Chairman’s report - 2020 Annual General Meeting, 26 March 2020

WELCOME.

This 2020-edition of Scandinavian Tobacco Group’s Annual General Meeting is turning out different than any of us could have anticipated only a few weeks ago. Following the global outbreak of the Corona virus and the requirements and recommendations from the Danish authorities to prevent the virus from spreading we are today having a rather unusual Annual General Meeting.

We have taken a number precautionary measures to ensure the safety of all and have actively encourage our shareholders not to attend. I hope for your understanding and that many of our shareholders are watching the Annual General Meeting from home as we present the Board's report for 2019. A year where we saw strong results and good progress on our strategy.

Today, Scandinavian Tobacco Group is one of the global leaders in the cigar and pipe tobacco industry and our vision is to become the undisputed global leader. In 2019, we took significant steps towards achieving this vision as we saw accelerated roll-out of modernisation initiatives across our Group, reported good progress on all aspects of our strategy and announced the biggest acquisition in recent history of our Group: namely that of Agio Cigars.

LET ME START BY REVIEWING THE FINANCIAL HIGHLIGHTS FOR THE PAST YEAR. For the full year 2019, Scandinavian Tobacco Group delivered net sales of DKK 6,870 million and EBITDA before special items of DKK 1,513 million. This is a negative 2.6% organic growth in net sales and a 7.1% organic growth in EBITDA and this is in line with the financial guidance for the year. Net profit was DKK 748 million, while free cash flow before acquisitions was at a record high DKK 1,187 million.

The Board of Directors proposes a dividend of DKK 6.10 per share, which is an increase of 1.7% compared to 2018 and an increase in the ordinary dividend for the fourth consecutive year. The DKK 6.10 per share means a total distribution of dividend of DKK 610 million for 2019. In addition, we will in 2020 initiate a share buy-back programme with a total value of up to DKK 300 million. The timing of when we initiate this may be affected by the uncertainties following the global outbreak of the Corona virus. Both are testament to the strength of the underlying business and of our ability to generate strong cash flow in Scandinavian Tobacco Group.

NOW, LET'S TURN TO OUR PERFORMANCE IN OUR FOUR DIVISIONS

One of many changes in 2019 in Scandinavian Tobacco Group was our reporting structure. We have aligned it with the new divisional structure of the Group and for the first time on 27 February 2020 we announced full-year results in the four divisions: North America Online & Retail, North America Branded, Region Machine-Made Cigars and Region Smoking Tobacco & Accessories.

LET'S BEGIN with our North America Online and Retail Division. The division is anchored in Cigars International and includes direct-to-consumer sales of all product categories sold via our own online catalogue and retail channel in North America. It is the largest of our four divisions measured in volume and accounts for 35% of the total Group net sales.

The largest product category in the division is handmade cigars with 84% of net sales. The total market for handmade cigars in the US is estimated to be declining by 1% per year.

2019 net sales in the division were DKK 2,398 million (compared to DKK 2,111 million in 2018) with an organic growth of 0.5% (compared to 6.3% in 2018) and a gross margin before special items of 37.7% (compared to 37.5% in 2018).

During 2019, the North America Online & Retail Division completed the integration of Thompson Cigar; an acquisition that was closed in 2018. Thompson Cigars was the third-largest online retailer of cigars in the US and has proved to be a great addition to our existing online business. Also, the division continued its retail expansion and announced plans for two new Cigars International Super-Stores in Florida which are expected to open in 2020.

OUR North America Branded Division includes sales of all product categories to wholesalers and distributors that broadly supply retail in North America. The division is anchored in General Cigar, which develops and produces branded cigars sold through retailers.

The largest product category in the North America Branded division is handmade cigars with 42% of sales. The handmade cigar volume development in the division is primarily driven by the sell-in to the online distribution channel and the brick-and-mortar trade. Machine-made cigars accounts for 27% and smoking tobacco accounts for 19% of net sales in the division.

Net sales of the division in 2019 were DKK 1,219 million (compared to DKK 1,247 million in 2018) with an organic growth of -6.3% (compared to -1.2% in 2018) and a gross margin before special items of 56.6% (compared to 57.1% in 2018). The product category handmade cigars delivered a 5.6% negative organic growth as a result of a substantial negative volume impact due to weather conditions and lower online volumes.

THE REGION Machine-Made Cigars, holds the overall Group responsibility for product development, sales and marketing activities of machine-made cigars outside North America with the top 5 European markets being France, Belgium, the UK, Spain and the Netherlands.

