A consistent strategy for building
shareholder value

BRITISH AMERICAN TOBACCO
ANNUAL REPORT 2009

BRITISH AMERICAN
TOBACCO

RESULTS AT A GLANCE

British American Tobacco continued to deliver sustainable growth and had another very successful year. Group revenue was 17 per cent higher (10 per cent at constant rates of exchange). Group profit from operations was 15 per cent up, 20 per cent on adjusted profit from operations (10 per cent at constant rates).

Group volume from subsidiaries, at 724 billion, was up by 1 per cent.

Adjusted diluted earnings per share were 19 per cent higher and dividends for the year also increased by 19 per cent.

GROUP RESULTS 2009

	£ MILLION
GROSS TURNOVER (including duty, excise and other taxes)	40,713 +20%
REVENUE	14,208 +17%
PROFIT FROM OPERATIONS	4,101 +15%
ADJUSTED PROFIT FROM OPERATIONS	4,461 +20%

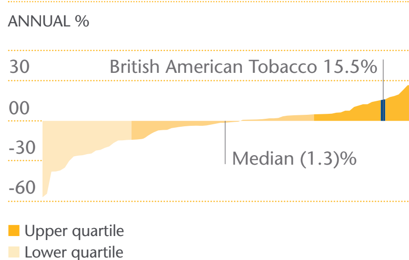
	PENCE
BASIC EARNINGS PER SHARE	137.0 +11%
ADJUSTED DILUTED EARNINGS PER SHARE	153.0 +19%
DIVIDENDS PER SHARE	99.5 +19%

	BILLIONS
GROUP CIGARETTE VOLUMES, EXCLUDING ASSOCIATES	724 +1%

	BILLIONS
GROUP CIGARETTE VOLUMES, INCLUDING ASSOCIATES	907 -1%

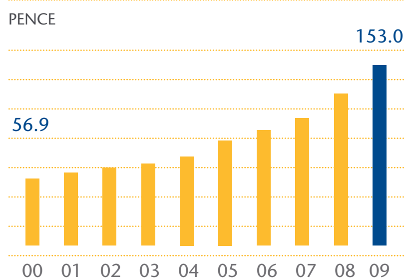
TOTAL SHAREHOLDER RETURN

FTSE 100 – 1 January 2007 to 31 December 2009
The FTSE 100 comparison is based on three months' average values.



10 YEAR EARNINGS PER SHARE

Adjusted diluted EPS



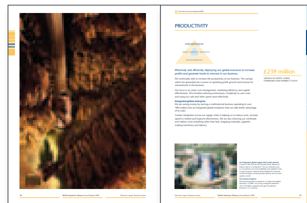
Cautionary statement The Business review and certain other sections of the Annual Report contain forward-looking statements which are subject to risk factors associated with, among other things, the economic and business circumstances occurring from time to time in the countries and markets in which the Group operates. It is believed that the expectations reflected in these statements are reasonable but they may be affected by a wide range of variables which could cause actual results to differ materially from those currently anticipated.

OUR VISION

Our vision is to achieve leadership of the global tobacco industry in order to create shareholder value.

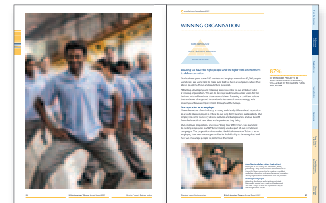
OUR STRATEGY

GROWTH
PAGE 13



PRODUCTIVITY
PAGE 19

RESPONSIBILITY
PAGE 23



WINNING ORGANISATION
PAGE 29

The strategy to deliver our vision is based on growth, productivity, responsibility and building a winning organisation. We use a range of indicators to assess our performance against our strategy.

These include our Key Performance Indicators, as well as our other Business Measures, financial and non-financial. These are also monitored and assessed frequently as we believe that they contribute to the success of the Group, particularly over the long term.

OUR GLOBAL DRIVE BRANDS

Dunhill, the 'perfectionist in tobacco', sells in more than 120 countries. It offers a diverse range of premium and super premium cigarettes and cigars at the top end of the tobacco market. 41 billion Dunhill cigarettes were sold in 2009, up 9 per cent on 2008. Key markets include South Korea, Malaysia, Brazil, Taiwan, Saudi Arabia, South Africa and Australia.

Kent is our largest premium brand, selling more than 61 billion cigarettes in 2009, down 4 per cent on 2008. Sold in more than 70 countries, Kent is positioned as 'the modern way to smoke'. Key markets include Russia, Japan, Eastern Europe and Chile.

Lucky Strike was launched in 1871 and remains one of the world's most iconic trademarks. It is among our leading premium brands and offers consumers a 'rich tobacco experience'. Its volumes rose 4 per cent to 26 billion cigarettes. Sold in more than 60 countries, key markets include Germany, Spain, Japan, France, Italy, Argentina and Chile.

Pall Mall is our leading global value-for-money brand, positioned to exceed consumer expectations. Introduced in 1899, it now sells in more than 80 countries, offering a range of cigarette and make-your-own products. Volumes were up 10 per cent on 2008 to 68 billion cigarettes. Key markets include Germany, Italy, Russia and Uzbekistan.

KENT

PALL MALL

OUR REGIONS

	VOLUME (BNS)	REVENUE (£M)	ADJUSTED PROFIT FROM OPERATIONS (£M)
ASIA-PACIFIC	185 +3%	3,270 +20%	1,148 +24%
AMERICAS	151 -6%	3,156 +10%	1,186 +13%
WESTERN EUROPE	130 +6%	3,884 +21%	994 +31%
EASTERN EUROPE	131 -4%	1,628 +2%	409 -13%
AFRICA AND MIDDLE EAST	127 +11%	2,270 +31%	724 +41%

Adjusted profit from operations is derived after excluding the adjusting items from the profit from operations. Adjusting items include restructuring and integration costs, the 2008 Canadian settlement, amortisation of trademarks and gains on disposal of businesses and trademarks.

CONTENTS

DIRECTORS' REPORT: BUSINESS REVIEW

From the Chairman 2

Performance and strategy 4
Chief Executive's review 6
Measuring our performance 8
Our strategy
- Growth 13
- Productivity 19
- Responsibility 23
- Winning organisation 29

Key Group risk factors 32

Regional review 40
Chief Operating Officer's overview 42
Asia-Pacific 44
Americas 45
Western Europe 46
Eastern Europe 47
Africa and Middle East 48
Associates 49

Financial review 50

DIRECTORS' REPORT: GOVERNANCE

Governance 60
Board of Directors 62
Management Board 63
Corporate governance statement 64
Remuneration report 78
Other statutory and regulatory information 98
Responsibility of Directors 105

FINANCIAL STATEMENTS AND OTHER INFORMATION

Group financial statements 107
Report of the independent auditors 108
Group income statement 109
Group statement of comprehensive income 110
Group statement of changes in equity 111
Group balance sheet 112
Group cash flow statement 114
Notes on the accounts 115
Five year summary 191
Half-yearly analyses of profit 192
Principal subsidiary undertakings 193
Principal associate undertakings 194

Parent Company financial statements 195
Report of the independent auditors 196
Balance sheet 197
Notes on the accounts 198

Shareholder information 201
Shareholder and contact information 202

READ OUR ANNUAL REPORT 2009 ONLINE
WWW.BAT.COM/ANNUALREPORT2009

British American Tobacco p.l.c. (No. 3407697) Annual Report
This is the Annual Report of the British American Tobacco Group and the Company, comprising the Directors' report and the audited financial statements, for the year ended 31 December 2009. It has been drawn up and is presented in accordance with, and reliance upon, applicable English company law and the liabilities of the Directors in connection with that report shall be subject to the limitations and restrictions provided by such law.

The Annual Report is published on www.bat.com. A printed copy is mailed to shareholders on the UK main register who have elected to receive it. Otherwise, shareholders are notified that the Annual Report is available on the website and will, at the time of that notification, receive a short Performance Summary (which sets out an overview of the Group's performance, headline facts and figures and key dates in the Company's financial calendar) as well as a Notice of Annual General Meeting and Proxy Form. Specific local mailing and/or notification requirements will apply to shareholders on the South African branch register.

FROM THE CHAIRMAN

> “We have a clear and consistent strategy and an excellent management team that will maintain sustainable growth and build shareholder value.”

Richard Burrows Chairman

Dear Shareholder,

2009 was a remarkable year to join British American Tobacco. While many companies have struggled in the harsh economic climate and international markets have wavered, I find myself with the great privilege of being Chairman of a business that continues to deliver excellent results and has a well established strategy for achieving sustainable growth.

Revenue rose by 10 per cent at constant rates of exchange and by 17 per cent to £14,208 million at current rates. Adjusted profit from operations increased by 10 per cent at constant rates of exchange and by 20 per cent to £4,461 million at current rates. The benefit from the translation of our results into sterling was £355 million.

These fine figures resulted in adjusted diluted earnings per share growing by 19 per cent to 153.0p.

The Board has recommended a final dividend of 71.6p per share, an increase of 16 per cent, which will be paid on 6 May 2010 to shareholders on the register at 12 March 2010. This takes the total dividend for the year to 99.5p, an increase of 19 per cent, and maintains our target of paying out 65 per cent of sustainable earnings in dividends.

It is to the credit of all our people that British American Tobacco has had yet another successful year and I am delighted with the performance of our executive team. At the end of 2009, Jimmi Rembiszewski, our outstanding and long-serving Marketing Director, retired and was succeeded by Jean-Marc Lévy. Jean-Marc, who was previously Regional Director, Western Europe, has been succeeded by Jack Bowles.

My fellow Non-Executive Directors have played an important role in constructively challenging our strategy and ensuring that the Group is very well governed. My thanks to them for their help and support in my new role.

May I also extend my warmest thanks on behalf of all shareholders to my predecessor, Jan du Plessis, who led the Board so skilfully over the past five years. He set an exemplary standard of Chairmanship and is a tough act to follow. I know I speak for everyone at British American Tobacco in wishing him continued success.

Jan's time here has certainly been a period of impressive value creation for shareholders. Over the past five years, British American Tobacco has achieved a compound annual growth rate of 15 per cent in earnings per share and 19 per cent in dividends per share. Over the same five year period, our total shareholder return has been 175 per cent compared to 35 per cent for the FTSE 100.

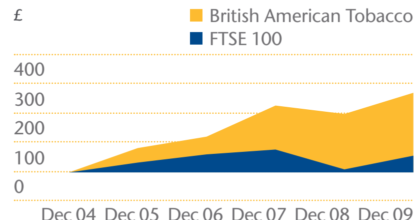
In summary, I am delighted to be here and optimistic about the future for British American Tobacco. We have a well established company in one of the more resilient industries. Indeed, as an outsider, I have been struck by both the broad stability of the tobacco sector and the opportunities for growth within it.

There are signs that the global economy is beginning to improve, although unemployment, which is an important influence on our business, may continue to rise in developed markets. We have a very clear strategy and excellent management, with a well balanced portfolio of brands. Our unrivalled geographic spread mitigates risk for shareholders and will help us maintain sustainable growth and build shareholder value.

Richard Burrows
Chairman

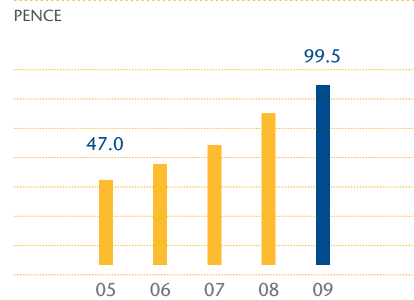
Historical total shareholder return performance

Growth in the value of a hypothetical £100 holding over five years
FTSE 100 comparison based on 30 trading day average values.



Five year dividend per share 1 January 2005 to 31 December 2009

PENCE



HIGHLIGHTS

+19%

ADJUSTED DILUTED EARNINGS PER SHARE GROWTH FOR 2009

+15%

COMPOUND GROWTH RATE OVER THE LAST FIVE YEARS, BASED ON ADJUSTED DILUTED EARNINGS PER SHARE

PERFORMANCE AND STRATEGY

PAGE

Chief Executive's review 06

Paul Adams, Chief Executive, reviews the Group's performance in 2009 against the corporate strategy and discusses the industry outlook and our competitor landscape.

Measuring our performance 08

We have a wide range of measures and indicators by which the Board assesses performance compared to the Group's strategy, including our key performance indicators and other business measures.

Our strategy 12

Our vision is to achieve leadership of the global tobacco industry. Our strategy to deliver our vision is based on growth, productivity, responsibility and building a winning organisation.

Key Group risk factors 32

This section describes the main risk factors that may affect the British American Tobacco Group's businesses, identifies their potential impact on the Group and outlines the principal activities in place to manage the risk.

CHIEF EXECUTIVE'S REVIEW

"The importance of a consistent business strategy that delivers in bad times as well as good has never been more amply demonstrated than over the past year."

Paul Adams Chief Executive

OUR STRATEGY

Our strategy to deliver our vision is based on growth, productivity, responsibility and building a winning organisation.

VISION: To achieve leadership of the global tobacco industry.

GROWTH: Increasing our volume and value share of the global tobacco market through organic growth and mergers and acquisitions.

PRODUCTIVITY: Effectively and efficiently deploying our global resources to increase profits and generate funds to reinvest in our business.

RESPONSIBILITY: Balancing our commercial objectives with the expectations of a broad range of stakeholders, thus ensuring a sustainable business.

WINNING ORGANISATION: Ensuring we have the right people and the right work environment to deliver our vision.

Sustainable growth in troubled times

The first decade of the 21st century has been characterised by both boom and bust and, in 2009, the world found itself in the grip of the deepest global recession since the 1930s. Tough times indeed, with investors and consumers alike looking for stability amid the turmoil of financial uncertainty and rising unemployment.

The importance of a consistent business strategy that delivers in bad times as well as good has never been more amply demonstrated than over the past year. While our volume was up 1 per cent, our revenue in constant currency improved by 10 per cent, due to favourable pricing conditions and the resilience of our Global Drive Brands (GDBs) – Dunhill, Kent, Lucky Strike and Pall Mall – which grew by a combined 4 per cent.

Acquisitions continue to play a part in our growth strategy. Tekel and Skandinavisk Tobakskompagni (ST), both acquired in mid-2008, were fully integrated into the Group in 2009, contributing to our overall growth in volumes. During 2009, we acquired Bentoel in Indonesia, giving us a stronger position in the fourth largest cigarette market in the world and enabling us to enter the distinctive 'kretek' segment.

Productivity driving profit

Productivity savings represent released resources that can be reinvested in the business and drive profit growth. Savings in supply chain, general overheads and indirect costs amounted to £239 million in 2009. We are firmly on track to achieve our £800 million per year savings target by 2012.

These cost savings enabled the Group to offset the impact of higher leaf prices and other input costs due to adverse foreign exchange rates, and our overall operating margin increased from 30.7 to 31.4 per cent in the year.

In further support of our £800 million target, we have initiated a major programme to help us take better advantage of our global scale and simplify and accelerate the execution of our strategy.

