Management Discussion & 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 reduced-risk products to our consumers.

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

Drive Value from Combustibles

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

In 2022, our combustible business experienced an overall decline in market share by 0.8 percent following a strategic exercise to delist Pall Mall and Kent brands in the second quarter of this year as part of the portfolio simplification. However, the Group's Value-for-Money (VFM) brands – KYO & Rothmans, captured additional market share and Dunhill continued to cement its strong foothold by securing growth in the premium segment.

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

Strengthening Premium Segment Leadership

Dunhill continues to strengthen its position as the leading premium brand in Malaysia, delivering growth of 1.1 ppt in the premium segment. This was accomplished by reinforcing Dunhill's position as the benchmark brand for taste, quality, modernity and innovation.

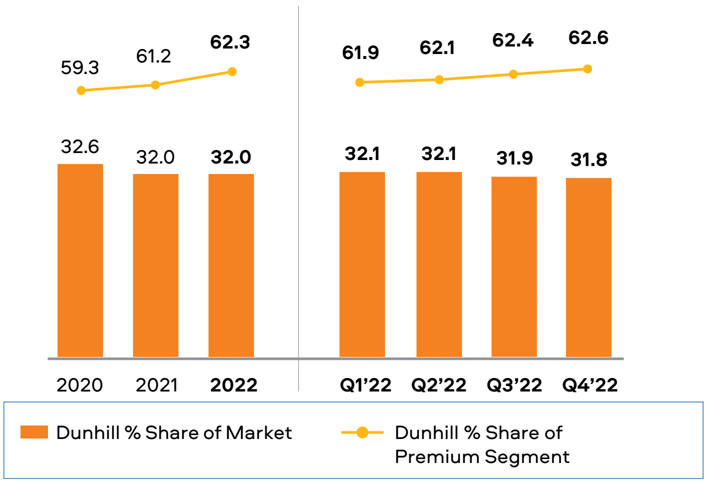
DUNHILL

Resilience in Aspirational Premium Segment

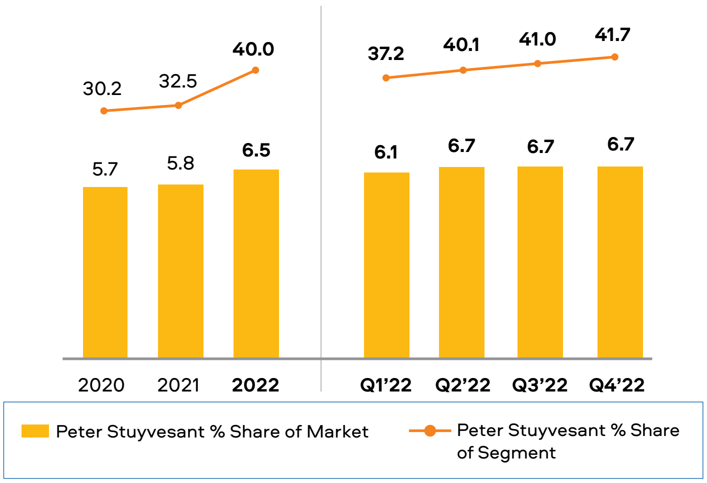
Our Peter Stuyvesant brand grew its share of segment by 7.5 ppt in 2022.

Peter Stuyvesant

DUNHILL SHARE PERFORMANCE



PETER STUYVESANT SHARE PERFORMANCE



Drive Value from Combustibles

Continuous Growth in Value-For-Money Segment

Our VFM portfolio continued to be a key growth driver for the Company in 2022, with a total of 1.0 ppt 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 was restaged to a new progressive expression of the brand to drive growth.