The division accounts for 24% of the total Group net sales, and machine-made cigars account for 79% of the Division's net sales.

In 2019, machine-made cigars in our top 5 European markets displayed a 3% volume decline, while the Group's combined market share in these markets was stable compared to the year before.

In the UK, Belgium, Spain and Canada, we increased our market share during the year. Following a turnaround based on 1) the launch of our new product "Gold" in the growing value-for-money segment, 2) a general portfolio simplification and 3) effective pricing strategies, machine-made cigars in France delivered positive organic growth in net sales.

Net sales for the division were DKK 1,653 million (compared to DKK 1,682 million in 2018). with an organic growth of -2.0% (compared to -6.4% in 2018) and a gross margin before special items of 52.0% (compared to 49.5% in 2018).

Region Smoking Tobacco & Accessories includes sales of all product categories to wholesalers and distributors that supply retail, and the division holds the overall Group responsibility for product development, sales and marketing activities of smoking tobacco – that is pipe tobacco and fine-cut tobacco – as well as accessories outside North America. The main markets are Australia, Germany, Denmark and Norway.

The three product categories; smoking tobacco, machine-made cigars and accessories & contract manufacturing are about equally sized accounting for 38%, 31% and 29% of the division net sales. In 2019, net sales were DKK 1,601 million (compared to DKK 1,677 million in 2018) with an organic growth of -4.4% (compared to 1.9% in 2018) and a gross margin before special items of 53.8% (compared to 52.6% in 2018).

During the year, we acquired certain well-known pipe tobacco trademarks and designs from Dunhill Tobacco Company of London. The acquisition has strengthened Scandinavian Tobacco Group's product range in the premium pipe tobacco segment in important pipe tobacco markets such as the US, Germany and across Asia.

FOR YOU AS A SHAREHOLDER, IT IS OBVIOUSLY IMPORTANT that the company is working to create value for its owners. Our model for doing so is quite simple and can be briefly explained: 1) Moderate to stable growth in net sales, 2) increasing earnings and 3) strong cash flows. We also wish to successfully contribute to industry consolidation by making value-adding acquisitions as we have done continuously since 2008.

In 2019, we did exactly that again when we announced the largest acquisition in recent history of our Group, namely that of Agio Cigars. We hereby took an important step towards our vision of becoming the undisputed global leader in cigars and pipe tobacco.

Agio Cigars is a leading European cigar company based in Duizel, the Netherlands with approximately 3,200 full-time employees with operations in several countries, and its products are sold in about 90 countries.

With Agio Cigar's strong cigar portfolio and important market positions in key European machine-made cigar markets, this acquisition significantly strengthens our position in several key machine-made cigar markets in Europe and enables us to deliver an even more attractive range of cigars of the highest standards to our consumers.

The acquisition – which had a transaction value of EUR 210 million – was completed on 2 January 2020, and we are currently in the process of developing the plans for integrating Agio Cigars into Scandinavian Tobacco Group.

IN 2019, WE ALSO MADE SIGNIFICANT PROGRESS on Fuelling the Growth. Fuelling the Growth was launched in 2018 and is a groupwide transformational program, which is making Scandinavian Tobacco Group a stronger and more competitive company better equipped to achieve our vision of becoming the undisputed global leader in cigars and pipe tobacco.

Since the launch of the program in 2018, we have worked hard to modernise and change our Group from a complex and decentralized entity towards a more simple, agile and effective global organisation. During 2019, we saw accelerated implementation and good progress on several initiatives in the five overall workstreams of the program. This resulted in improved operational performance, increased cost efficiency and faster than expected net savings.

Focusing on commercial initiatives, cost reduction and cash flow improvement, Fuelling the Growth is integral to all aspects of the business. With a new organisation and operating model improving competitiveness and with a persistent focus on efficiency and costs, the program is a key component in the execution of our strategy.

The operational efforts in Fuelling the Growth are organised under five overall initiatives: organisation, commercial resources, global logistics, global procurement and operational cost efficiency. Let me briefly take you through some of the initiatives within each of the five work streams.

On the **organisational** front we have implemented a new organisational structure and a more efficient operating model enabling us to improve the execution of our strategic agenda.

Substantial strives were made on the **commercial** agenda. We succeeded with a turnaround in the important machine-made cigar market in France and conducted an in-depth business analysis of the Group's North America online business, with the purpose of raising the competitiveness of this important division.