Sustainability agenda

Sustainability, for us, means business sustainability, as well as being green. In 2009, we continued to focus on our established agenda of harm reduction, the marketplace, our supply chain, our impact on the environment and our people, and our corporate culture. Our 2009 Sustainability Report will be published in May 2010 (read the report online at www.bat.com/sustainabilty).

The right working environment

We conduct a global employee opinion survey every two years. The last one, in 2008, found that 87 per cent of our people were proud to be associated with our organisation and 90 per cent said they understood how their role contributed to the achievement of the Group's strategy. The next survey will be held in 2010.

Industry outlook

Global economy

While most commentators are forecasting improving economic conditions in 2010, unemployment is likely to worsen in developed countries and we would expect some level of adverse consumer response in

these markets. However, some developing markets have been less affected by the global recession and are likely to see a measure of economic recovery and lower levels of unemployment in the year ahead. Some two-thirds of our revenue comes from developing markets.

Sales of our premium brands remained reasonably resilient in 2009, driven by our commitment to innovation, and we are well placed to meet the needs of consumers, whether they are down-trading in times of recession, or up-trading as situations improve. Our volume is still approximately one-third in each of the premium, mid-price and low-price segments.

Tobacco regulation

It is important for us to maintain channels of communication with regulators globally. We believe there is much to be gained by including responsible tobacco businesses that compete in the legal market in the regulatory process and we remain in dialogue with many governments.

World consumption

Forecasts suggest that the world market is likely to remain fairly stable at 6 trillion cigarettes, one-third of which are sold in China. Trends indicate that individual smokers will consume fewer cigarettes each and smaller percentages of populations will smoke. However, offsetting these trends, the number of adults in the world over the age of 20 continues to grow.

Volume declines have been evident in a number of markets in 2009 and we expect global volumes to remain under pressure in 2010. We estimate that the global legal market, excluding China, fell by 3 per cent in 2009, compared to its long-term trend of declining by 1-1.5 per cent each year. Pricing has remained positive, however, and the global profit pool is expected to continue to grow. In many key markets, legal volumes have been affected as consumers move to illicit products.

Illicit trade

The illicit trade in tobacco products – smuggled, counterfeit or tax-evaded in other ways – is in effect one of our major global competitors, representing anything up to 12 per cent of world consumption. That's a black market estimated at up to 660 billion cigarettes a year, losing governments up to £30 billion a year in tobacco taxes.

We support the development of the World Health Organisation's Framework Convention on Tobacco Control protocol aimed at creating an international regulatory framework for addressing illicit trade. However, we are increasingly concerned that some of their other guidelines, especially those relating to significant excise increases, retail display bans and plain packaging, are playing into the hands of organised crime by creating fertile conditions for further growth in illicit trade.

Managing risks

Each of these areas could represent a risk to our business. As shareholders can see from our review of the key Group risk factors, we regularly monitor their potential impact and a number of controls are in place to ensure that, where possible, they are carefully managed.

Competitive landscape

Excluding China, our principal competitors are Philip Morris International, Japan Tobacco and Imperial Tobacco. British American Tobacco and these three companies account for around 70 per cent of the market outside China.

Our corporate activity in 2009 has been confined to relatively small acquisitions, such as Bentoel in Indonesia, rather than the large scale, transformational deals that have seen significant consolidation in our marketplace in recent years.

The future

It's tough out there. No one can dispute that and the next few years may be just as turbulent in the marketplace as the last two or three have been. However, we won't change our strategy. Our strong brand portfolio with a balance of products across price segments and geographies has allowed us to deliver consistent growth year on year, whatever the trading conditions. With the right products and the right people, working hard to ensure our strategy is executed effectively and ever more efficiently, I look forward to many successful years ahead for our business.

GROUP NUMBERS 2009

£40,713 million

GROSS TURNOVER (INCLUDING DUTY, EXCISE AND OTHER TAXES)

£14,208 million

REVENUE

£4,461 million

ADJUSTED PROFIT FROM OPERATIONS

153.0 pence

ADJUSTED DILUTED EARNINGS PER SHARE

£112 million

RESEARCH & DEVELOPMENT EXPENDITURE

724 billion

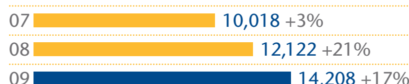
GROUP CIGARETTE VOLUMES, EXCLUDING ASSOCIATES

MEASURING OUR PERFORMANCE
1. KEY PERFORMANCE INDICATORS

We have a wide range of measures and indicators by which the Board assesses performance compared to the Group's strategy. To ensure management's focus is aligned with the interests of our shareholders, the Key Performance Indicators are reflected in our management incentive schemes.

1. Revenue growth
Revenue

£ MILLION



+17% IN 2009

Revenue for 2009 grew by 17 per cent compared to the target of growing revenue, on average over the medium to long term, by 3-4 per cent per annum. Revenue growth in 2008 was 21 per cent, benefiting from our acquisitions and favourable exchange rate movements.

3-4% LONG-TERM TARGET

This figure is calculated as the revenue of the Group after the deduction of any duties, excise and other taxes, as published in the Group income statement.

2. Global Drive Brand volume

BILLIONS

+4% IN 2009

A key strength of the Group is its diversified Global Drive Brand (GDB) portfolio – Dunhill, Kent, Lucky Strike and Pall Mall. In 2009, GDB overall volume grew by 4 per cent to 195 billion, compared to growth of 16 per cent in 2008. Our target is to achieve high single-figure growth, on average, over the long term.

LONG-TERM TARGET,
HIGH SINGLE-FIGURE GROWTH

GDB volumes are calculated as the total volumes of the four brands sold by our subsidiaries. More information about the GDBs and their individual performances is provided in the section 'Our Strategy – Growth'.

3. Group's share of key subsidiary markets
Share in its key 40 markets

%

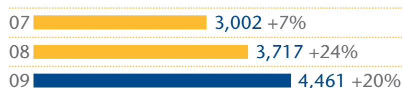
The Group subsidiaries' market share softened from 28.2 per cent to 27.9 per cent. The target is to continue to grow market share.

CONTINUE TO GROW SHARE

Retail market share in the Group's key 40 markets which covers around 80 per cent of the volumes of subsidiaries. The information used in this calculation is based on publicly available information and internal company analysis.

4. Adjusted profit from operations

£ MILLION



+20% IN 2009

The Group's target is to grow adjusted profit from operations on average by 6 per cent per annum. For 2009 it was 20 per cent, compared to 24 per cent growth in 2008.

+6% LONG-TERM TARGET

Profit used in this assessment is the adjusted profit from operations of the Group's subsidiaries – adjusted for the items shown as memorandum information on the Group income statement.

5. Overheads

EXCEEDED SAVINGS TARGET SET FOR 2009

SPECIFIC TARGET, SET FOR EACH YEAR

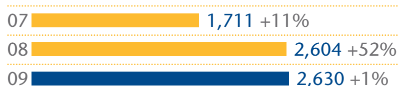
This additional measure was introduced for 2009 with the goal of focusing the Group on further reducing its cost base. A specific target was set for 2009 in order to contribute to the £800 million savings target set for 2012.

Overheads are calculated as the total costs of all subsidiaries, less variable costs and less all marketing investment.

6. Cash flow

Free cash flow

£ MILLION



EXCEEDED TARGET

SPECIFIC TARGET, SET FOR EACH YEAR

The Group's free cash flow in 2009 was £2,630 million, up £26 million from 2008. The calculation of, and the change in, free cash flow for the year is described in the Financial review.

Free cash flow is defined as net cash from operating activities (including dividends from associates, restructuring costs and taxation) less net interest, net capital expenditure and dividends to minorities. A specific target is set each year for free cash flow.

7. Earnings per share

Adjusted diluted EPS

PENCE

+19% IN 2009

LONG-TERM TARGET, ON AVERAGE, HIGH SINGLE-FIGURE GROWTH

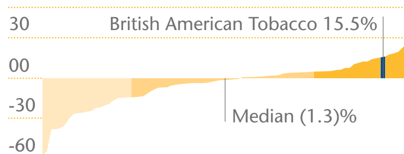
Adjusted diluted earnings per share (adjusted diluted EPS) have grown at an average of 11 per cent per annum over the 10 years to 2009. This compares favourably to the target of growing at the rate of high single-figures per annum, on average, over the medium to long term. Adjusted diluted EPS grew by 19 per cent in 2009 (2008: 19 per cent).

The detail of the calculation and the adjustments made are explained in note 7 to the financial statements.

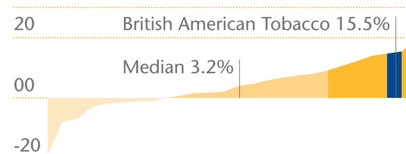
8. Total shareholder return (annual %)

Upper quartile
Lower quartile

FTSE 100 – 1 January 2007 to 31 December 2009
The FTSE 100 comparison is based on three months' average values.



FMCG group – 1 January 2007 to 31 December 2009
The FMCG group comparison is based on three months' average values.



The Group's strategy is focused on increasing shareholder value, which is measured using Total Shareholder Return (TSR) compared to the FTSE 100 Index and also to the Fast Moving Consumer Goods (FMCG) peer group.

The FMCG comparator group is reviewed annually to ensure that it remains both relevant and representative.

The target is to show an above average performance in the long term, compared to the two comparator groups, based on a three year average.

On the TSR measure, the Company ranked 8 out of the FTSE 100 group of companies while it ranked 2 in the peer group of international FMCG companies. The Group has achieved a top quartile performance in both of these categories since 1999.

TSR is measured according to the return index calculated by Datastream, on the basis of all companies' dividends being reinvested in their shares. The return is the percentage increase in each company's index over a three year period.

See the Remuneration report for more information.

MEASURING OUR PERFORMANCE
2. BUSINESS MEASURES

A number of other business measures, financial and non-financial, are monitored and assessed frequently to ensure that the Group's strategy is delivered. Although these are not included in management's incentives, we believe that these business measures contribute to the success of the Group, particularly over the long term. Further details of our performance against these measures, in relation to the four elements of our strategy, are shown on pages 12 to 31.

GROWTH

Business measure	Description	Target and status
Adult smokers under 30 (see page 14)	Our share of volume in the Adult smokers under 30 (ASU30) segment in the Group's top 40 markets (excluding volume from acquisitions made in 2008 and 2009).	To maintain or grow our share of volume each year on an organic basis. In 2009, our share of volume in the ASU30 segment was 24.0 per cent, up from 23.7 per cent in 2008.
Lights (see page 14)	Our share of volume in the Lights segment in the Group's top 40 markets (excluding volume from acquisitions made in 2008 and 2009).	To maintain or grow our share of volume each year on an organic basis. In 2009, our share of volume in the Lights segment was 25.4 per cent, down from 25.7 per cent in 2008.
Premium (see page 14)	Our share of volume in the Premium segment in the Group's top 40 markets (excluding volume from acquisitions made in 2008 and 2009).	To maintain or grow our share of volume each year on an organic basis. In 2009, our share of volume in the Premium segment was 26.8 per cent, up from 26.7 per cent in 2008.
Menthol (see page 14)	Our share of volume in the Menthol segment in the Group's top 40 markets (excluding volume from acquisitions made in 2008 and 2009).	To maintain or grow our share of volume each year on an organic basis. In 2009, our share of volume in the Menthol segment was 23.8 per cent, up from 23.4 per cent in 2008.

PRODUCTIVITY

Business measure	Description	Target and status
Operating margin (see page 52)	Percentage of adjusted profit from operations divided by revenue.	To increase operating margin to 34.0 per cent by 2012. Operating margin was 31.4 per cent in 2009, up from 30.7 per cent in 2008 and 30.0 per cent in 2007.
Productivity savings (see page 19)	The savings in supply chain, overheads and indirect costs (anything other than leaf, wrapping materials, cigarette making machinery and labour).	To achieve £800 million in cost savings between 2008 and 2012. In 2009, we made cost savings of £239 million, bringing the total figure achieved since 2008 to £484 million.
Free cash flow as a percentage of adjusted earnings (see page 57)	Free cash flow as a ratio of the adjusted diluted earnings per share.	To maintain the percentage figure in the mid 80s. In 2009, the figure was 86 per cent.

RESPONSIBILITY

Business measure	Description	Target and status
Dow Jones Sustainability Indexes (see page 25)	The Indexes track the economic, environmental and social performance of leading companies based on the integration of sustainability into their businesses.	To achieve a higher score than the sector average in a minimum of 14 out of 18 categories. In 2009, we achieved a higher score than the sector average in 16 out of 18 categories.
Group energy use (see page 24)	This measure tracks Group energy use in gigajoules per million cigarettes equivalent.	To reduce energy use by 6.7 per cent by 2012 from our 2007 base. In 2009, our energy use in gigajoules per million cigarettes equivalent was down 5.9 per cent from our 2007 base.
Carbon dioxide (CO_2) (see page 24)	CO_2 equivalent is largely derived from energy consumption. Like energy, we measure this using a 'normalised' figure, in this case tonnes per million cigarettes equivalent.	To reduce Group CO_2 equivalent by 50 per cent by 2030 from our 2000 base. In 2009, our CO_2 tonnes per million cigarettes equivalent was down 37 per cent from our 2000 base.
Waste to landfill (see page 26)	This measure tracks Group waste sent to landfill in tonnes per million cigarettes equivalent.	To reduce waste sent to landfill in tonnes per million cigarettes equivalent by 12 per cent by 2012 from our 2007 base. In 2009, this was down 24 per cent from our 2007 base.
Recycling (see page 26)	This measure tracks the total percentage of Group waste re-used or recycled against total waste generated.	To recycle more than 75 per cent of waste generated in each year by 2012. In 2009, Group recycling was at 83 per cent of waste generated.
Water use (see page 24)	This measure tracks Group water use in cubic metres per million cigarettes equivalent.	To reduce water use by 48 per cent by 2012 from our 2002 base. In 2009, our water use in cubic metres per million cigarettes equivalent was down 45 per cent from our 2002 base.

WINNING ORGANISATION

Business measure	Description	Target and status
'Your Voice' survey 2008 (see page 30)	We collect views from employees through our 'Your Voice' survey once every two years to help us measure our progress in employee engagement.	To achieve more positive scores than the other FMCG companies in our comparator benchmark group in all areas. We achieved this in our last survey in 2008.
Lost Workday Case Incident Rate (LWCIR) (see page 30)	The LWCIR is a standard health and safety measure that helps us measure working days lost through injury on a consistent basis year on year.	We have a long-term aspiration of zero accidents and aim to achieve a global LWCIR in the region of 0.10-0.20. The rate was 0.37 in 2009, down from 0.40 in 2008.

GROWTH

Increasing our volume and value share of the global tobacco market through organic growth and mergers and acquisitions.

Organic growth comes from increasing our revenue from our existing business. To achieve organic growth, we focus on key market segments that offer the best long-term prospects, including premium and international brands.

We also aim to optimise the performance of our Global Drive Brands – Dunhill, Kent, Lucky Strike and Pall Mall – and seek opportunities for profitable volume growth in the value-for-money and low-price segments. We see innovative products that offer consumers meaningful, value-added differentiation as key to organic growth.

Strategically important and financially attractive mergers and acquisitions can provide us with further growth opportunities.