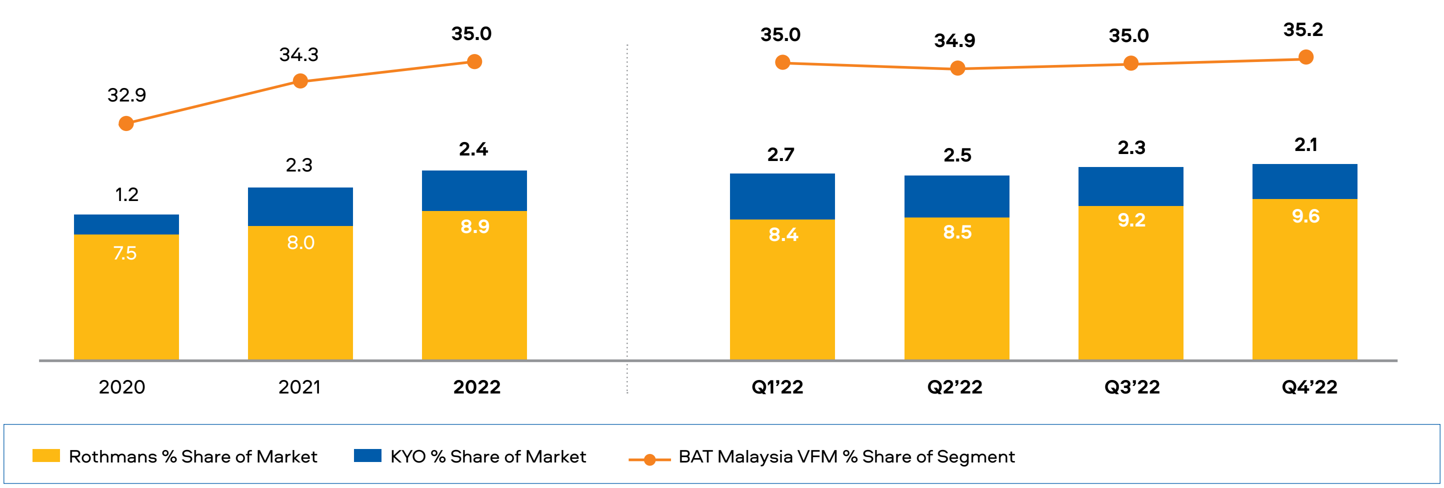
Since its debut in 2020, KYO has established itself as the fastest-growing brand in the moderation space and expanded its range in the Fresh & Stimulation and Full Flavour segments in 2021. The brand debuted in 2020 with two Stock Keeping Units (SKUs), KYO Original and KYO Silver, which feature a charcoal filter. There was an addition of two SKUs in 2021, KYO Switch (Mint Capsule) and KYO Red (Full Flavour).

In 2022, the brand continued to build its credentials in the market through brand building activities.

Rothmans

KYO

ROTHMANS AND KYO SHARE PERFORMANCE



Ensure a Step Change in New Categories Performance

Reduced-Risk Products*

Our corporate purpose is to build A Better Tomorrow™ by reducing the health impact of our business by offering a greater choice of 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. Our ambition is to deliver long-term sustainable growth with a range of innovative and 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.

BAT Malaysia continued its transformation to a multicategory consumer goods business with the Malaysian launch of our flagship global Tobacco Heating Product (THP) brand, glo™. Our THP product features Advanced Heat Technology™, reducing toxicant emissions by 90%** and therefore giving adult consumers a choice to enjoy reduced-risk products.* With the new Hyper X2 model, users can also control the intensity and duration of their session with a dedicated Boost Button. glo™ uses viio™ tobacco sticks developed exclusively for glo™ by specialist tobacco blenders and flavourists that come in four different flavours, to provide consumers with the real taste of tobacco by heating not burning.

Find out more at www.discoverglo.com

Through glo™ and viio™, we intend to grow our non-combustible portfolio and then other new categories with respect to the regulatory environment. One such product that we plan to introduce in the future is Vuse, which is also backed by science-based regulations. Vuse is the first global carbon neutral vape which is designed with sustainability in mind and is a result of our focus on innovation. This will ensure that Malaysian consumers have access to more reduced-risk products.

We are encouraged by the Government's commitment to regulate the vape industry in Malaysia. We strongly urge the Government to adopt policies that are evidence-based and data-driven, to ensure that Malaysian vape users have access to reduced-risk products that are compliant with quality and safety standards. BAT Malaysia will strongly support any sensible, pragmatic regulations on vaping, in tandem with our purpose to build A Better Tomorrow™.

* Based on the weight of evidence and assuming a complete switch from cigarette smoking.

** Comparison of smoke from a scientific standard reference cigarette (approximately 9 mg tar) and emissions from glo™, in terms of the average of the nine harmful components the World Health Organisation recommends to reduce in cigarette smoke.

Disclaimer:
This product is not risk-free and contains nicotine, an addictive substance.

