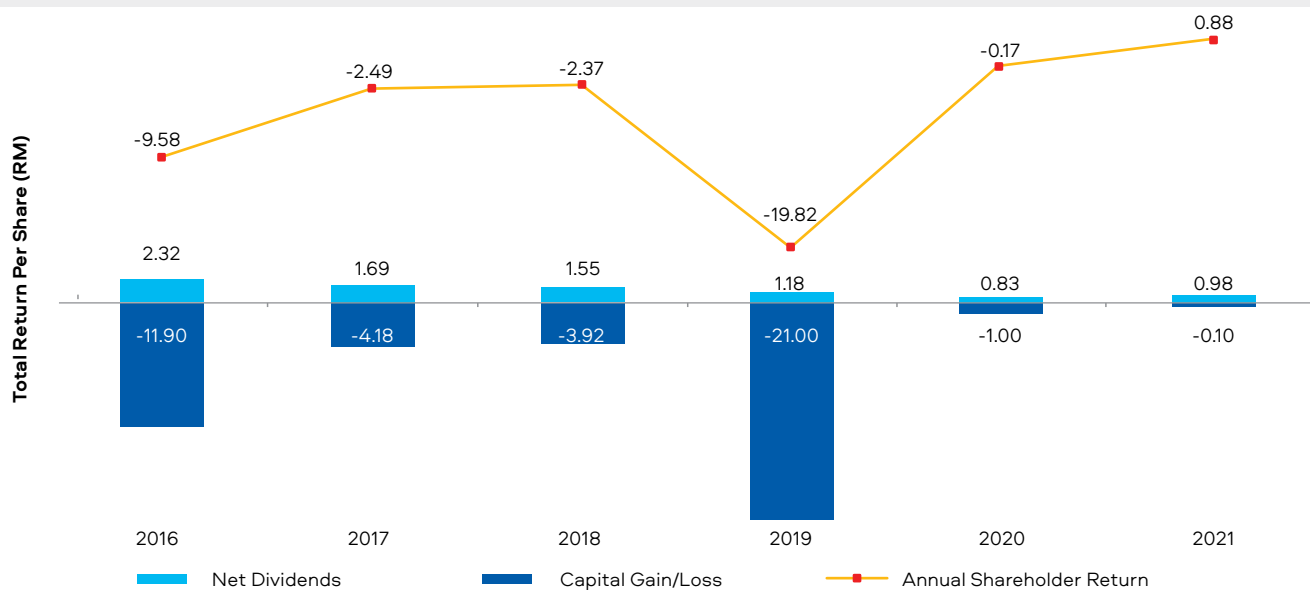
The Group continues to ensure that shareholders' return is maximised via sound strategies, with a focus on continuously building and strengthening a robust brand portfolio, increasing the Group's market share of the legal market and driving further cost efficiencies for delivering growth. Apart from the business, the Group focused on the environmental, social and corporate governance agenda for a sustainable future.

TREASURY

The Group's foreign currency exposure mainly arises from the purchase of finished goods. As part of the Group's treasury policy, foreign currency exposure is minimised by hedging the net exposure for the next 18 months, in line with the hedging period allowed under the Foreign Exchange Control guidelines enforced by Bank Negara Malaysia. The permitted range for the hedge ratio within the 18 months of the transaction date is 50% to 95%. The primary objective of the hedging strategy is to protect shareholder value by minimising the impact of foreign exchange rate fluctuations. This is achieved by layering the hedges monthly within the allowable boundaries set by Bank Negara Malaysia.

Finance Director's Review

SHARE PERFORMANCE 2021



OUTLOOK

2022 will see a continued focus on the Group's purpose of building A Better Tomorrow™, with a particular emphasis on tobacco harm reduction.

In this regard, the Group has been encouraged by the government's announcement in October 2021 that nicotine vapour products will be legalised. The Group calls on the government to pursue a science-based approach to lessen the impact of smoking and to establish a specific regulatory framework for nicotine vapour products. A failure to do so could drive the over one million Malaysians currently vaping to the black market.

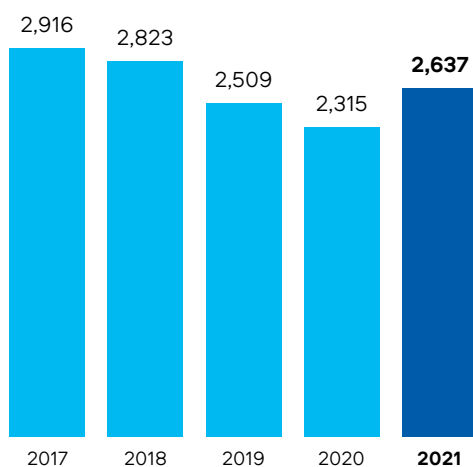
As much as the Group will be focusing on tobacco harm reduction, traditional cigarettes will be at the core of our business for some time. The tobacco black market issue remains at a crisis point, with smugglers now turning to small coastal jetties. The Group urges the government to take the necessary enforcement actions to shut down these channels to further address illegal supplies.

To effectively reduce the tobacco black market, supply restrictions must be complemented with measures that address the affordability pressures that consumers in Malaysia currently face. As such, the Group is hopeful that there will be no tobacco excise increase in Budget 2023. Any increase would further widen the price gap between legal and illegal cigarettes and drive more consumers to the tobacco black market.