Sustainable growth

In 2009, Group volumes from subsidiaries were 724 billion, up 1 per cent, mainly as a result of the acquisitions made in 2008.

With our strong brand portfolio and an overall brand mix that is broadly balanced between premium, mid-price and low-price, combined with our wide geographic spread, we continue to be very well placed to deliver sustainable growth.

£14,208 million

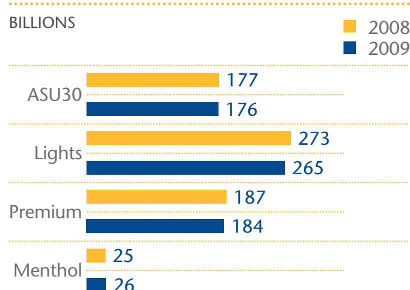
REVENUE

Building retailer relationships (main picture)
A British American Tobacco Russia trade representative confirms an order with an independent retailer in Moscow. We work closely with our retail partners to ensure that at all times they can offer the products our consumers want to buy, at the right price and quantity, and with the quality they expect.

Public place smoking
We support sensible restrictions on smoking in indoor public places and are committed to working with governments and the hospitality industry to provide practical, comfortable solutions for non-smokers and smokers.

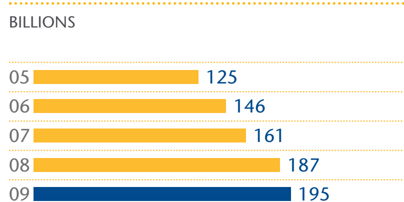
GROWTH CONTINUED

Strategic segment volume in 40 key markets



Based on data from the 40 key markets, our share in each segment in 2009 was ASU30 (24%), Lights (25%), Premium (27%) and Menthol (24%). These figures exclude acquisition volumes.

Global Drive Brand volume growth



Since 2005, our four GDBs – Dunhill, Kent, Lucky Strike and Pall Mall – have increased combined volume by 56%.

Our approach to marketing

Our business is about offering adult consumers high quality brands that they will choose over competitors' products. It is not about boosting the number of smokers, increasing the amount they smoke or targeting those who are underage.

Our International Marketing Standards detail our commitment to marketing appropriately and only to adult consumers. The Standards apply to our companies globally and govern our tobacco marketing across all areas, including print, billboards, electronic media, promotional events and sponsorship.

A review of adherence to these Standards was conducted by all Group companies in 2008. Although the assessment reported an overall adherence rate of 97 per cent, it also identified some areas where we were not yet meeting our Standards. These were principally related to inconsistencies in interpretation of the Standards at a local level.

During 2009, we focused on action plans to address these issues and progress was monitored by our regional audit and corporate social responsibility (CSR) committees, with updates reported to our Board CSR Committee. Actions taken have included issuing guidance to clarify the sanctions that can be applied to retailers found to have sold tobacco products to those who are underage and training to raise awareness of how our updated Standards cover technological developments, such as electronic and interactive displays in shops.

Full adherence to our International Marketing Standards was achieved in all but 12 companies. A total of 15 instances of non-adherence were reported to have occurred. Action plans were already in place by the end of 2009, with the aim to achieve full adherence in 2010.

We are committed to bringing our recently acquired business in Indonesia into line with our global practices. However, our plans to introduce our International Marketing Standards have been overtaken by proposed regulations from the Ministry of Health.

The market in 2009

2009 has been a difficult year for fast moving consumer goods in general and tobacco products did not escape the challenge. The global economic recession has affected the market to varying degrees in different geographies. Total market volume declined by around 2 per cent in our key markets, with consumer down-trading moving some of this volume into illicit trade.

Despite this, our overall performance has held firm. We continued to invest in marketing programmes and innovation throughout the year. As a result, our overall volume share in key markets was virtually unchanged. Our Global Drive Brands (GDBs) – Dunhill, Kent, Lucky Strike and Pall Mall – have grown by a combined 4 per cent in volume and have gained market share, helped by continued organic volume growth. Our portfolio has proved resilient in difficult times and, as consumers come out of recession, we are in an excellent position.

Balanced and innovative brand portfolio

Our GDBs cover the premium and value-for-money (VFM) segments and are at the forefront of our successful innovations, product refinements and our trade marketing strategy. They account for 27 per cent of the global volume sales of our total portfolio and our overall brand mix is broadly balanced between premium, mid-price and low-price.

In geographic terms, our brand contributions are evenly split between developed and developing markets, although some 74 per cent of our volume comes from developing markets.

Our continued focus on strengthening our GDBs is complemented by our investments in local and regional brands where they play a strategic role in a particular market. This gives us the flexibility to respond appropriately to consumer opportunities.

We are confident that the balance of our brand portfolio across price segments and geographies will continue to allow us to build strong consumer loyalty through uncertain economic times.

Global Drive Brands continue to grow
195 billion cigarettes sold in 2009
+4% volume growth

Our GDBs grew by 4 per cent, or 8 billion cigarettes, in 2009. This rise is due 60 per cent to brand migrations and 40 per cent to continued organic growth. This strong performance has enabled us to grow both share and volume within the premium segment, where volumes have been under pressure.

We saw some consumer down-trading with premium volumes declining 2 per cent, while both VFM and low-price segments each grew by 3 per cent. Total Group volumes increased to 724 billion, up 1 per cent as a result of acquisitions.

Dunhill
41 billion cigarettes sold in 2009
+9% volume growth

Dunhill enjoyed consistent growth throughout 2009 with a strong financial performance. Market share increased in both established and new markets, indicating the growing relevance of the brand to consumers. Dunhill's growth in the Americas and the Middle East broadened its brand footprint across the world.

Innovation continues to fuel growth. Reloc®, the resealable pack exclusive to Dunhill, was launched in most core markets, driving gains in market share. Fine Cut grew by 30 per cent, proving particularly popular with consumers in Russia, Romania, Hungary and South Korea.

The brand migration from Carlton to Dunhill in Brazil is proving very successful and has been well received by consumers. The brand was further strengthened with the launch of the Nanocut range, a new offering that serves as a contemporary expression of Dunhill's heritage and expertise.

Kent
61 billion cigarettes sold in 2009
-4% volume decline

Our largest premium brand performed well in the majority of key markets, increasing volume and improving both market share and brand image. Volume growth in the Africa and Middle East region was particularly strong. However, the economic downturn in Japan and Eastern Europe resulted in an overall decline in volumes as consumers' spending power was squeezed in these markets.

Kent's leading role in innovation continues to deliver positive results, with Nanotek growing by 24 per cent in 2009 and the new 'Surround' product quickly establishing share in Russia. Kent 'HD' was also launched in several major markets with encouraging sales results.

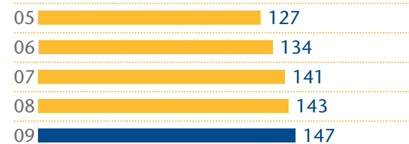
Lucky Strike
26 billion cigarettes sold in 2009
+4% volume growth

Lucky Strike delivered another year of solid growth, with major volume growth in France, Italy, Chile and Syria. Market share grew, or was maintained, in nine out of the top 10 markets.

The brand is particularly successful among Adult smokers under 30, and this segment accounts for more than 60 per cent of its consumers. We focus on these consumers by delivering packaging options and taste experiences that they value.

Other International Brands volume growth

BILLIONS



Since 2005, other International Brands – excluding the four GDBs – have risen by 16%.

From the Chairman
Performance and strategy
Regional review
Financial review
Governance
Group financial statements
Parent Company financial statements
Shareholder information

GROWTH CONTINUED

Preferred business partner
We regularly survey our international customer base to benchmark our performance against our peers and the results continue to place us as the best overall supplier in the tobacco category.

Pall Mall
68 billion cigarettes sold in 2009
+10% volume growth

Pall Mall continued its strong performance of the past few years, with significant volume growth in Europe and the Americas, as well as market share increases across its key markets, including Germany, Uzbekistan, Mexico, Chile, Spain and Turkey.

The brand was enhanced by several new offerings in 2009: 'Nanokings' is our slimmer king size range in Eastern Europe; a 'Pocket Edition' slim variant was launched in Germany, Mexico and the Netherlands; and there was a stronger mix of value-for-money offerings across Western Europe. Each of these has contributed to significant growth.

Consumer perception of Pall Mall has strengthened globally as a result of improvements to the brand's king size packaging and communications. Along with further successful migrations from smaller, local value-for-money brands, we continue to increase the profitability of Pall Mall.

Other International Brands
147 billion cigarettes sold in 2009
+3% volume growth

As well as our GDBs, we also support our other International Brands, accounting for some 20 per cent of our volumes in 2009. Several of these brands saw good volume growth in the year, particularly Kool in Japan; State Express 555 in Asia-Pacific Global Travel Retail; Rothmans in Egypt; and John Player Gold Leaf in Pakistan, Bangladesh and the Gulf Cooperation Council countries.

Trade marketing and distribution
Managing business-to-business relationships with retailers makes up a large part of our trade marketing activities. We work with our retail partners to ensure that at all times they can offer the products our consumers want to buy, where they want to buy them, when they want to buy them, at the right price and quantity, and with the quality they expect.

Customer management
We take pride in the fact that our customers rate us for the most part as a preferred business partner. We regularly survey our international customer base to benchmark our performance against our peer group within the FMCG industry overall and against our competitors in the tobacco category in particular. The results continue to place British American Tobacco as the best overall supplier in both.

For the third successive year in 2009, we were recognised in the Dow Jones Sustainability Index as the leading business in the tobacco category for Customer Relationship Management.

Key marketing channels
We make a special effort to understand and develop joint marketing programmes with our retail partners, who engage with our consumers in key market channels such as Global Travel Retail and Global Convenience Retail. With their enormous spread and reach, these strategic customers acknowledge British American Tobacco as a partner of choice and, during 2009, we received several accolades from the trade organisations operating in these marketing channels.

Direct store sales
Where appropriate, we believe that direct to store sales, or DSS, is the most effective way of serving customers and building sustainable business partnerships. DSS gives us visibility and control over the sales and distribution process and allows us greater access to both the market and consumer information. It also provides a direct commercial link to our most strategic retail accounts.

During 2009, the proportion of our total volume distributed through DSS reached 50 per cent for the first time.

STRATEGY IN ACTION

NEW PRODUCT LAUNCH KENT HD

Kent HD is the product of significant investment by British American Tobacco in the Kent brand. Inspired by the superior quality standards seen in high definition technologies, this evolution of the brand range delivers the smooth, signature Kent taste using a new and unique taste transmission system.

Already available in 25 markets by the end of 2009, Kent HD has had an encouraging start and is performing solidly in a very challenging economic environment. Despite evidence of a decline in premium sales in 2009, Kent HD succeeded in stabilising king size volume sales in most of Eastern Europe, particularly in Russia and Romania.

The launch of Kent HD built upon the previous successes of innovative Kent products such as Nanotek, reinforcing the brand's reputation as the leader in product technology and taste innovation.

Our research also shows that Kent HD's 'forward-looking' style appeals to consumers, improving the modern, innovative and dynamic perception of the brand range.

The global roll-out of Kent HD will continue in 2010 with a number of launches that we expect will make it another successful year.

PRODUCTIVITY

Effectively and efficiently deploying our global resources to increase profits and generate funds to reinvest in our business.

We continually seek to increase the productivity of our business. The savings which are generated are a source of operating profit growth and revenue for reinvestment in the business.

Our focus is on smart cost management, marketing efficiency and capital effectiveness. This includes reducing unnecessary complexity to save costs and using our cash and other assets more effectively.

Integrated global enterprise

We are saving money by turning a multinational business operating in over 180 markets into an integrated global enterprise that can take better advantage of its scale.

Greater integration across our supply chain is helping us to reduce costs, increase speed to market and improve effectiveness. We are also reducing our overheads and indirect costs (anything other than leaf, wrapping materials, cigarette making machinery and labour).

£239 million

SAVINGS IN SUPPLY CHAIN, OVERHEADS AND INDIRECT COSTS

An integrated, global supply chain (main picture)
A farmer in Rio Grande do Sul state, Brazil, attends to tobacco leaf in a curing barn. The raw materials used in our products are sourced globally and supplied to the Group's factories using the latest distribution methods and technologies, ensuring timely delivery and constant quality control.

Our factory footprint
Manufacturing tobacco products is a large-scale global operation. In 2009, our Group companies produced some 724 billion cigarettes through 50 cigarette factories in 41 countries.

PRODUCTIVITY CONTINUED

Efficient production
The consolidation of manufacturing around the Group means that more of our factories are now serving a larger number of markets.

Productivity savings

Savings in supply chain, overheads and indirect costs amounted to £239 million in 2009 at constant rates of exchange. We are firmly on track to achieve our £800 million savings target by 2012.

Supply chain

Most of the productivity improvements in 2009 resulted from our continuous focus on primary supply chain efficiencies. These were largely as a result of further standardisation of our processes and simplification of our portfolio. The supply chain is increasingly being managed above market, driving further efficiencies through smarter planning and resource allocation.

We have reduced product costs every year from 2003 to 2008. In 2009, product costs rose due to transactional foreign exchange costs and a significant increase in the price of many inputs. However, our productivity improvements enabled us to mitigate this, meaning the overall increase in costs of key items, such as internationally traded tobacco leaf, were contained to less than half of what they would have been.

Since 2000, the number of cigarette factories within the Group has been reduced from 83 to 50, including acquisitions. Both the Riga factory in Latvia and the Tokat factory in Turkey ceased production in 2008, while further factories were added with the acquisition of Bentoel in Indonesia and the beginning of manufacture in Oran for the Algerian domestic market. In 2009, we announced the closure of our factory in Soeborg, Denmark, and the rationalisation of our Vranje factory in Serbia. We also commenced the consultation process for the downsizing of our factory in Pagewood, Australia.

The consolidation of factories around the Group has been undertaken responsibly and with care for affected employees and local communities. It has removed much of our previous excess capacity and means that more of our factories are now serving a larger number of markets.

Taking advantage of this new model means we have had to become more effective and efficient at above-market planning. This is crucial for ensuring we meet demand on time and in full, roll-out innovations more quickly and take better advantage of the benefits of scale.

Globally and regionally we continue to achieve considerable savings by consolidating purchases of materials and services, reducing duplication and standardising data and processes.

Moving to an above-market planning model is also enabling us to rationalise our machine technology by targeting capital expenditure and establishing a more cost-effective operational base for the future.

Global operations

In 2009, we started managing our Eastern and Western European supply chains centrally. This delivered greater alignment of systems and processes and has improved global transparency of supply and demand, facilitating more productive investment and sourcing decisions.

To further advance the development of our supply chain, we signed a Framework Partnership Agreement with Cranfield University for collaborative research and development.

We continue to build a consumer-led, customer-focused, high-performing, globally-integrated supply chain, dedicated to winning in the markets where we operate. This is a key aspect of the Group's strategy and we will see more areas of our supply chain being managed at a global level where it will deliver greater benefits.

