

MD AND CHIEF EXECUTIVE OFFICER'S STATEMENT



MICHAEL KOEST

MD and Chief Executive Officer



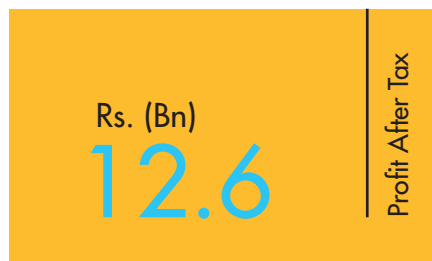
Read the MD and Chief Executive Officer's statement online.

Scan the QR Code with your smart device to view this message online.

“We remain steadfast in our commitment towards contributing to the development of the country’s economy - through taxes, value injection to the local economy and the development of highly skilled, future-ready business leaders.”

We faced a year of unprecedented challenges in 2016, which tested the soundness of our strategy, the strength of our business model and the resilience of our people. Our strategy served us well against these tough conditions and we successfully delivered consistent value to our stakeholders with revenue and profit increasing by a respective 14.1% and 18.1% in 2016. The Company generated Rs. 12.6 billion for our shareholders which translated to earnings per share of Rs. 67.05.

We remain steadfast in our commitment towards contributing to the development of the country’s economy - through taxes, value injection to the local economy and the development of highly skilled, future-ready business leaders. CTC is the country’s single largest individual tax contributor, injecting Rs. 87.4 billion in excise taxes to State coffers during the year in review and our total contribution in 2016 amounted to 7% of the State’s total tax revenue. However, due to an excessive ad-hoc excise hike in October and the introduction of VAT in November, the Government lost Rs. 13.2 billion during the last quarter. We hope this will encourage the Government to consider the impact of such excessive measures in the future.



CTC is the country’s single largest individual tax contributor, injecting Rs. 87.4 billion in excise taxes to State coffers during the year in review.

We continue in our commitment to create prosperous livelihoods for over 178,000 supply chain partners including in excess of 20,000 persons involved in tobacco cultivation, through whom we infused a record high Rs. 11.2 billion to the local economy in 2016. The Company offers a holistic value proposition to tobacco leaf farmers which comprise skills development, propagation of sustainable agricultural practices, development of infrastructure and strengthening community networks. CTC’s compelling employee value proposition is characterised by substantial investments in talent development, a goal-oriented, performance driven culture. The opportunities for cross border exposure has enabled us to nurture highly-skilled global professionals for decades. These individuals have emerged as leaders not only within CTC but also within other BAT Group companies, contributing towards the growth of our international business across the world.

Our long-term aspiration is to achieve sustainable growth in our business while delivering growth in government revenue and injecting value to the local economy. However, irrational policy decisions and unlawful enforcement of tobacco regulations in recent times will jeopardise our ability to create value and reinforce the need to take some tough decisions for

MD AND CHIEF EXECUTIVE OFFICER'S STATEMENT

“The beedi industry is under regulated and therefore severely under-priced. The exponential growth over the past decade or so has resulted in beedi contributing 44% of total smoking, compared to just 20% in 2007.”

our business by finding sustainable ways of operating in such a hostile environment. Unfortunately, this means that the entire value injection into the Sri Lankan economy is at risk. In 2016, we and our valued business partners pursued legal action and obtained stay orders against unlawful enforcement of regulations affecting our industry and ensured the continuity of operations with minimal disruptions. That said, if the relevant authorities continue to pursue such unfair enforcements, it will have a substantial impact on the Company's ability to generate value.

The lack of a level playing field continues to insert pressure on CTC as rapid and frequent increases in excise duties applicable on our products have increased price disparities and tipped the scales in favour of cheaper alternatives such as beedi. The beedi industry is under regulated and therefore severely under-priced. The exponential growth over the past decade or so has resulted in beedi contributing 44% of total smoking, compared to just 20% in 2007. As the affordability of legal cigarettes continues to diminish, we anticipate higher consumer down trading and estimate beedi to

amount to at least half the tobacco market - a trend that will cost the Government billions in lost tax revenue. More importantly, beedi are not manufactured under a controlled environment and given the lack of quality standards the likelihood of inferior, hazardous products entering the market is high. This is in stark contrast to our products which adhere to world class quality standards and are supported by the global research capabilities of our parent company. Proposals to increase regulation and levies on beedi are welcome and will serve to create a level playing field in the tobacco industry, which we believe is the right way forward.