We took further steps to simplify our **global logistics network** as we analysed the logistics set-up in the EU and North America.

Our global **Procurement** organisation continues to increase spend transparency across the organisation, and during the year the Procurement department completed a review of the majority of Group spending and reduced the number of suppliers.

In efforts to **increase operational cost efficiency,** we took steps to further optimise our production footprint and accelerated our lean efforts to include all our production facilities.

As mentioned, Fuelling the Growth is embedded in all aspects of our business. With a new operating model ensuring improved competitiveness and a persistent focus on efficiency, costs and cash, the program is a key component in the execution of our strategy and in the future value creation for Scandinavian Tobacco Group.

WHILE FUELLING THE GROWTH HAS CHANGED THE WAY WE ARE ORGANISED AND THE WAY WE WORK, our strategy and strategic objectives remain the same – and in 2019, we saw significant progress in all areas of our strategy.

Our strategy is built on a framework with four business priorities and six must win battles. The four business priorities outline the strategic focus for decisions; and the six must win battles represent our key priorities and dictate the prioritisation of time and resources.

Our four business priorities are:

- To **outperform** the market and win market shares.
- To **globalise** our business further.
- To **simplify** by improving efficiency and doing more with less.
- And all this should be driven by competent and engaged people **empowered** to achieve extraordinary results.

Our six must win battles are:

- **Win in machine-made cigars**
- **Accelerate North America**
- **Drive Mergers & Acquisitions**
- **Lead performance to the next level**
- **Enable a winning organisation**
- **Raise IT capabilities**

Let me walk you through the progress we have seen in 2019 within each of our six must win battles.

I'll start with **Win in machine-made cigars** where we aim to increase market shares and to optimise and manage prices effectively. As already mentioned, a turnaround in the important French market was initiated with a brand launch in the growing value-for-money segment as a key driver. Also, the top machine-made cigar brands, Café Crème and Captain Black, made a re-entry into the Turkish market, and general portfolio simplification across markets continued.

In order to allow us to **accelerate growth and improve efficiency across our business in North America**, we continued Cigars International's retail expansion and disclosed plans for two new cigar Super-Stores in Florida. Also, the integration of Thompson Cigar was successfully completed, while a business analysis of the full online sales platforms was initiated.

During the year, we also **executed on our Mergers & Acquisition strategy to strengthen our market position**. With the acquisition of Agio Cigars, we announced the biggest acquisition in recent history of the Group, while the acquisition of pipe tobacco trademarks and designs from Dunhill Tobacco Company of London reinforced the Group's position in the premium pipe tobacco category.

To **take our performance to the next level**, we have launched several initiatives to develop leaner, faster and more agile operations. In 2019, Lean implementation – which is a management theory focusing on eliminating inefficiencies and continuous improvement - resulted in productivity improvements across all production facilities of the Group.

Over several years, we have invested in stronger HR capabilities to **enable a winning organisation,** and during the year a new organisational structure and operating model was implemented across the global organisation. Also, a new global IT system supporting standardisation and global harmonisation of HR processes was rolled out.

Finally, we have made solid progress on our IT agenda. In order to **raise IT capabilities** and bring IT to the next level to fully support the business, the project of transforming and harmonising ERP platforms was initiated. So we have taken the first steps in a Group-wide data management process aiming to standardise all Group data and increase data transparency.

THIS BRINGS ME TO THE ITEM OF THE COMPOSITION OF THE BOARD OF DIRECTORS and management remuneration.

All members of the Board of Directors elected by the general meeting are elected for one year at a time. As a consequence, a number of Board Members are up for re-election and the Board of Directors proposes re-election of all of them, namely

Nigel Northridge (Chairman), Henrik Brandt (Vice-chairman), Dianne Neal Blixt, Luc Missorten, Anders Obel, Marlene Forsell and Claus Gregersen.

During the second half of the year, the Board of Directors carried out an evaluation of the performance of the Board of Directors and its collaboration with the Executive Management. The evaluation process was carried out as a combination of a survey and interviews and with the assistance of an external consultant. The overall result of the evaluation was that the Board is well-functioning, but areas for potential improvements of the Board's work were also identified. Thus, going forward the Board will give additional attention to succession and IT- and cyber issues, and materials used in connection with Board meetings will be simplified and shortened to focus the Board's discussions at the meetings.