Overheads and indirects

The process of moving procurement above-market continued to allow us to streamline our processes and reduce overheads. In 2009, the geographic spread of Agrega – our joint venture with the brewer AB InBev – was expanded to include offices in London to cover Western Europe and to coordinate global activities, and in Moscow to cover Eastern Europe.

STRATEGY IN ACTION

STRENGTHENING OUR SUPPLY CHAIN GLOBAL LEAF POOL

Our Global Leaf Pool (GLP) initiative, launched at the end of 2007, has transformed British American Tobacco's leaf supply chain business. It gives global visibility of stocks, provides assured supply and has delivered significant financial benefits in the first two years.

The GLP controls the global movement of our leaf supplies. This logistical operation involves around 1,000 containers being at sea at any given time, delivering stock from 52 ports to British American Tobacco's factories worldwide, along 4,500 possible transportation routes.

The initiative continues to improve our ability to have the right quantity and quality of tobacco in the right places to meet the growth requirements of our brands. At the same time, the GLP has focused on efficiencies that have allowed us to reduce leaf stocks by the equivalent of three months' supply, saving the business hundreds of millions of pounds in working capital.

The GLP has enabled us to mitigate the effects of a 30 per cent increase in the price of internationally traded leaf and has helped to ensure that the overall increase in costs to our business for blended tobacco leaf have been much lower.

In 2009, we focused on consolidating this new business model, enhancing the way it uses information technology, and fine tuning and further improving its organisational structure.

Today, the GLP is responsible for the demand planning, procurement and deployment of all our internationally traded tobacco leaf and for agreeing our domestic crop requirements.

RESPONSIBILITY

Balancing our commercial objectives with the expectations of a broad range of stakeholders to ensure a sustainable business.

Because our products pose real risks to health, we strongly believe that our business must demonstrate responsibility in everything it does. Our commitment to responsible behaviour is integral to our sustainability agenda. This addresses key business-related social, environmental and economic impacts in ways that aim to build value for all our stakeholders, including shareholders.

Our Business Principles and our Standards of Business Conduct set out what we require of our companies and employees in terms of responsible corporate behaviour and personal integrity.

We support tobacco regulation that balances the preferences of consumers with the interests of society, establishes an open-minded approach to harm reduction as a policy and enables our businesses to continue to compete and prosper. Harm reduction is an important element of our strategy.

Sustainability

Our sustainability agenda comprises five key goals that include all areas of the Group strategy and is integral to delivering it. The goals cover developing reduced risk products, the way we operate in the marketplace, responsible management of our supply chain, addressing our environmental impacts and developing our employees within a great workplace culture.

£112 million

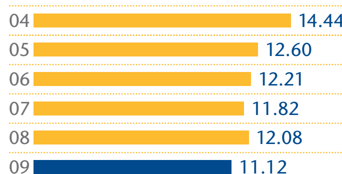
OUR RESEARCH & DEVELOPMENT EXPENDITURE IN 2009

Responsible leaf growing (main picture)
We work with around 250,000 farmers worldwide, who supply all the leaf we buy, to promote high environmental and work place standards. We have programmes in place to help build a sustainable supply chain, benefiting both farmers and our business.

Research & Development
We seek to develop innovative technologies and new products to reduce the harm caused by tobacco use. We invest heavily in scientific research and are committed to engaging with the external scientific community.

Group energy use

GIGAJOULES PER MILLION CIGARETTES EQUIVALENT

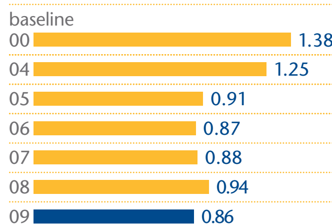


We define Group energy use as the energy used by the Group in its own operations plus energy used in Group business travel and freight.

We do not include energy used to produce and deliver purchased energy, which in effect tracks performance of energy suppliers.

Carbon dioxide (CO_2)

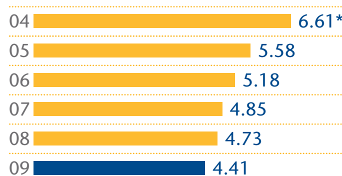
TONNES CO_2 PER MILLION CIGARETTES EQUIVALENT



Group CO_2 is calculated from the energy used in Group operations, from Group business travel and freight and from Group incineration and landfill.

Water use

CUBIC METRES PER MILLION CIGARETTES EQUIVALENT



**For comparison purposes, the 2004 figure excludes data from Peru relating to the use of irrigation water by farms owned by a company we acquired in late 2003. It is unusual for the Group to own farms. The farms have now been sold.*

Our approach to sustainability

We established our vision for sustainability in 2007 and in 2008 we addressed key challenges it raised. To make significant progress against our sustainability agenda, we need robust, commercial sustainability plans. In 2009, we focused on embedding sustainability into our business, to ensure that our people understand that sustainability benefits, rather than compromises, commercial success.

These activities are covered in detail in our Sustainability Report 2009, which is due for publication in early May 2010 and will be available online at www.bat.com/sustainability.

Dow Jones Sustainability Indexes (DJSI)

In 2009, we were, for the eighth year running, the only tobacco company included in the Dow Jones Sustainability World Index. This index tracks the economic, environmental and social performance of leading companies based on how well they integrate sustainability into their businesses.

We use the DJSI as a primary business measure and set ourselves a target each year of recording a higher score than the sector average in a minimum of 14 out of 18 categories.

Our overall score in 2009 decreased from 84 per cent in 2008 to 81 per cent, while the sector average increased from 69 per cent to 71 per cent. We achieved a score of 100 per cent in three categories (Environmental reporting, Fuels for tobacco curing and Responsible marketing); a higher score than the sector average in 16 (exceeding our business measure target); and the top score in 10.

Harm reduction

Our approach to tobacco harm reduction is to pursue the research, development and test-marketing of innovative tobacco products, including smokeless, that will be acceptable to consumers and be recognised by the scientific and public health communities and regulators as posing reduced risks to health. This is an important element in our business and we have increased our expenditure and greatly developed our capabilities over recent years to meet this challenge.

We aim to reduce the harm caused by smoking and we continue to make progress in our scientific research in this area. In 2009, we published more scientific papers than in any year to date and we are starting to see results from our clinical studies. Engagement with stakeholders on scientific issues is also improving and our External Scientific Panel, a group of independent scientists set up in 2008, continues to help inform our research programmes.

Research & Development (R&D)

Group R&D provides scientific support for our current range of products and seeks to develop innovative technologies and new products. It also provides guidance on the use of ingredients in our products to help our companies meet Group standards and comply with national legislative requirements.

Environmental performance

We recognise that we need to maintain a clear strategic approach to managing our environmental footprint. It not only makes good economic and environmental sense for us to use raw materials, energy and water in a sustainable manner, but it is also our responsibility to do so. Our key performance measures are energy use, water use, waste to landfill and recycling.

Responsibility for our Environment, Health & Safety policy lies with the Management Board and it applies to our own activities and to our approach to managing our supply chain. Our Environment, Health & Safety management is based on international standards, including ISO 14001.

DOW JONES SUSTAINABILITY INDEXES

Dow Jones criteria	Was 2009 score same or better than 2008?	Was score higher than sector average?
Economic dimension	✔	✔
Environmental dimension	✘	✔
Social dimension	✘	✔
Economic dimension		
Corporate governance	✘	✔
Risk and crisis management	✔	✔
Codes of conduct/compliance/ corruption and bribery	✔	✔
Customer relationship management	✔	✔
Combat smuggling	✔	✔
Environmental dimension		
Environmental policy/management	✔	✔
Environmental performance (eco-efficiency)	✘	✘
Environmental reporting	✔	✔
Fuels for tobacco curing	✔	✔
Raw material sourcing	✔	✔
Social dimension		
Labour practice indicators	✘	✔
Human capital development	✔	✔
Talent attraction and retention	✘	✔
Social standards for suppliers	✔	✔
Corporate citizenship/philanthropy	✘	✔
Social reporting	✔	✔
Responsible marketing policies	✔	✔
Occupational health and safety	✔	✘
TARGET REACHED*		✔

*Our target is to record a higher score than the sector average in a minimum of 14 out of 18 categories.

Biodiversity
As part of our commitment to environmental issues, we also focus on minimising our impacts on biodiversity.

Energy use
Group energy use in 2009 reduced by 7.9 per cent to 11.12 gigajoules per million cigarettes equivalent. Total energy use was 12.2 million gigajoules. An increase in freight was offset by reduced business travel, although the overall increase in energy efficiency was largely due to more detailed measurement of both energy consumption and output at unit level, rather than specific efficiency improvements.

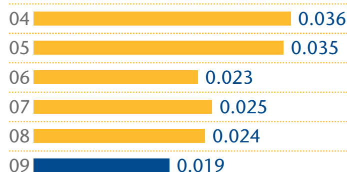
Carbon dioxide (CO_2)
Group CO_2 equivalent was down in 2009 by 8.5 per cent at 0.86 tonnes per million cigarettes equivalent produced, primarily for the same reasons as those affecting energy use.

Water use
Group water use in 2009 was down by 6.8 per cent to 4.41 cubic meters per million cigarettes equivalent. Total water use was 4.8 million cubic metres. The increase in water efficiency was largely due to more detailed measurement of consumption and output at unit level, as with energy use.

RESPONSIBILITY CONTINUED

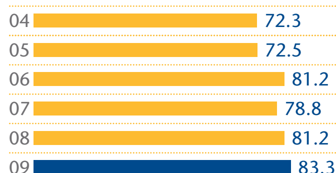
Waste to landfill

TONNES PER MILLION CIGARETTES EQUIVALENT



Recycling

PERCENTAGE OF WASTE RECYCLED



Landfill and recycling

Group waste sent to landfill decreased in 2009 by 21 per cent to 0.019 tonnes per million cigarettes equivalent, largely due to more detailed measurement at unit level. Group recycling increased by 2.1 per cent to 83.3 per cent of waste generated.

Youth smoking prevention (YSP)

Our primary responsibility in this area is to ensure that our marketing is not aimed at the underage, a subject that is covered by our International Marketing Standards. Our Group companies continue to run YSP programmes and, during 2009, our focus has been on a more consistent global approach to YSP across all our markets.

Supply chain

Our sustainability agenda extends beyond our own operations: we want to see social, environmental and economic improvements in our supply chain too. Across the Group, our companies purchase some 390,000 tonnes of tobacco leaf a year, around 80 per cent of it from farmers and suppliers in emerging economies. We also purchase significant quantities of other raw materials, such as packaging, cigarette paper, filter materials, glues, inks and plug wraps.

Social and community issues

We approach social and community issues primarily in terms of the economic, environmental and social impacts of our core operations and our supply chain. We also invest in a range of philanthropic projects.

Corporate social investment

Our corporate social investment (CSI) activities include a range of community and charitable projects, centred on empowerment (giving people training, education and opportunities to help them develop), civic life (activities that aim to enrich public and community life) and sustainable agriculture and environment (contributions to local agriculture).

Our global CSI expenditure in 2009 was £14 million (2008: £18 million) as defined by the statutory reporting criteria for charitable donations.

Biodiversity Partnership

Since 2001, we have worked with three conservation NGOs in the British American Tobacco Biodiversity Partnership. We donated £1 million a year to the Partnership in its first five years and committed £1.5 million a year for five years from 2006. For more, see www.batbiodiversity.org.

Eliminating child labour

We helped to establish the Eliminating Child Labour in Tobacco Growing Foundation in 2001 and have actively supported it since. It brings together the major tobacco manufacturers, leaf suppliers and representatives of the trades unions and growers' associations. For more, see www.eclt.org.

STRATEGY IN ACTION

YOUTH SMOKING PREVENTION
BRITISH AMERICAN TOBACCO RUSSIA

Underage smoking is a significant problem in Russia, which has one of the highest rates of youth smoking in the world. To help tackle this, our local company, British American Tobacco Russia, has run a youth smoking prevention (YSP) programme since 1999, two years before minimum age legislation was first passed in the country.

Our company supports industry-wide action to reduce underage access to tobacco and works with other companies, NGO partners and government departments to reach their shared YSP objectives.

British American Tobacco Russia provides information to retailers encouraging them to take the issue of underage smoking seriously, to observe the minimum age law, and to refuse to sell tobacco products to minors. Retailers are also provided with stickers to be placed at entrances and at point of sale, stating that the retailer does not sell tobacco products to anyone under 18.

The caption "Sales to minors are prohibited" is also printed on all cigarette packs that are manufactured or imported, and on all advertising and point of sale materials.

In 2009, events for retailers were held in more than 30 cities including Irkutsk, Vladivostok, Volgograd, Moscow and St Petersburg. Our company also supported a YSP conference, with participants from Russia, Belarus and Kazakhstan, including representatives from local and national government bodies, health organisations, retailers and other businesses.

Other activities have focused on educating parents to understand the issue of youth smoking and how they can help prevent it.

British American Tobacco Russia measures the effectiveness of its YSP activities in a number of ways, including independent research to assess compliance with minimum age laws and the evaluation of any educational events.

WINNING ORGANISATION

Ensuring we have the right people and the right work environment to deliver our vision.

Our business spans some 180 markets and employs more than 60,000 people worldwide. We work hard to make sure that we have a workplace culture that allows people to thrive and reach their potential.

Attracting, developing and retaining talent is central to our ambition to be a winning organisation. We aim to develop leaders with a clear vision for the business who will motivate those around them. Fostering a confident culture that embraces change and innovation is also central to our strategy, as is ensuring continuous improvement throughout the Group.

Our reputation as an employer

Given the nature of our industry, a strong and clearly differentiated reputation as a world-class employer is critical to our long-term business sustainability. Our employees come from very diverse cultures and backgrounds, and we benefit from the breadth of new ideas and experiences they bring.

Our employer proposition, known as 'Bring Your Difference', was launched to existing employees in 2009 before being used as part of our recruitment campaigns. The proposition aims to describe British American Tobacco as an employer, how we create opportunities for individuality to be recognised and how we encourage people to perform at their best.

87%

OF EMPLOYEES PROUD TO BE ASSOCIATED WITH OUR BUSINESS, WELL AHEAD OF THE GLOBAL FMCG BENCHMARK

A confident workplace culture (main picture)
Employees at our factory in Cachoeirinha, Brazil, performing a daily exercise routine before the start of their shift. We are committed to creating a confident workplace culture that embraces change and innovation, allows people to thrive and to reach their full potential.

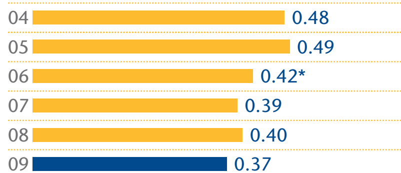
Investing in our people
Attracting, developing and retaining motivated, high-quality people from a variety of backgrounds and with a range of skills and experience is key to delivering business results.

WINNING ORGANISATION
CONTINUED

What do our people say?
Over 90 per cent of our people responded to our most recent employee opinion survey with 82 per cent saying they would recommend British American Tobacco as a good place to work.