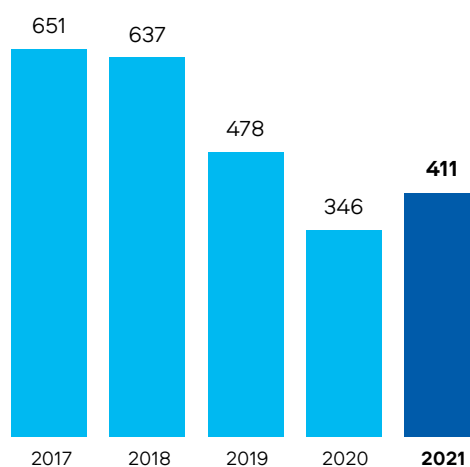
Finance Director's Review

FIVE-YEAR PERFORMANCE HISTORY

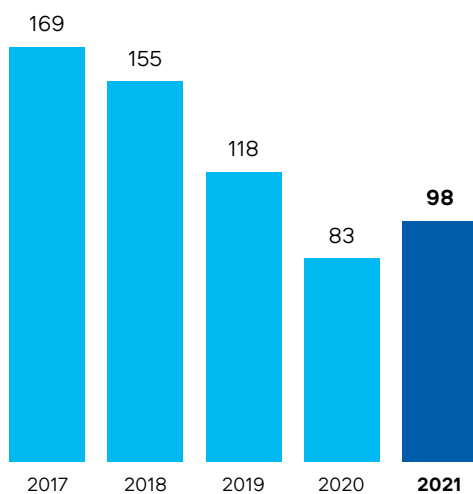
REVENUE (RM MILLION)



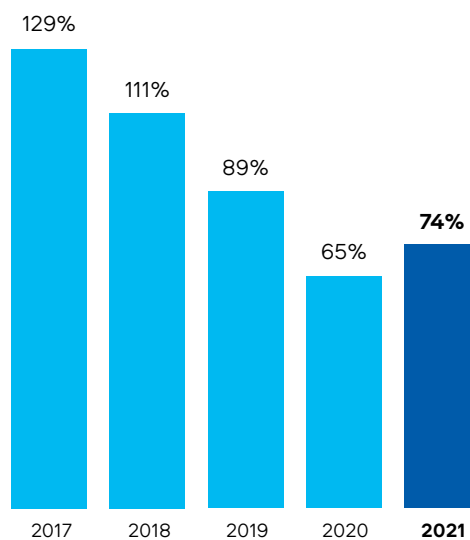
PROFIT FROM OPERATIONS (RM MILLION)



NET TOTAL DIVIDEND PER SHARE (SEN)



RETURN ON EQUITY



Finance Director's Review

FIVE-YEAR PERFORMANCE HIGHLIGHTS

2017

The Group completed the closure of its factory operations in June 2017 and changed its sourcing from local manufacturing to full importation. The Group entered into the VFM segment of the legal market through the launch of Rothmans in October 2017. Tobacco black market levels continued to trend upwards to 59 percent.

2018

It was a stabilising year for BAT Malaysia after consecutive years of double-digit decline. Malaysia saw the historic changeover in government in May 2018, resulting in visible policy changes. The government announced the abolishment of GST and reintroduced SST on 1st September 2018 to address affordability concerns. Following the SST implementation, a price increase of 40 sen per pack of cigarettes took place as the tobacco industry is regulated to pass on tax to consumer price.

2019

The tobacco landscape evolved significantly with the emergence and challenge of illegal vaping and continuous high levels of the tobacco black market. A year after the change of government, the Group did not see any significant action taken to address illegal tobacco as well as affordability issues. As a result, legal tobacco industry was greatly impacted, with the Group registering a 25 percent decline in its operating profit. The Group undertook aggressive cost rationalisation and restructuring measures to achieve a sustainable cost base and profitability level for the future. However, an urgent structural reform was needed in order to secure a sustainable tobacco framework for the industry and legal tobacco companies.

2020

This was an unprecedented year marked by the COVID-19 global pandemic. The tobacco black market and illegal vaping incidence continued to be high at 70 percent of the total nicotine market. Despite these external challenges, the Group had been resilient and showed strong signs of recovery quarter on quarter. Dunhill, our flagship brand, gained share of segment, increasing by 2.2 percentage points. During the year, the Group extended its portfolio with the launch of KYO in the VFM segment to capture a fair share of down traders. KYO's performance was encouraging with 2.8 percent share of the market, achieved within two months of launch. With this new addition to the Group's portfolio, the corporate share of the market increased by 1.1 percentage points versus 2019 to 51.7 percent. It was encouraging to see the government's efforts in setting regulations and enforcement in curbing illegal cigarettes via the Budget 2021 announcement.

2021

This was the second consecutive year of the COVID-19 global pandemic. Despite this, BAT Malaysia produced stellar results, registering volume growth for the first time since 2002 and profit growth for the first time since 2015. Dunhill, our flagship brand, gained market share of 2.1 percentage points, while our KYO brand in the VFM segment has continued to see encouraging response. In the year, we expanded its range with the launch of KYO Switch and KYO Full Flavour. As a whole, the KYO brand has established itself as the fastest-growing modern consideration offer. Altogether, the Group's total market share has grown to 52.4 percent, an increase of 0.8 percentage points from 2020. It is also encouraging to note that the incidence of illicit cigarettes has decreased to 57.7 percent from 63.8 percent in 2020. Lastly, we welcome the Budget 2022 announcement that the Malaysian government intends to legalise the sale of nicotine vapour products, which will help accelerate our own aspirations to reduce the health impact of our business.