Illicit cigarettes are increasingly challenging government revenue with the sudden influx seen following the excise led price increase during the 4th quarter of 2016. This is evident by the upsurge in the number of smuggled cigarettes detected during this period and with the disparity in prices of legal and illegal cigarettes, we foresee the illicit tobacco segment growing to 8% of the total tobacco market in 2017, posing an enormous threat to government revenue and the legal cigarette industry. We will continue to support law enforcement

agencies to curtail illegal trafficking of cigarettes through raising awareness and sharing resources.

Implications of climate change and unreasonable cultivation restrictions are also making it extremely challenging to maintain our value injection to the rural economy. As a policy, CTC sources the entirety of its tobacco leaf requirement from local farmers; however unreasonable restrictions on cultivation and the unlawful enforcement of regulations through pressurizing farmers to abandon tobacco cultivation have diminished the tobacco farmers' only income.

Emerging external challenges have compelled us to revisit our strategy and engage in decisive management interventions to ensure the viability of our business. Portfolio growth was a key pillar of our strategy and we focused on building a more relevant and innovative product portfolio catering to the evolving needs of our consumers. For us, growth is not about encouraging more people to smoke but understanding and meeting the changing preferences of adult consumers with high quality, innovative products. JPGL continues to be the primary brand in the Sri Lankan market. During the year, however, we pursued expansion of BAT's Strategic Brand DUNHILL, with the introduction of the 'Tube Filter' and 'Fine-cut' products, resulting in DUNHILL volumes growing by 43%. In demonstrating its commitment towards harm reduction, BAT is also developing a portfolio of Next Generation Products which address consumer demand for potentially less risky alternatives to regular cigarettes. Over the longer-term we are keen to launch some of these innovative products in Sri Lanka, thereby offering more choice to adult consumers while supporting our harm reduction efforts.

“Ad-hoc and unreasonable regulations however, could have unwelcome and unintended consequences, which could threaten the viability of our industry.”

We have always been clear that we support regulation that is evidence based, balanced, inclusive and delivers on intended public health policy goals. Ad-hoc and unreasonable regulations however, could have unwelcome and unintended consequences, which could threaten the viability of our industry. As one of the world's largest cigarette manufacturers, our parent Company BAT has extensive experience and expertise in this industry, meaning we have much to offer the Government and regulators in helping develop policies around tobacco. We are keen to contribute to the debate and engage openly on regulation to offer our perspectives, information and ideas to help

regulators address the key issues such as eliminating youth smoking – just to name one. We would equally welcome a debate around a more coherent framework for excise calculation to ensure a sustainable increase in the tobacco related revenue to the Government.

The increasingly challenging operating environment and persistent excise-led increases in the price of our products have compelled us to focus on continuously improving the efficiency of our supply chain to safeguard our margins. Ongoing emphasis on streamlining processes and improving productivity have enabled CTC to achieve operational excellence and in 2016 we ranked 2nd among BAT's global companies for manufacturing effectiveness and efficiency. Meanwhile, global uniformity in governance practices, policy frameworks and risk management standards across BAT markets ensure that we maintain the highest level of transparency and integrity in our operations.

We have strengthened our relationships with our distributors and retailers and enhanced their product knowledge and improved business standards. We have continued to add sustainable value to our trade partners through ongoing, systematic initiatives aimed at developing their core competencies, enhancing business knowledge and building capacity. The Company also works closely with retailers to prevent under-age smoking. This includes raising awareness of minimum age laws and providing training to shop staff to enforce age verification procedures.

As an employer of choice, people development has always been vital to our strategy and we continue to invest in nurturing an engaged, motivated and empowered team. An increasingly difficult external environment has forced

us to look inwards and develop an agile and lean team, which can effectively respond to market challenges. During the year we focused on developing skills and fortitude to remain resilient in this operating environment. We have encouraged enhanced collaboration across the organisation to effectively master our challenges. With several changes in the Executive Committee and the Extended Leadership Team, we have created a stronger, more agile and fit to fight organisation. I am happy to report that we have significantly rejuvenated the organisation as well as retained 100% of our high potential population, attesting to the attractiveness of CTC's employee value proposition. We are a high performing team, consistently delivering on the Company's strategic direction and I am certain that the skills, attitudes and diversity of our talents will set us up to take on the challenges our industry will continue to face in 2017.

I would like to extend my appreciation to the Chairman, the Board and the Executive Committee for their continued guidance and support during my first year as the MD and CEO of CTC. I am extremely fortunate to lead such a talented and motivated team and I would like to thank them for their commitment which ensured that we continued to deliver value in such tough circumstances. I look forward to working with you all in the coming year.



MICHAEL KOEST
MD and Chief Executive Officer

24 February 2017