Lost Workday Case Incident Rate (LWCIR)

LWCIR: LOST WORKDAY CASES THROUGH INJURY x 200,000 ÷ TOTAL HOURS WORKED



**From 2006, the figure includes cases of assault as well as accidents.*

Recruitment and induction

New globally aligned standards for recruitment and induction were developed in 2009, addressing a number of areas, from process improvements to helping us to match people's expectations with their actual job experiences. A new standard 90-day induction plan for new employees and line managers will be rolled out throughout the Group during 2010.

Work environment

We are committed to a work environment free from harassment, bullying and discrimination. We do not discriminate against people with disabilities who apply for jobs and they get the same opportunities for promotion, training and career development as other staff.

We measure how well we create a safe place to work by using the Lost Workday Case Incident Rate (LWCIR). This is derived by multiplying the number of lost workday cases by 200,000 and dividing by the total number of hours worked to provide a 'normalised' figure that can be tracked consistently.

In 2009, the LWCIR was 0.37, a decrease from 0.40 in 2008, largely due to increased efforts to reduce injuries across both European regions.

The highest proportions of injuries were vehicle related at 25 per cent (17.3 per cent in 2008), slips and trips at 22 per cent (26.6 per cent in 2008) and manual activity at 20 per cent (21 per cent in 2008). Entrapment accidents increased to 12 per cent compared with 9.8 per cent in 2008.

Regrettably, there were three fatalities in 2009 (compared to three in 2008). One was the result of an attack during a robbery and two others resulted from vehicle accidents.

Employment Principles

Our Employment Principles set out our commitment to good employment practices and workplace related human rights. The Principles are available on www.bat.com and our intranet. All our companies have committed to the Employment Principles and are required to demonstrate that they are embedding them in the workplace and encouraging key suppliers to meet similar standards. Adherence is monitored through our audit process.

Diversity

We aim to have a 70/30 ratio of local to expatriate senior management team members at business unit level, not as a 'quota' but because we place a high value on local experience and diversity in our workplace. We also continue to work towards our goal of increasing the proportion of women in senior management positions by actively supporting the career development of our senior female talent.

Global integration

We are entering a period of change as the Group becomes a more globally integrated organisation. It is clear that, as our business changes, what we need from our employees also changes. During 2009, we updated our 'leadership capabilities' to reflect the commercial skills and knowledge that are becoming increasingly important attributes in our people.

In 2010, we plan to review our leadership and management development training at all levels and aim to ensure that learning opportunities are accessible to as many employees as possible through the use of face-to-face and e-learning techniques.

Employee opinion survey

Our 'Your Voice' global employee opinion survey is conducted by independent consultants Towers Perrin ISR every two years and benchmarks our performance against a comparator group of FMCG companies. Our 2008 survey showed that we were ahead of this comparator group in all 11 categories measured.

Our next survey will be during 2010. In the meantime, we will continue addressing the gaps identified in the 2008 survey and, in light of the organisational changes we are going through, we will also seek to further develop our people's change management capabilities.

STRATEGY IN ACTION

COACHING IN SOUTH AFRICA

British American Tobacco South Africa has introduced a programme that enables its managers to coach employees in developing key skills, rather than relying on structured classroom training to tell people what they need.

This one-to-one approach to learning and development creates bonds among the company's people over time and can accelerate the development of key leadership skills and qualities. It has many advantages over traditional training, particularly as it helps make sense of real life dilemmas and challenges instead of using abstract case studies, giving people first-hand experience in coaching which they can then pass on.

A number of initiatives have been put in place to develop a coaching culture, including workshops for new joiners and support to practices such as executive coaching and coaching circles.

The company has found that building a coaching culture has challenges and that the most important considerations include:

- incorporating the coaching agenda into the business strategic plan;
- the support and commitment of top managers;
- robust performance management; and
- sustained momentum, focus and continuous communication.

As well as enabling people to develop faster, the programme has helped to provide solutions to business challenges that are better thought through. It has created a business environment where knowledge is shared widely and where networks can more comfortably work across traditional organisational boundaries.

KEY GROUP RISK FACTORS

This section identifies the main risk factors that may affect the British American Tobacco Group's business. The following table provides a brief description of the key risks to which the Group's operations are exposed and identifies, in each case, their potential impact on the Group and the principal activities in place to manage the risk. Each risk is considered in the context of the Group strategy by identifying the principal strategic element to which it relates, although other elements may also be relevant. The Group strategy is discussed in detail in the preceding pages of this Business review.

It is not the intention to provide an extensive analysis of all risks affecting the Group. Not all of the factors listed are within the control of the Group and other factors besides those listed may affect the performance of its businesses. Some risks may be unknown at present and other risks, currently regarded as immaterial, could turn out to be material in the future.

The risk factors listed in this section and the specific activities in place to manage them should be considered in the context of the Group's internal control framework, which is addressed in detail in the statement on internal control in the Corporate governance statement. This section should also be read in the context of the cautionary statement regarding forward-looking statements at the end of this section.

Risk registers are used at Group, regional, area and individual market levels. The Group risk register is reviewed by the Audit Committee at six-monthly intervals and provides the basis for the assessment of the key Group risk factors identified below.

ILLICIT TRADE

Illicit trade in the form of counterfeit products, smuggled genuine products and locally manufactured products on which applicable taxes are evaded, represents a significant and growing threat to the legitimate tobacco industry. Increasing excise rates can encourage more consumers to switch to illegal cheaper tobacco products and provide greater rewards for smugglers. The risk is exacerbated by the current economic downturn.

Competition from illicit trade

Principal relevance to Group strategy: Potential impact on **Growth** (organic revenue growth)

Principal potential causes

- sudden and disproportionate excise increases and widening excise differentials between markets;
- ineffective regulatory environment;
- lack of law enforcement and weak border controls.

Potential impact on Group

- erosion of brand equity;
- investment in trade marketing and distribution is undermined;
- product is commoditised;
- lower volumes and reduced profits.

Principal activities in place to address risk

- dedicated Anti-Illicit Trade (AIT) teams operating at global, regional, area and key market levels;
- active engagement with key stakeholders;
- global AIT strategy development supported by a research programme to further the understanding of the size and scope of the problem;
- AIT Intelligence Unit (including a dedicated analytical laboratory) cooperates with law enforcement agencies in pursuit of priority targets and capacity building;
- strong internal business conduct and customer approval policies.

EXCISE AND TAX

Tobacco products are subject to substantial excise and sales taxes in most countries in which the Group operates. In many of these countries, taxes are generally increasing but the rate of increase varies between countries and between different types of tobacco products.

Excise shocks from tax rate increases or structure changes

Principal relevance to Group strategy: Potential impact on **Growth** (organic revenue growth)

Principal potential causes

- government initiatives to raise revenues;
- increases advocated within context of national health policies.

Potential impact on Group

- consumers reject the Group's legitimate tax-paid products for products from illicit sources;
- lower sales volume or alteration of sales mix.

Principal activities in place to address risk

- requirement for Group companies to have in place formal pricing and excise strategies and contingency plans to manage significant excise changes;
- annual review of brand portfolio, brand health and equity.

FINANCIAL

The Group's underlying operations give rise to certain financial risks. The principal risks in this regard, and the controls in place to address them, are identified below and further details about the Group's financial management and treasury operations can be found within the Financial review.

Liquidity risks, including capital structure and leverage

Principal relevance to Group strategy: Potential impact on **Productivity** (capital effectiveness)

Principal potential causes

- downturn in macroeconomic climate and/or failures in financial systems – global or in individual markets;
- limited liquidity, access to cash and sources of finance;
- fluctuations in interest rates due to movements in international capital markets.

Potential impact on Group

- increased funding costs and requirement to raise or issue equity or seek new sources of capital;
- inability to fund strategic opportunities or respond to threats;
- underperforming share price and erosion of shareholder value;
- damage to corporate reputation.

Principal activities in place to address risk

- established and conservative financing principles, which target a minimum level of liquidity, a minimum average maturity for the total debt portfolio and a maximum allowable proportion of total debt maturing in any one year, with regular reporting against those principles;
- targeted investment grade rating;
- retained cash flow spread across a wide banking group;
- maintenance of a substantial committed bank facility which may be drawn at short notice and liquidity pooling structures to access operating company cash balances.

FINANCIAL CONTINUED

Management of cost base

Principal relevance to Group strategy: Potential impact on **Productivity** (cost management)

Principal potential causes

- macroeconomic conditions lead to high inflation of key commodities (leaf, wood pulp, energy) and/or wage inflation;
- productivity programmes and above market projects do not achieve objectives due to lack of alignment and/or insufficient resources;
- incomplete, inefficient or misaligned organisational changes.

Potential impact on Group

- higher product costs and/or increased salary costs, with impact on profit and cash flow;
- inability to manage cost savings leads to lower profits and reduced funds for investment in long-term growth;
- ineffective structural changes restrict future growth potential, increase short-term cost base and result in short-term loss of business focus;
- reduced shareholder confidence.

Principal controls in place to address risk

- multiple sources of key commodities and development of new sources in low-cost countries;
- harmonisation of product specifications and production efficiencies to reduce variable costs;
- wage inflation is monitored globally via established compensation committee structures; in areas of high inflation, salary increases are staggered to mitigate impact;
- programme in place to achieve costs savings of £800 million by 2012;
- regular tracking of actual productivity savings and forecast improvements in operating margin and supply chain, overheads and indirect projects and above market projects; periodic reviews of long-term savings;
- for 2009, costs have been one of the performance measures for payments under the International Executive Incentive Scheme.

Foreign exchange rate exposures

Principal relevance to Group strategy: Potential impact on **Productivity** (capital effectiveness)

Principal potential causes

- translational foreign exchange (FX) rate exposures for earnings/cash flows from the Group's global business, from exchange rate movements against sterling, the Group's reporting currency;
- transactional FX rate exposures generated from underlying operations across the Group's global business due to receipts and payments in non-domestic currencies.

Potential impact on Group

- fluctuations in translational FX rates of key currencies against sterling introduce volatility in reported results;
- fluctuations in transactional FX rates introduce volatility in costs of operations, with a potential adverse impact on financial performance.

Principal activities in place to address risk

- while translational FX exposure is not hedged, its impact is identified in results presentations and financial disclosures, and earnings are restated at constant rates for comparability;
- debt and interest are matched to assets and cash flows to mitigate volatility where possible;
- transactional FX exposures from the Group's underlying operations are monitored and hedged under defined policies, procedures and limits; illiquid currencies, where hedging is not possible or uneconomic, are regularly reviewed.

FINANCIAL CONTINUED

Counterparty risks

Principal relevance to Group strategy: Potential impact on **Productivity** (capital effectiveness)

Principal potential causes
– failure of counterparties with whom the Group has dealings.

Potential impact on Group
– significant financial loss reflected in adverse impact on Group assets, financial risk profile and liquidity;
– disruption to operations due to failure of a transactional banking counterparty.

Principal activities in place to address risk
– risk is spread through a wide banking group focused on strong counterparties across the globe; exposure to each financial counterparty is monitored and risk is limited according to the counterparty's credit rating;
– financing principles and treasury policy compliance/monitoring reflect global counterparty risk strategy.

Wrongly valued acquisition opportunities

Principal relevance to Group strategy: Potential impact on **Growth** (mergers and acquisitions)

Principal potential causes
– lack of market intelligence;
– overvaluation of assets or understatement of liabilities.

Potential impact on Group
– loss of opportunity;
– loss of volume, market share and profit;
– damage to corporate reputation.

Principal activities in place to address risk
– specialist and properly resourced mergers and acquisitions department;
– contacts at all major investment banks to monitor opportunities;
– transactions must meet defined financial investment criteria;
– oversight by senior management or Board where appropriate.

Retirement benefits

Principal relevance to Group strategy: Potential impact on **Productivity** (capital effectiveness)

Principal potential causes
– the Group operates a number of defined benefit pension schemes;
– these create risk through their exposure to the volatility in financial markets and shifting actuarial assumptions.

Potential impact on Group
– increased deficits force higher contributions and profit and loss charges;
– increased net liabilities impact on the Group's credit worthiness and put pressure on its credit rating.

Principal activities in place to address risk
– established limits on the proportion of assets that can be held in riskier investment classes;
– regular actuarial valuations and agreed funding plans;
– defined benefit schemes are now closed to new entrants.

KEY GROUP RISK FACTORS
CONTINUED

MARKETPLACE

The Group has substantial operations in over 180 countries. Its results are influenced by the economic, regulatory and political situations in the countries and regions in which it has operations, as well as by the actions of competitors.

Inability to obtain adequate supplies of leaf

Principal relevance to Group strategy: Potential impact on **Growth** (organic revenue growth)

Principal potential causes
- natural disasters, including major impact of climate change;
- competition for land use from other agricultural products;
- government initiatives to move farmers away from tobacco.

Potential impact on Group
- increased blend costs through lack of supply;
- potential deterioration in smoke quality impacting consumer;
- loss of market share in one or more markets.

Principal activities in place to address risk
- global sourcing and globally integrated management of leaf supply chain;
- on average, two-thirds of tobacco requirements met from within Group;
- three year planning cycle to identify and manage potential shortages;
- scenario planning and contingency plans.

Economic crisis impact on secondary supply chain

Principal relevance to Group strategy: Potential impact on **Growth** (organic revenue growth)

Principal potential causes
- collapse of economic environment in key geographic area;
- trading partners in secondary supply chain fail or suffer lack of capital.

Potential impact on Group
- one-time loss of revenue led by reduction in inventories within the secondary supply chain;
- significant increase in bad debts and/or write-offs;
- significant supply disruptions causing material consumer out-of-stocks.

Principal activities in place to address risk
- established route-to-market strategy, involving direct distribution to retail where appropriate, and effective relationships with distributors/wholesalers;
- monitoring of retail stocks, distributors/wholesalers inventories and reordering patterns, to identify potentially adverse trends;
- strict adherence to established trading terms and conditions.

Trading environment

Principal relevance to Group strategy: Potential impact on **Growth** (organic revenue growth)

Principal potential causes
- downturn in macroeconomic climate reduces consumers' disposable incomes and may lead to consumer down-trading;
- competitors seek volume growth by price discounts.

Potential impact on Group
- price increases to cover cost rises are not achieved;
- profit growth in short term falls below shareholders' expectations;
- reduction in funds for investment in long-term growth.

Principal activities in place to address risk
- regular regional and management reviews of budgeted pricing scenarios;
- close monitoring of sales to detect changes in consumer purchasing patterns;
- development of strong brands and brand portfolios;
- price war simulations.

MARKETPLACE CONTINUED

Trading performance in key markets

Principal relevance to Group strategy: Potential impact on **Growth** (organic revenue growth)

Principal potential causes

- inability to predict consumers' changing behaviours through lack of market insights;
- insufficient internal resources committed to develop, launch and maintain innovative products;
- inability to capture growth opportunities in individual markets and/or synergistic benefits from strong brand portfolio.

Potential impact on Group

- reduction in market share and volume;
- profit growth in the short term fails to meet shareholders' expectations;
- reduction in funds for investment in long-term growth;
- diminished shareholder confidence in the Group's growth prospects;
- erosion of consumer base;
- weakened brand portfolio.