Naturally, we have also discussed management remuneration in the past year. The Board's objective is to align management's remuneration with our goals for value creation of the company. For that purpose, the total remuneration package consists of a fixed base salary and both short-term and long-term incentive programmes. For the year 2019, the total cost of remuneration for the Executive Management amounted to DKK 46.9 million compared to DKK 62.1 million in 2018. The main reason for the decrease is a severance pay made in 2018 to senior management that left the company.

Again in 2019, we have published a Remuneration report to increase transparency on remuneration for Executive Management and Board of Directors. The Remuneration report can be found on our corporate website. The remuneration of the Executive Management is consistent with the company's Remuneration Policy and the Board considers it appropriate.

On the agenda for today we also have the Board's proposed new Remuneration Policy which sets the framework for the remuneration of the company's Executive Management and Board of Directors. The updated policy is meant to replace the current policy from 2016. It has been prepared in order to ensure that we have a policy in accordance with the most recent changes to the Danish Companies Act, and it also takes into consideration the most recent Recommendations on Corporate Governance issued by the Danish Committee on Corporate Governance.

The proposed policy sets the framework for the contractual terms and compensation of the Executive Management and the Board of Directors and how these are reviewed and managed. The policy has been drafted with the purpose to ensure that Scandinavian Tobacco Group can:

- Attract and retain high calibre, experienced and qualified individuals to its Board of Directors and Executive Management.
- Incentivise the Executive Management to deliver the company's strategic ambitions, and do so in a way that creates sustained shareholder value.
- Reward the Executive Management appropriately for achieving core short- and long-term business goals.
- Focus the Executive Management on managing and growing the Company to ensure its continued sustainability, and in a way that aligns with the interests of shareholders and stakeholders.

If approved today, the revised remuneration policy will apply to agreements on remuneration and incentive pay entered into in the financial year 2020 and subsequent financial years. By law the Remuneration Policy must be approved by the General Meeting at least once every four years, and any material changes to the Remuneration Policy in the meantime would also have to be approved by the company's shareholders at a General Meeting.

We, the Board of Directors, recommend that you approve the proposed Remuneration Policy when we get to that item on the agenda today.

LET ME FINISH BY LOOKING FORWARD to 2020.

Based on our results and achievements in 2019, we have given ourselves every opportunity to keep delivering on our strategy and create further value for our shareholders.

We operate in attractive niche segments of the global tobacco industry and will continue to pursue the growth opportunities available to us. We will also continue to invest in the future of our business to create greater long-term value while driving cost and operational efficiency to optimise cash flow. This balance is key to creating shareholder value.

We will maintain momentum in the on-going modernisation and optimisation of our business and develop new efficient ways of working. It is an integrated part of how we run our business. So is capital discipline, especially in terms of reducing our inventories. Our focus is to generate strong cash flows from our day-to-day business and to ensure optimal capital allocation.

We have had a good start to 2020 where the underlying business has performed in line with the expectations we had for the year as presented in the Annual Report. However, as a result of the global outbreak of the Corona virus and the resulting lack of transparency, we recently found it prudent to suspend the financial guidance for 2020.

As authorities across the world are implementing measures to contain and fight the spread of the virus, we are seeing increasing restrictions to consumer movement which affect purchase and consumption patterns.

While we expect consumer behaviour to normalize, when the virus outbreak will come under control, and consider the effect temporary we are currently unable to accurately assess the short-term impact on our business.

Our business is fundamentally resilient with healthy earnings and strong cash flows and we are in a good position to deal with the issues we are facing. We are dedicating all our efforts to protect both our employees, our customers and our business.

We expect to provide an update on the financial guidance for 2020 as soon as we can properly assess the impact of the Corona virus on our business.

Our financial ambition and shareholder return policy remain unchanged: The ambition remains to be an organic EBITDA growth by 3-5%, to deliver continuous growth in the free cash flow before acquisitions, and to secure a continued steady increase in the annual ordinary dividends. Any capital that the Board evaluates to be in excess will be distributed to shareholders either as an extraordinary dividend and/or in a share buy-back program.

We recognize the importance of the ordinary dividend to many shareholders and we regularly evaluate our total cash distribution to ensure it is aligned with the performance and investment needs of the business.

THIS MARKS THE END OF MY REPORT TODAY. On behalf of Scandinavian Tobacco Group's Board of Directors, Executive Management and all employees, we would like to thank our shareholders, business partners and customers for the interest and trust they have shown our company in 2019.

Let me finish by congratulating all employees and the Executive Management for a job very well done in 2019 and thanking my colleagues on the Board for their constructive and positive collaboration during the year.

Thank you.