Simpler and Smarter Organisation

EMBRACING DIGITAL TRANSFORMATION

At BAT Malaysia, we recognise that change is an important driving element for us to achieve A Better Tomorrow™. Over the years, we have harnessed the power of digital transformation to improve our front-end business and provide better customer service as we understand that this transition is crucial in supporting us to keep up with the market's demands in digitalisation.

In 2022, we rolled out a new digital and online ordering platform that allows our retailers to order products, obtain product information and monitor their performance at any time, regardless of the hour, directly and seamlessly. The system is enhanced with the option of automated ordering/subscription whereby the platform allows for repeat fixed orders to be placed at regular intervals without any intervention/action required from retailers.

This helps our retailers to minimise instances of failure to order due to unforeseen circumstances, therefore ensuring product availability at all times. In addition, a new contact centre is established to support all of our retailers' requirements via calls and is also capable of taking orders, tracking deliveries and providing payment information. In 2023, we will be introducing this to an expanded number of our retail partners.

Our digital automation systems and analytics has enhanced our service level and enabled us to achieve effective partnerships through digital engagement as our partners can now enjoy greater flexibility. This is aligned with our global strategy of having a leaner, faster organisation.

OPTIMISING OUR SUPPLY CHAIN

Reducing Cost

In 2022, we optimised working capital level and operational cost through various initiatives.

- Transition from a prepaid to a postpaid excise model resulting in working capital reduction of RM106 million;
- Effective use of hedging to manage the Ringgit's fluctuation;
- Employed innovative negotiation techniques for the rental of new state offices;
- We changed to fleet leasing in 2022 and achieved reductions in capital expenditure; and
- Rigorous maintenance of equipment resulted in an increase in efficiency and reduction of waste by 3% compared to 2021.

Advancing Innovation

On 30 May 2022, BAT Malaysia held an ESG-focused Innovation Day, which was conducted physically and virtually. Among the highlights of the event were talks by four guest speakers on sustainable energy, sustainable Point of Sales Materials (POSM) and Recycling of End-of-Life POSM. There were also seven ESG-related booths to promote ESG and embed an ESG mindset among employees.

Finance Director's Review

REVENUE

Total revenue for BAT Malaysia declined slightly by 1.5% to RM2.60 billion compared to RM2.64 billion in 2021. The decrease was mainly due to a volume decrease of 2.0% when compared to 2021 as a result of the one-off benefit in volume observed during the route-to-market model transition that took place in 2021. Gross profit margin improved by 0.5% from 25.6% (RM675 million) in 2021 to 26.1% (RM678 million in 2022).

The Group's total market share was 0.8% lower in 2022, mainly attributed to the planned delisting of the Kent and Pall Mall brands during the year. In line with the downtrading trend observed in the market, our VFM brands – KYO and Rothmans – captured an additional 1.0% market share.

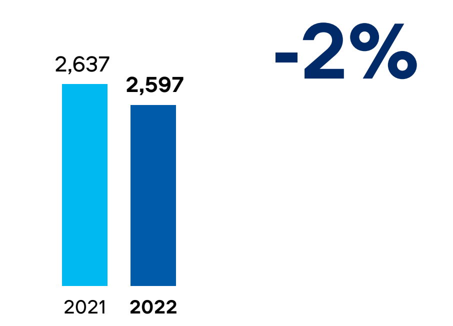
COST OF SALES

The Group's cost of sales decreased by 2.2% (RM44 million) in line with the lower sales due to the aforementioned one-off benefit from the implementation of the route-to-market model in 2021. The Group continued to drive cost optimisation initiatives across its value chain to deliver a competitive product cost, leveraging its robust supply chain model.

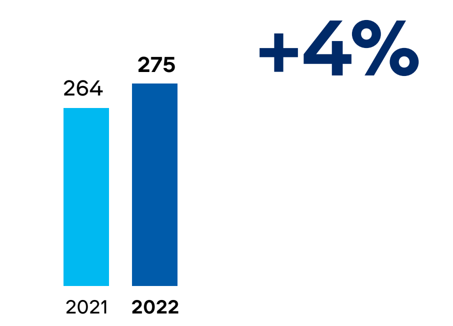
OPERATING EXPENSES

In 2022, the Group's operating expenses increased by 4.1% (RM11 million) to RM275 million, mainly driven by restructuring expenses. Marketing expenses increased marginally following efforts taken in preparation for the launch of the new tobacco heating product, glo™, in early 2023. The overall increase in cost was offset by the Group's sustained strategy to optimise spending despite operating under increased inflationary pressures.