Principal activities in place to address risk

- established innovations process and strategy;
- standard methodology to address consumer surveys and brand value segmentation;
- regular reviews of key markets, levels of investment, brand focus, industry outlook and competitor activity.

REGULATION

The Group's businesses operate under increasingly stringent regulatory regimes around the world. Further regulation is expected, particularly as a result of the World Health Organisation's Framework Convention on Tobacco Control (FCTC) and, increasingly, active tobacco control activities outside the FCTC.

Regulation risks covering: packaging and labelling; advertising and promotion; design, contents and emissions of products; testing and measuring; public place smoking; and industry participation

Principal relevance to Group strategy: Potential impact on **Growth** (organic revenue growth)

Principal potential causes

- adoption of differing regulatory regimes in different countries/groups of countries and/or lack of consensus on interpretation/application;
- adoption of more stringent regulations on communications, such as point of sale display bans and plain packaging;
- exclusion of industry from participating in engagement with regulators;
- contribution to denormalisation of smoking.

Potential impact on Group

- cost complexity of meeting regulations;
- generic or plain packaging leads to loss of brand equity and commoditisation;
- reduced ability to communicate brand portfolio and innovations, contributing to an increase in illicit trade;
- reduced consumer acceptability of new product specifications, leading to loss of volume;
- restriction of industry participation leads to inability to mitigate other regulatory risks.

Principal activities in place to address risk

- Group companies have regulatory strategies in place in order to identify issues material to their operating environment and develop plans to address them in a manner consistent with local law and Group policy;
- engagement is sought with scientific and regulatory communities, and stakeholder engagement takes place at global, regional and individual market levels;
- global monitoring of regulatory trends and developments and analysis of regulatory proposals to determine impacts, if any, on business;
- development of corporate positions and best practice examples for markets to address regulation.

LITIGATION

The Group is involved in a number of legal and regulatory court proceedings in a number of countries, including the US. These proceedings may be characterised as covering smoking and health issues and include claims for personal injury and claims for economic loss arising from the treatment of smoking and health-related diseases. Regulatory proceedings may result in a challenge to new regulations. A fuller analysis of current legal proceedings to which the Group is subject is set out in note 30 in the Notes on the accounts.

Loss of a smoking and health-related court case

Principal relevance to Group strategy: Potential impact on **Productivity** (capital effectiveness)

Principal potential causes

– continuing exposure to new litigation;
– outcomes of legal and regulatory court proceedings in various jurisdictions.

Potential impact on Group

– unfavourable outcome or settlement of pending or future litigation;
– material impact on consolidated results of operations, cash flows and financial position in a particular fiscal quarter or fiscal year.

Principal activities in place to address risk

– a specialist centre of expertise, the Strategic Litigation Team (SLT), has responsibility for directing and managing the litigation risk globally;
– Group companies are required to assess their litigation exposure and liaise with the SLT in connection with specific claims.

DATA RISKS

The Group is increasingly reliant on information technology systems for its internal communications, controls, reporting and relations with customers and suppliers, as well as for the management of business information. The loss or misuse of sensitive information, or its disclosure to outsiders, including competitors and trading partners, could potentially have a significant adverse impact on the Group's business operations and/or give rise to legal liability.

Disruption to the Group's information technology systems

Principal relevance to Group strategy: Potential impact on **Productivity** (cost management)

Principal potential causes

– loss of wide area of communications;
– effects of a computer virus attack;
– loss of operations in a major data centre;
– Group data processed, stored or transported by IT systems (Group or third party) is corrupted, lost or disclosed.

Potential impact on Group

– loss or delay in sales or cash collections and/or inability to pay suppliers or staff;
– goods unable to be shipped;
– loss of telephony or email systems;
– loss or corruption of data;
– delays in meeting statutory or internal reporting requirements;
– reputational loss or legal liability.

Principal controls in place to address risk

– information technology architecture based on established solutions from leading suppliers, with contingency plans in the event of counterparty failure;
– all critical financial and planning systems have secure backup systems and disaster recovery plans; largest systems have full failover designs with dual-site hosting;
– comprehensive anti-virus protection in place Group-wide, with external testing to confirm protection;
– backup communication links in place for data centres and major sites;
– strict security standards and firewall protection for external links.

DATA RISKS CONTINUED

Loss of confidential information or malicious manipulation of data

Principal relevance to Group strategy: Potential impact on **Productivity** (cost management)

Principal potential causes

- inadequate controls regarding the creation, storage and sharing of confidential information;
- inadequate access controls to key systems and data.

Potential impact on Group

- loss of revenue and/or profit due to use of inaccurate data, loss of trade secrets and/or competitors gaining advantage;
- increased costs in restoring lost data and/or reversing inaccurate transactions;
- regulatory action, civil action and/or criminal prosecution for breach of legal obligations;
- damage to corporate reputation and loss of shareholder confidence;
- negative impact on share price.

Principal controls in place to address risk

- information technology controls (see above);
- established information security and information technology policies and procedures;
- promotion of awareness and understanding of information security issues.

Cautionary statement

The Business review and certain other sections of this document contain forward-looking statements which are subject to risk factors associated with, among other things, the economic and business circumstances occurring from time to time in the countries and markets in which the Group operates. It is believed that the expectations reflected in these statements are reasonable but they may be affected by a wide range of variables which could cause actual results to differ materially from those currently anticipated.

REGIONAL REVIEW

PAGE

Chief Operating Officer's overview 42

Nicandro Durante, Chief Operating Officer, reviews our global performance and discusses the trends that had an effect on our businesses worldwide.

Group performance by region 43

The contribution of each region to Group volumes, revenue and adjusted profit from operations, with the change from the previous year.

Regional highlights 44

An overview of our regions – Asia-Pacific, Americas, Western Europe, Eastern Europe and Africa and Middle East – with a summary of our position in the important markets in each region.

Results of associates 49

The associate companies of the Group now principally comprise Reynolds American in the US and ITC in India.

free
free
free
free

REGIONAL REVIEW

"Revenue growth of 17 per cent and Global Drive Brand volume up 4 per cent in the economic climate experienced in 2009, is an outstanding performance."

Nicandro Durante Chief Operating Officer

OVERVIEW

The Group grew revenue by 17 per cent in very difficult times, to £14,208 million. This was the result of favourable exchange rate movements, good pricing momentum, volume from acquisitions made in the middle of 2008 (Skandinavisk Tobakskompagni (ST) and Tekel) and the acquisition of Bentoel in June 2009. Revenue increased by 10 per cent at constant rates of exchange. All the regions contributed to this good result.

The reported profit from operations was 15 per cent higher at £4,101 million. Adjusted profit from operations was 20 per cent higher and would have been up 10 per cent at constant rates of exchange, despite the adverse transactional impact of exchange rates on costs.

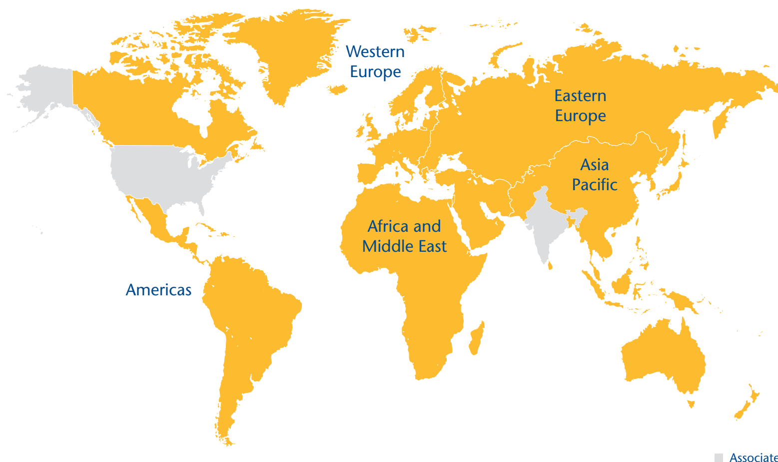
Group volumes from subsidiaries were 724 billion, an increase of 1 per cent, as a result of the acquisitions of ST, Tekel and Bentoel.

Market shares increased in a number of markets but, on an organic basis, volumes were down 3 per cent mainly as a result of deteriorating economies which led to declines in the total size of a number of markets and, in some markets, down-trading and an increase in illicit trade. Good volume growth in Bangladesh, South Korea, Vietnam, Uzbekistan, Nigeria, Egypt and the Gulf Cooperation Council (GCC) was more than offset by declines in Malaysia, Japan, Brazil, Mexico, Argentina, Venezuela, Italy, Russia, Ukraine, Romania and South Africa.

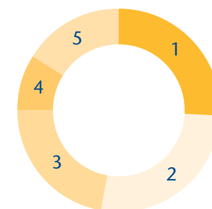
Despite market size declines in many countries, the four Global Drive Brands achieved good overall volume growth of 4 per cent and improved share in a number of markets. Just over half of the growth was contributed by brand migrations. Although there was pressure on the premium segment, Dunhill grew market share in all its key markets, except in Taiwan, while Kent increased market share in its main markets, apart from Japan.

Kent volumes fell by 4 per cent mainly as a result of industry declines in Russia and Japan, its principal markets and despite a higher market share in Eastern Europe and an increased premium segment share in Russia. Volumes grew in Kazakhstan, Ukraine, Uzbekistan and Azerbaijan, while they were slightly down in Romania. Dunhill rose by 9 per cent, mostly driven by a brand migration in Brazil, with growth in South Korea, the GCC, South Africa and Russia, partially offset by declines in Malaysia, Taiwan and Australia.

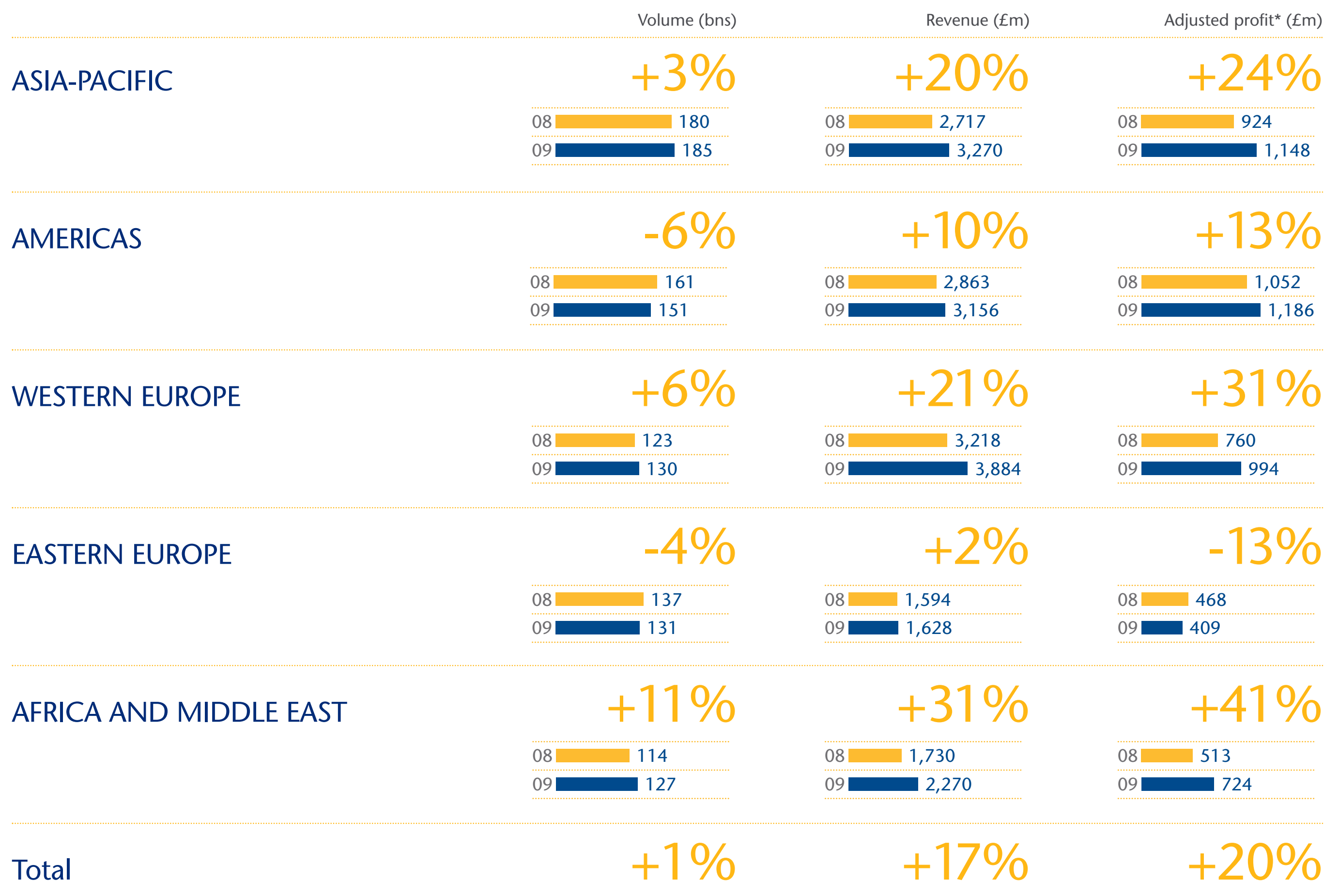
Lucky Strike volumes were 4 per cent higher with growth in Germany, France, Italy and Chile, partially offset by declines in Spain, Japan and Argentina, largely as a result of the industry volume decline. Market share grew well across all its key markets. Pall Mall volumes increased by 10 per cent with growth in Germany, Uzbekistan, Spain, Mexico, Chile and Turkey, partially offset by lower volumes in Pakistan, Russia, Romania and Hungary.



Percentage of Group profit per region



1. ASIA-PACIFIC 26%
2. AMERICAS 27%
3. WESTERN EUROPE 22%
4. EASTERN EUROPE 9%
5. AFRICA AND MIDDLE EAST 16%



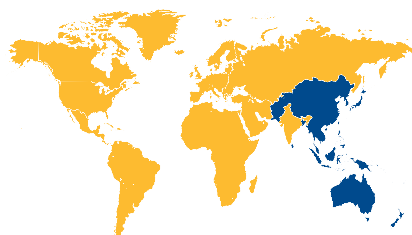
	Volumes		Revenue		Adjusted profit*	
	2009 bns	2008 bns	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Asia-Pacific	**185**	180	**3,270**	2,717	**1,148**	924
Americas	**151**	161	**3,156**	2,863	**1,186**	1,052
Western Europe	**130**	123	**3,884**	3,218	**994**	760
Eastern Europe	**131**	137	**1,628**	1,594	**409**	468
Africa and Middle East	**127**	114	**2,270**	1,730	**724**	513
	724	715	**14,208**	12,122		
*Adjusted profit from operations					**4,461**	3,717
Revenue and adjusted profit from operations, restated at constant rates of exchange			**13,280**	12,122	**4,106**	3,717

*The profit discussed in the Regional review is based on adjusted profit from operations and therefore excludes the impact of restructuring and integration costs, the 2008 Canadian settlement, amortisation of trademarks and gains on disposal of businesses and trademarks.

ASIA-PACIFIC

“The strength of the region is reflected by the strong volume, revenue and profit growth.”

John Daly Director, Asia-Pacific



26%

PERCENTAGE OF GROUP VOLUME

185 billion

VOLUMES
+3%

£3,270 million

REVENUE
+20%

£1,148 million

PROFIT
+24%

In **Asia-Pacific**, profit at £1,148 million was up £224 million, mainly as a result of favourable exchange rates, backed by strong performances in Australia, Pakistan, Bangladesh, Taiwan and Vietnam, as well as the contribution resulting from the acquisition of Bentoel mid-year. Bentoel's performance was in line with expectations. At constant rates of exchange, profit would have increased by £91 million or 10 per cent. Volumes at 185 billion were 3 per cent higher as increases in Bangladesh, Vietnam and South Korea, and the additional volumes from Bentoel, were partially offset by lower volumes in Japan, Malaysia and Taiwan.

Strong profit growth in Australia was attributable to higher pricing and continued cost saving initiatives. Volumes were in line with last year while market share was slightly lower despite the growth experienced by Pall Mall and Winfield. In New Zealand, volumes and market share were down as competitor discounting intensified, although Pall Mall performed well. Profit was up due to price increases, lower costs and a stronger exchange rate.

In Malaysia, Kent's market share grew after its relaunch in 2008 and Dunhill achieved a record share. However, volumes were down due to steep excise increases over the last two years and legal industry volume decreases as a result of the growth of illicit trade. Profit rose as a result of a favourable exchange rate, higher pricing and cost management, partially offset by the lower volumes.

In Japan, strong profit growth was achieved predominantly through favourable exchange rates, productivity savings and a better product mix. Volumes suffered as a result of significant industry decline. The premium-priced brand Kool grew share, although overall market share was slightly lower.

In Vietnam, higher volumes, supported by a combination of price increases, productivity initiatives and favourable exchange rates, led to strong profit growth. Whilst market share was down slightly, Dunhill performed well.

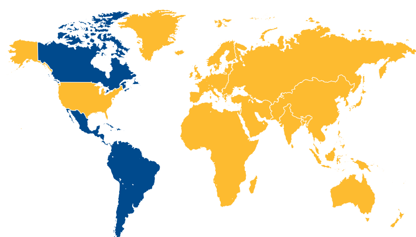
Volumes and market share in South Korea grew due to a good performance from Dunhill. Profit decreased as a weaker exchange rate had an adverse transactional impact, leading to higher material costs. In Taiwan, profit improved due to excise-led price increases, cost savings and the favourable exchange rate. Market share increased in a substantially contracted market.

Market share in Pakistan continued to grow and despite lower volumes, excise-led price increases resulted in a strong growth in profit. In Bangladesh, profit was significantly higher due to increased volumes, improved sales mix, lower costs and favourable exchange rates. Market share was slightly lower due to the substantial growth in the low-price segment of the market. In Sri Lanka, profit was up strongly benefiting from price increases, a better sales mix and productivity improvements. Volumes were adversely affected by the excise-led price increases, although Dunhill and Pall Mall increased share.

AMERICAS

"Strong revenue and profit growth were the results of exchange rate benefits and an improved product mix, driven by the growth in the Global Drive Brands."

Mark Cobben Director, Americas



21%

PERCENTAGE OF GROUP VOLUME

151 billion

VOLUMES
-6%

£3,156 million

REVENUE
+10%

£1,186 million

PROFIT
+13%

In **Americas**, profit rose by £134 million to £1,186 million, mainly attributable to a strong performance from Brazil, an improved product mix and exchange rate benefits. At constant rates of exchange, profit would have risen by £68 million or 6 per cent. Volumes were down 6 per cent at 151 billion, with decreases experienced in most markets across the region, despite some market share gains.

In Brazil, strong profit growth was achieved as a result of a substantial excise-led price increase, coupled with a better premium mix and improved margins on the tobacco leaf export business. Higher prices led to lower industry volumes but share increased in the legal market. Dunhill is performing well after its migration from Carlton.

Profit in Canada increased, benefiting from a strong currency and some reduction in illicit trade partially offset by slightly lower volumes, provincial tobacco tax increases and an adverse product mix. Market share declined slightly due to down-trading but share grew in the value-for-money and low-price segments.

In Mexico, industry volumes were reduced by the excise-driven price increase at the end of 2008. Montana performed well and Boots was successfully migrated to Pall Mall. However, market share was lower. The impact of the reduction in volumes and increased marketing investment was only partially offset by the price increase and lower overheads, resulting in a profit decline. Profit in Argentina was in line with last year as the adverse exchange impacts on variable costs, other cost pressures and lower volumes, were offset by higher prices.

In Chile, the contraction of the market led to lower volumes. Although Lucky Strike and Pall Mall both performed well, market share was in line with last year. Profit decreased as a result of the lower volumes and higher costs, including the impact of foreign exchange on imported materials. Profit increased in Peru as a result of stable volumes and an improved product mix. Market share improved, driven by distribution expansion and strong growth by Lucky Strike and Pall Mall.

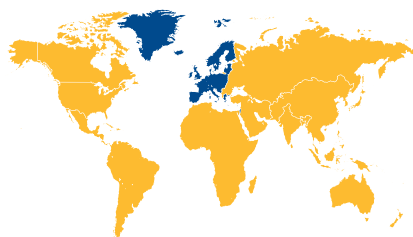
Market share in Venezuela was up strongly as a result of the growth of Lucky Strike and the refocusing of the brand portfolio. However, industry volumes declined sharply, affected by significant price increases to offset excise increases and high inflation. Profit was significantly lower due to the impact of foreign exchange and lower volumes. In Colombia, market share was lower than last year and industry volumes also declined. Profit rose as a result of lower costs.

Profit grew strongly in the Central America and Caribbean area despite lower industry volumes. This was due to higher prices and an improved product mix in key markets, as well as exchange gains. Market share increased, with Pall Mall and Dunhill being the main drivers for the growth.

WESTERN EUROPE

“The inclusion of the full year benefits of the acquisition of ST and good performances in a number of markets, resulted in impressive volume, revenue and profit growth.”

Jack Bowles Director, Western Europe



18%

PERCENTAGE OF GROUP VOLUME

130 billion

VOLUMES
+6%

£3,884 million

REVENUE
+21%

£994 million

PROFIT
+31%

Profit in **Western Europe** increased by £234 million to £994 million, mainly as a result of the acquisition of ST in 2008 and stronger exchange rates, partially offset by continuing losses in Poland. At constant rates of exchange, profit would have increased by £119 million or 16 per cent. Regional volumes were up 6 per cent to 130 billion, as a result of the additional volumes due to the acquisition of the ST businesses and growth in Greece, France and Spain, partially offset by declines in Italy, Switzerland and the Netherlands.

Profit increased in Italy mainly driven by higher prices, a better product mix and productivity savings. Volumes dropped as the total market contracted and there was a slight decline in share, mostly due to MS and other local brands, partly offset by growth in Lucky Strike.

In Germany, volumes were in line with last year, benefiting from higher market share with strong growth by Pall Mall and higher volumes from Lucky Strike, compensating for a decline in local brands. This, along with higher margins, favourable exchange rates and lower overheads, contributed to a significant rise in profit.

Market share in France was stable with industry volumes up. Lucky Strike and Pall Mall continued their growth. Profit increased on last year, mainly attributable to the favourable exchange rate and the price increase in November 2009. In Spain, profit and volume grew despite a sharp decline in the total market. Higher volumes were driven by Pall Mall and Lucky Strike increasing their market shares. Increased profit reflected the impact of price rises, as well as overhead savings.

Profit in Switzerland was lower due to increased price discounting by competitors and lower volumes, partially offset by favourable exchange rates and a price increase. Market share was slightly down while the total market contracted, with Parisienne demonstrating strong share growth.

Profit improved significantly in Belgium with stable volumes and mix benefits supported by lower costs. There was strong growth in Pall Mall following the 2008 migration from Winfield, supported by an increase in Kent. In the Netherlands, cigarette volumes decreased following the excise increase in late 2008. Profit rose due to favourable exchange rates, partially offset by the impact of the overall market decline.

In Poland, reported volume increased significantly due to the incorporation of the ST Polish business. Organic volumes were down driven by the contraction in the market as a result of general economic conditions and excise-driven price rises.

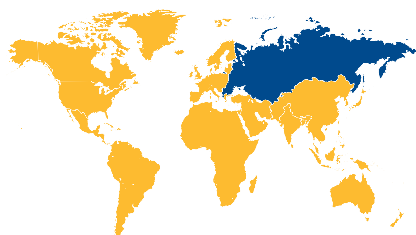
In Hungary, the impact of declining volumes was partially offset by productivity benefits and improved margins leading to a slight decrease in profit. Market share remained stable.

The acquisition and the integration of ST transformed our businesses in Scandinavia. The combined volumes and market share were slightly lower, although Prince remained stable. Profit was in line with expectations at the time of the acquisition.

EASTERN EUROPE

"Global Drive Brands performed well despite lower industry volumes. The weakening of many currencies impacted product cost and results in sterling."

David Fell Director, Eastern Europe



18%

PERCENTAGE OF GROUP VOLUME

131 billion

VOLUMES
-4%

£1,628 million

REVENUE
+2%

£409 million

PROFIT
-13%

Profit in the **Eastern Europe** region decreased by £59 million to £409 million. This was principally due to lower volumes and the adverse effect of exchange rates on transactional costs and on translation to sterling. At constant rates of exchange, profit would have decreased by £35 million. Volumes at 131 billion were 4 per cent lower than last year, with decreases seen in Russia, Ukraine and Romania due to industry declines as a result of lower consumption and an increase in illicit trade, partially offset by a strong performance in Uzbekistan.

In Russia, volumes were reduced by a decline in market size and competitor pricing. Profit was down as a result of lower volumes, down-trading and adverse exchange effects on costs, which more than offset the impact of higher prices. Market share decreased, although share grew in the premium segment with Dunhill and Kent performing well.

In Romania, an impressive performance by Kent and strong growth by Dunhill and Vogue resulted in a record corporate share. Industry volumes declined due to a number of excise price rises and increased illicit trade. Higher marketing investment, higher product costs, together with the reduction in volumes, led to lower profit.

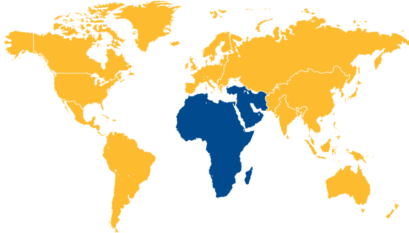
In Ukraine, Kent continued growing volumes and overall share in a market where industry volumes declined sharply. Profit was higher despite lower volumes and market share, rapid currency devaluations and excise increases.

Strong volumes and market share performances were achieved in the Caucasus through the growth of Kent, Pall Mall and Viceroy. In Uzbekistan, profit increased significantly.

AFRICA AND MIDDLE EAST

“Outstanding performances by many markets, complemented by the full year benefit of the Tekel acquisition, resulted in impressive growth.”

Andrew Gray Director, Africa and Middle East



18%

PERCENTAGE OF GROUP VOLUME

127 billion

VOLUMES
+11%

£2,270 million

REVENUE
+31%

£724 million

PROFIT
+41%

Profit from the **Africa and Middle East** region grew by £211 million to £724 million. At constant rates of exchange, profit would have increased by £146 million or 28 per cent, mainly driven by South Africa, Nigeria, the GCC and the benefit of the acquisition of Tekel during 2008. Volumes were 11 per cent higher at 127 billion, following increases in Turkey, the GCC, Nigeria and Egypt, which were partly offset by declines in South Africa and Iran.

In South Africa, the overall market contracted and with a reduction in trade inventories and down-trading to illicit trade, volumes were much lower. However, market share increased, with Peter Stuyvesant showing strong growth, whilst Dunhill and Kent performed well, assisted by the migration of Courtleigh Gold Band to Dunhill. Profit was up, benefiting from price increases and lower costs.

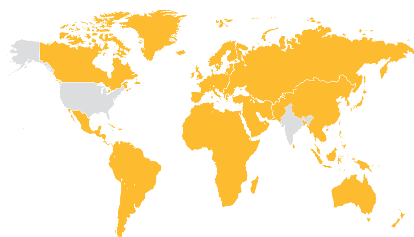
Profit in Nigeria increased significantly due to higher volumes and lower costs, partially offset by a weaker local currency. Volumes and market share grew well. The market benefited from anti-illicit trade initiatives by the government.

Volumes in the Middle East increased strongly. Dunhill achieved excellent growth in the GCC whilst sales of Kent and Lucky Strike improved markedly in the Levant. This led to growth in market share across the area and profit rose as a result of higher prices and volumes, improved product mix and lower costs, coupled with the favourable exchange rate.

In Egypt, there was significant volume and market share growth, supported by an expansion in distribution.

In Turkey, the Tekel business acquired in 2008 was successfully integrated. Kent, Pall Mall and Viceroy all performed extremely well, although total market share was lower as a result of a decline in the Tekel local brands. The financial performance remains in line with our expectations at the time of the acquisition.

ASSOCIATES



Results of Associates
Associates principally comprise Reynolds American and ITC, while they also included ST for the first six months of 2008.

The Group's share of the post-tax results of associates decreased by £20 million, or 4 per cent, to £483 million. Excluding the adjusting items in 2008 and in 2009, explained on page 54, the Group's share of the post-tax results of associates increased by 13 per cent to £541 million, with a decline of 1 per cent at constant rates of exchange as a result of accounting for ST as a subsidiary from July 2008.

The contribution from Reynolds American excluding adjusting items was 19 per cent higher at £388 million, mainly driven by higher pricing and gains in productivity, offset by lower volumes and legal expenses. At constant rates of exchange the increase was 1 per cent.

The Group's associate in India, ITC, continued its strong profit growth and its contribution to the Group rose by £27 million to £144 million. At constant rates of exchange, the contribution would have been 17 per cent higher than last year.

Associates' volumes decreased by 10 per cent to 183 billion largely as a result of ST being consolidated as a subsidiary from July 2008.

FINANCIAL REVIEW

PAGE

Finance Director's overview 52

Ben Stevens, Finance Director, reviews the Group's financial performance and activities.

Interest cover 53

Interest cover remains strong at 8.6 times, reflecting the increase in the Group's profit, cash generation and the contributions of acquisitions in 2008 and 2009, offset by the associated increase in interest costs.

Dividends 54

The total dividends per share increased by 19 per cent, in line with the Group's policy to pay dividends of 65 per cent of long-term sustainable earnings.

Cash flow 56

Free cash flow – the cash flow before dividends, share buy-backs and investing activities – grew by 1 per cent and exceeded the total cash outlay on dividends to shareholders by £832 million.

FINANCIAL REVIEW

> "Our history of consistent profit growth and high cash conversion, provides confidence in our ability to continue building a highly successful and competitive business."

Ben Stevens Finance Director

HIGHLIGHTS

- Revenue grew by 17 per cent.
- Adjusted profit from operations increased by 20 per cent.
- Adjusted diluted earnings per share up by 19 per cent.
- Total dividends per share for 2009 of 99.5p, up 19 per cent on 2008.
- Strong cash flow, with free cash flow at 86 per cent of adjusted earnings per share.
- Interest cover remains strong with interest payable covered 8.6x (2008: 8.5x).
- Committed long-term facilities of £1.75 billion were undrawn at year end.
- Operating margin increased by 0.7 percentage points to 31.4 per cent.