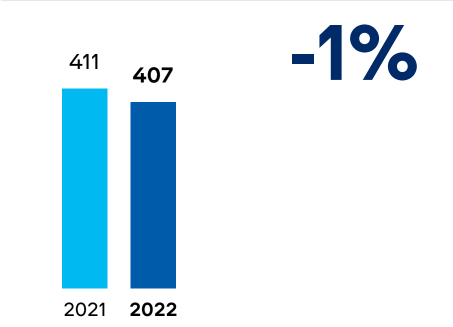
GROSS REVENUE
(RM million)



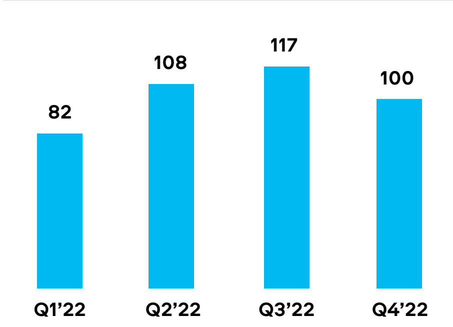
OPERATING EXPENSES
(RM million)



PROFIT FROM OPERATIONS
(RM million)



PROFIT FROM OPERATIONS
(RM million)



RESTRUCTURING EXPENSES

The Group incurred RM18 million in 2022 in line with the next phase of our strategy to deliver a fit-for-growth organisation. The restructuring exercise led to a simplified organisational structure that will enable greater collaboration and effective decision-making as we enter a post-pandemic competitive market.

PROFIT FROM OPERATIONS

Profit from operations trended upwards in the first three quarters of 2022 with a decline in the final quarter due to the timing of marketing spend as we geared towards the launch of the tobacco heating product glo™ Hyper X2 in the first quarter of 2023. Despite the high-inflation environment, profit from operations registered a year-on-year slight decrease of 1.0% to RM407 million owing to continuous cost optimisation initiatives.

TAXATION

The average effective tax rate of the Group for the financial year ended 31 December 2022 was 32%. The increase in the average effective tax rate compared to the actual tax rate of 24% was mainly due to the Prosperity Tax that was imposed by the government in 2022.

DIVIDENDS

Despite the challenging environment, the Group remained committed to paying dividends at a level above 90% of its earnings. In 2022, the Group declared four quarterly interim dividends amounting to 88 sen per share, equivalent to a 96% total earnings payout for the year and a dividend yield of 8% based on the average share price in 2022.

DEBT STRUCTURE, WORKING CAPITAL AND LIQUIDITY

As at 31 December 2022, 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 2022, the Group had RM695 million of revolving credit with a tenure of one month, compared to RM775 million in 2021. In 2022, cash from operations recorded an increase of 242% (RM342 million) as compared to 2021. The increase in cash from operations was largely attributed to improvements in working capital arising from the change in the excise duties payment model. Previously, excise duties were required to be paid when tax stamps were purchased. In 2022, as a result of intensive industry engagement, excise duties were paid only upon stock arrival at the Malaysian port, hence facilitating a lower requirement of upfront cash.

	2021 RM million	2022 RM million
Profit from Operations	411	**407**
Cash from Operations	141	**483**
Cash Conversion	34%	**119%**
Increase/(decrease) in cash and cash equivalents	(7)	**(5)**

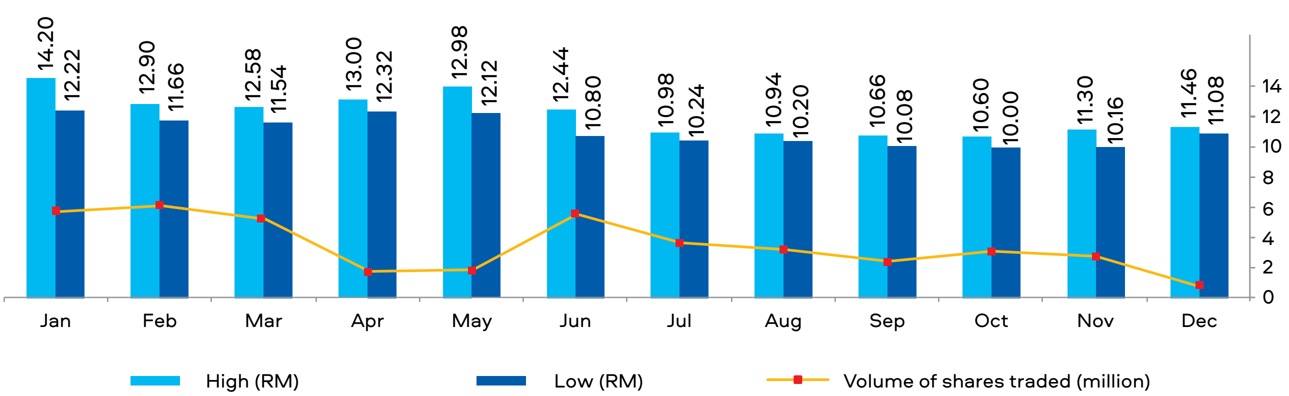
TREASURY

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 0% 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.

SHAREHOLDERS' RETURN

The share price of BAT Malaysia was mainly impacted by external factors such as the tobacco black market and the uncertainties surrounding the tobacco regulatory landscape. The share price was relatively stable in the first quarter of 2022 and subsequently saw a downward slide in the second and third quarters following intensified dialogues and press releases regarding the potential tightening of tobacco regulations. After the General Election was held in November 2022, the share price reflected an upward trend. Market capitalisation for the Group closed at RM3.2 billion in 2022. The annual dividend yield that the Group generated was estimated at 8%. The Group continues to ensure that shareholders' return is maximised through our A Better Tomorrow™ strategy and growing into a multicategory business.

BAT MALAYSIA SHARE PERFORMANCE 2022



Finance Director's Review

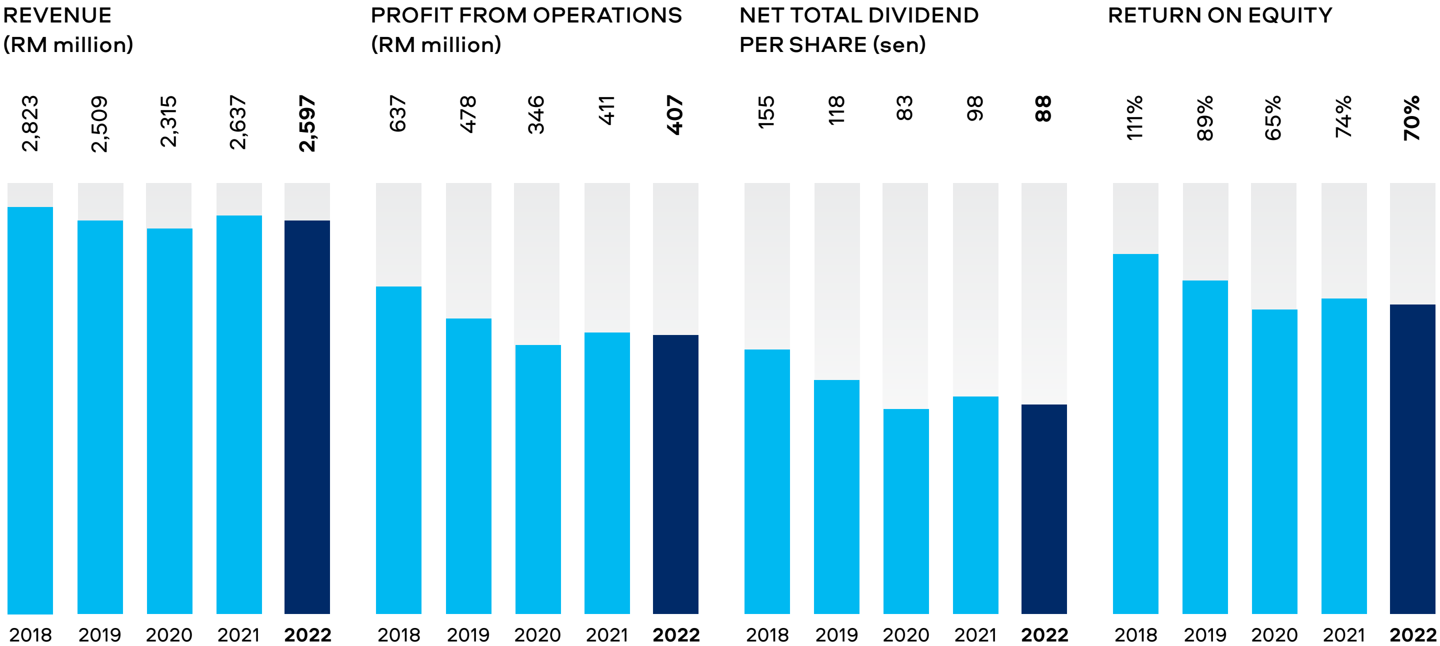
Share Performance	2016	2017	2018	2019	2020	2021	2022
Net Dividends	2.32	1.69	1.55	1.18	0.83	0.98	0.88
Capital Gain/Loss	(11.90)	(4.18)	(3.92)	(21.00)	(1.00)	(0.10)	(2.76)
Annual Shareholders' Return	(9.58)	(2.49)	(2.37)	(19.82)	(0.17)	0.88	(1.88)

OUTLOOK

The Group will continue to focus on driving its ambition of A Better Tomorrow™ in 2023. As we move into an economic environment that will see more moderate growth as a result of inflationary pressures and tighter monetary policy, we are cognisant that consumer spending power will be affected. Similarly, the Group will also be impacted by higher inflation and as such, we will continue to be diligent in optimising operational costs.

The Group remains focused on tobacco harm reduction and will continue to introduce innovative products, offering a choice of reduced-risk alternatives to adult smokers. In this context, the Group welcomes the government's announcement during the retabling of Budget 2023 in February 2023 that it would regulate the vapour market. We will continue to urge the government to establish a balanced science- and evidence-based regulatory framework for vapour products. We also welcome other initiatives outlined under Budget 2023 signalling the government's commitment to combating the black market.

FIVE-YEAR PERFORMANCE HISTORY



FIVE-YEAR PERFORMANCE HIGHLIGHTS

2018

It was a stabilising year for BAT Malaysia after consecutive years of double-digit decline. Malaysia saw a historic changeover in government in May 2018, resulting in visible policy changes. The government announced the abolishment of GST and reintroduced SST on 1 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 prices.

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, the legal tobacco industry was greatly impacted, with the Group registering a 25% 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, 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 incidences continued to be high at 70% of the total nicotine market. Despite these external challenges, the Group was resilient and showed strong signs of recovery quarter-on-quarter. Dunhill, our flagship brand, gained share of segment, increasing by 2.2% 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 a 2.8% 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%. 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 continued to see encouraging response. During the year, we expanded its range with the launch of KYO Switch and KYO Full Flavour. As a whole, the KYO brand established itself as the fastest-growing modern consideration offer. Altogether, the Group's total market share grew to 52.4%, an increase of 0.8 percentage points from 2020. It was also encouraging to note that the incidences of illicit cigarettes decreased to 57.7% from 63.8% in 2020. Lastly, we welcomed the Budget 2022 announcement that the Malaysian government intended to legalise the sale of nicotine vapour products, which would help push forward our own aspirations to reduce the health impact of our business.

2022

2022 saw Malaysia easing out of the COVID-19 global pandemic as the economy showed signs of gradual recovery. Businesses continued to find their footing in the post-pandemic high-inflationary environment while adjusting to the shifts in consumption patterns. In tandem with the market's downtrading trend, the Group's VFM brands – KYO and Rothmans – captured an additional 1% market share. Although the legal tobacco industry's premium segment declined by 1% during the year, Dunhill continued to cement its strong foothold in the premium segment as the brand secured growth of 1.1% share of segment. The Group's market share contracted by 0.8% when compared to last year following a strategic exercise to delist the Pall Mall and Kent brands in the second quarter of this year as part of the portfolio simplification. This allowed the Group to intensify its focus on business portfolio expansion of reduced-risk* products with the launch of glo™ in the first quarter of 2023. We are also encouraged by the decline of the illicit cigarettes trade from 57.7% in 2021 to 56.6% in the current year. The Group is in full support of the Malaysian government's stance to reduce the levels of the tobacco black market and urges the government to consider science- and evidence-based regulations to legalise the vapour market.

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