Profit from operations

The reported Group revenue at £14,208 million grew by 17 per cent and profit from operations at £4,101 million grew by 15 per cent.

The growth in Group revenue would have been 10 per cent, to £13,280 million, at constant rates of exchange.

In order to better understand the underlying performance of the business, it is necessary to adjust for a number of items relating, for example, to restructuring costs. We call the underlying profit after adjusting for these items, adjusted profit. These adjustments are described further below. Adjusted profit from operations was £4,461 million, up 20 per cent from £3,717 million in 2008.

Adjusted profit from operations translated at constant rates of exchange, was up 10 per cent to £4,106 million.

For 2009, revenue growth was enhanced by the full year benefits of the acquisitions of the cigarette and snus businesses of Skandinavisk Tobakskompagni (ST) and the purchase of the cigarette assets of Tekel, the Turkish state tobacco company. During 2009, the Group also acquired PT Bentoel Internasional Investama Tbk, which contributed to the second half of the year's results.

In 2008, it was announced that the Group wanted to continue the success of the previous five year programme of cost savings which ended in 2007, by launching a new five year programme – to achieve annual savings of £800 million by 2012. It includes areas such as supply chain efficiencies, back office integration and slimmer management structures. During the first two years of the programme, savings of over £484 million were delivered.

These cost reduction initiatives resulted in the adjusted profit from operations, as a percentage of net revenue, improving to 31.4 per cent compared to 30.7 per cent in 2008 and 30.0 per cent in 2007. More details of the Group's adjusted operating performance can be found in the Regional review.

Percentage increases in revenue and in profit from operations

	Revenue growth	Profit growth
As reported	+17%	+15%
Excluding adjusting items	+17%	+20%
Excluding adjusting items at constant rates	+10%	+10%

Adjusting items

The adjusting items below included in the profit from operations, are separately disclosed as memorandum information on the face of the income statement and in the segmental analysis. Excluding them from the reported profit from operations helps to provide a better understanding of the Group's underlying financial performance and is referred to as adjusted profit from operations.

During 2009, the Group incurred costs as a result of initiatives to improve the effectiveness and the efficiency of the Group as a globally integrated enterprise. These initiatives include a review of the Group's manufacturing operations, overheads and indirect costs, organisational structure and systems and software used. The costs of these initiatives plus the costs of integrating acquired businesses into existing operations were £304 million for the year ended 31 December 2009, compared to £160 million for 2008.

Restructuring and integration costs principally relate to costs in respect of the planned closure of the Soeborg factory in Denmark, the planned downsizing of the manufacturing plant in Australia, the continued integration of ST and Tekel and the merger of Bentoel with existing Indonesian operations, as well as other restructuring initiatives. The costs for these other initiatives include redundancies, principally in respect of activities in the Group's subsidiary in Canada, and impairment charges for certain software assets where developing global software solutions has resulted in these assets having minimal or limited future economic benefits.

On 31 July 2008, the Group's subsidiary, Imperial Tobacco Canada, announced that it had reached a resolution with the federal and provincial governments with regard to the investigation related to the export to the United States of Imperial Tobacco Canada products in the late 1980s and early 1990s. The subsidiary entered a plea of guilty to a regulatory violation of a single count of Section 240(i)(a) of the Excise Act and Imperial Tobacco Canada paid a fine of £102 million which was expensed in 2008 and treated as an adjusting item.

The acquisitions of the assets of Tekel and the ST businesses in mid-2008, as well as the Bentoel business in mid-2009, resulted in the capitalisation of trademarks which are amortised over their expected useful lives, which do not exceed 20 years. The 2009 amortisation charge in respect of trademarks amounted to £58 million, while it was £24 million in 2008.

As part of the ST transaction, the Group realised a gain of £139 million in 2008 with the disposal of its 32.35 per cent holding in the non-cigarette and snus businesses of ST. The acquisition was subject to regulatory approval which was received on the condition that the Group divest a small number of local trademarks, primarily in Norway. The disposal of the trademarks was dealt with in two packages, which were completed in February and May 2009. The total proceeds from the two packages resulted in a gain of £2 million.

Net finance costs

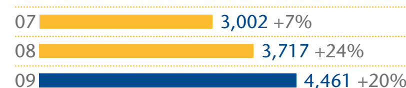
Net finance costs at £504 million were £113 million higher than last year. The increase principally reflects the full year impact of the costs of financing the two acquisitions made during 2008 and the acquisition of Bentoel in the middle of 2009, as well as exchange rate movements.

Interest cover

The Group assesses, as two principal measures of its financial capacity, cash flow and interest cover. Interest cover is distorted by the pre-tax impact of adjusting items. The chart shows gross interest cover, excluding adjusting items, on the basis of profit before interest payable over interest payable. The interest cover remains strong at 8.6x (2008: 8.5x), with the higher cover reflecting the Group's increased profit and the contribution of ST and Tekel since the middle of 2008 and Bentoel since the middle of 2009, offset by the increase in interest costs as a result of the financing arrangements for the acquisitions.

Adjusted profit from operations

£ MILLION



+20% IN 2009

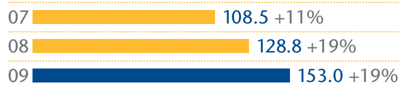
Gross interest cover

TIMES

8.6 TIMES IN 2009

Adjusted diluted EPS

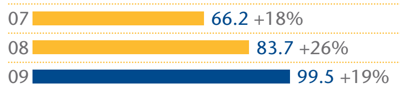
PENCE



+19% IN 2009

Dividend per share declared

PENCE



+19% IN 2009

Underlying tax rate

PERCENTAGE

30.3% IN 2009

Associates

The Group's share of the post-tax results of associates, included at the pre-tax profit level under IFRS, decreased by £20 million to £483 million, after net adjusting charges of £58 million (2008: £26 million income). Excluding the adjusting items in 2008 and 2009, the Group's share of the post-tax results of associates increased by 13 per cent to £541 million, with a decline of 1 per cent at constant rates of exchange as a result of accounting for ST as a subsidiary from July 2008. The Group's share of the net adjusting items from Reynolds American amounted to an expense of £58 million (2008: £13 million of income) and included trademark impairment charges, restructuring charges, a health plan credit and in 2008, a benefit from the termination of a joint venture agreement.

Associates' income in 2008 also included a £13 million benefit from accounting for an additional quarter's income of the ST group during 2008, prior to the acquisition of the cigarette and snus businesses on 2 July 2008. This was treated as an adjusting item in 2008.

Profit before tax

Profit before tax was up £396 million at £4,080 million, principally reflecting the higher profit from operations and favourable exchange rates, partially offset by the rise in interest costs and the decreased contribution from associates.

Effective tax rate

The tax rates in the Group income statement of 27.5 per cent in 2009 and 27.8 per cent in 2008 are affected by the inclusion of the share of associates' post-tax profit in the Group's pre-tax results and by the adjusting items.

The underlying tax rate for subsidiaries, reflected in the adjusted earnings per share below, was 30.3 per cent in 2009 and 30.8 per cent in 2008. The decrease arose mainly from a favourable change in the mix of profits and a reduction in tax rates in several countries.

Earnings per share

Basic earnings per share for 2009 were 137.0p, up 11 per cent (2008: 123.3p). With the distortions that adjusting items can cause in profit, as well as the potential dilutive effect of employee share schemes, earnings per share are best viewed on the basis of adjusted diluted earnings per share. The calculation of this measure is explained in note 7 of the financial statements. Profit for the year is adjusted by the adjusting items explained above, as well as for distortions in net finance costs and one-off adjustments in taxation in 2008.

On this basis, the adjusted diluted earnings per share were 153.0p, a 19 per cent increase over 2008, mainly as a result of the strong operating performance and benefits from foreign exchange movements.

Dividends

The Group's policy is to pay dividends of 65 per cent of long-term sustainable earnings, calculated with reference to the adjusted diluted earnings per share. Interim dividends are calculated as one-third of the total dividends declared for the previous year.

With the recommended final dividend of 71.6p, the total dividends per share for 2009 are 99.5p, up 19 per cent on the prior year. Under IFRS, the recommended final dividend in respect of a year is only provided in the accounts of the following year. Therefore, the 2009 accounts reflect the 2008 final dividend and the 2009 interim dividend amounting to 89.5p (£1,798 million) in total (2008: 69.7p – £1,393 million). The table below shows the dividends declared in respect of 2009 and 2008.

Treasury operations

Treasury is responsible for raising finance for the Group, managing the Group's cash resources and managing the financial risks arising from underlying operations. All these activities are carried out under defined policies, procedures and limits.

The Board reviews and agrees the overall treasury policies and procedures, delegating appropriate authority to the Finance Director, the Treasury function and the boards of the central finance companies. The policies include a set of financing principles including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital, including debt, is managed.

Clear parameters have been established, including levels of authority, on the type and use of financial instruments to manage the financial risks facing the Group. Such instruments are only used if they relate to an underlying exposure; speculative transactions are expressly forbidden under the Group's treasury policy.

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group, and obtaining this financing from a wide range of providers. The Group targets an average centrally managed debt maturity of at least five years with no more than 20 per cent of centrally managed debt maturing in a single year. As at 31 December 2009, the average centrally managed debt maturity was seven years (2008: five years) and the highest proportion of centrally managed debt maturing in a single year was 18 per cent (2008: 18 per cent).

The Group continues to maintain investment-grade credit ratings; as at 31 December 2009, the ratings from Moody's and S&P were Baa1/BBB+ with a stable outlook (end 2008: Baa1/BBB+). The strength of the ratings has underpinned the debt issuance during 2008 and 2009 and, despite the impact of the turbulence in financial markets, the Group is confident of its ability to successfully access the debt capital markets.

Subsidiary companies are funded by share capital and retained earnings, loans from the central finance companies on commercial terms, or through local borrowings by the subsidiaries in appropriate currencies. All contractual borrowing covenants have been met and none of them is expected to inhibit the Group's operations or funding plans.

Liquidity

In the year ended 31 December 2009, the Group entered into a number of transactions in the capital markets. The first was the repayment of the €900 million maturing debt at the end of February 2009. This was financed from bond issues during 2008 and from cash generated from operations. In May, there was the repayment of a MYR100 million bond, which was subsequently replaced in August by a new MYR250 million bond due 2014. The additional proceeds were used for the repayment of a MYR150 million bond which matured in November 2009.

Dividends declared

	2009		2008	
	Pence per share	**£m**	Pence per share	£m
Ordinary shares				
Interim	**27.9**	**557**	22.1	440
Final	**71.6**	**1,418**	61.6	1,241
	99.5	**1,975**	83.7	1,681

FINANCIAL REVIEW CONTINUED

Cash flow and net debt movements

	2009 £m	2008 £m
Net cash from operating activities excluding restructuring costs and taxation	**5,160**	4,692
Restructuring costs	**(187)**	(210)
Taxation	**(1,095)**	(943)
Net cash from operating activities	**3,878**	3,539
Net interest	**(499)**	(280)
Net capital expenditure	**(515)**	(482)
Dividends paid to minority interests	**(234)**	(173)
Free cash flow	**2,630**	2,604
Dividends paid to shareholders	**(1,798)**	(1,393)
Share buy-back		(400)
Purchase of Bentoel	**(370)**	
Purchase of Tekel cigarette assets	**(12)**	(873)
Proceeds from ST trademark disposals and purchase of ST businesses	**187**	(1,243)
Purchases of other subsidiaries, associates and minority interests	**(1)**	(9)
Other net flows	**(203)**	(218)
Net cash flows	**433**	(1,532)
Opening net debt	**(9,891)**	(5,581)
Exchange rate effects	**672**	(2,622)
Acquired debt	**(84)**	
Accrued interest and other	**28**	(156)
Closing net debt	**(8,842)**	(9,891)

In June, the Group issued a £250 million bond with maturity of June 2022. In November 2009, the terms of €481 million of the €1.0 billion bond maturing in 2013 were modified by extending the maturity to 2021. At the same time, the Group issued an additional €169 million bond with a maturity of 2021. In addition, £199 million of the £350 million bond maturing in 2013 was purchased and cancelled; at the same time, the Group issued a new £500 million bond with a maturity of 2034.

On 13 February 2008, the Group entered into an acquisition credit facility whereby lenders agreed to make available an amount of US$2 billion. On 1 May 2008, this facility was syndicated in the market and was redenominated into two euro facilities of €420 million and €860 million; €395 million and €759 million were outstanding as at 31 December 2008 respectively. The €395 million was repaid in September 2009 and €759 million was repaid in October 2009. The €759 million was refinanced by a new €700 million term loan facility with a maturity date of 31 October 2012 with an option to extend it to October 2013, at the discretion of the banking participants in the syndicated facility.

In mid-2009, the Group also re-established its euro commercial paper (ECP) programme of £1 billion.

At year end 2009, the £1.75 billion revolving credit facility described below, was undrawn. The revolving credit facility acts as a backstop for the ECP programme and £187 million of ECP was outstanding at year end.

In the year ended 31 December 2008, the €1.8 billion revolving acquisition credit facility arranged in December 2007 was cancelled and replaced with the issue of €1.25 billion and £500 million bonds maturing in 2015 and 2024 respectively. In addition to this, the Group increased its €1 billion (5.375 per cent, maturity 2017) bond by an additional €250 million, bringing the total size of the bond to €1.25 billion.

During 2008, the Group also issued US$300 million and US$700 million bonds, maturing in 2013 and 2018 respectively, pursuant to Rule 144A and RegS under the US Securities Act. The Group also repaid US$330 million and £217 million bonds upon maturity in May and November respectively. In addition, on 22 September 2008, the Group repurchased its maturing Mexican 2011 MXN1,055 million UDI bond and refinanced it with a floating rate borrowing of MXN1,444 million.

Cash flow

The IFRS cash flow includes all transactions affecting cash and cash equivalents, including financing. The alternative cash flow shown above is presented to illustrate the cash flows before transactions relating to borrowings.

The growth in underlying operating performance, partially offset by the timing of working capital movements, resulted in a £468 million increase in cash flow before restructuring costs and taxation, to £5,160 million. Although there was a £152 million increase in tax outflows, reflecting higher profits and the timing of payments, with the improved operating cash flow and lower restructuring costs, the Group's net cash flow from operating activities was £339 million higher at £3,878 million.

Free cash flow is the Group's cash flow before dividends, share buy-backs and investing activities. Although net interest payments, capital expenditure and dividends paid to minorities increased, the free cash flow was £26 million higher than 2008 at £2,630 million. The free cash flow exceeded the total cash outlay on dividends to shareholders by £832 million.

The ratio of free cash flow per share to adjusted diluted earnings per share was 86 per cent (2008: 101 per cent), with free cash flow per share increasing by 2 per cent.

During 2009, the cash outflows of £370 million on the purchase of Bentoel comprise the purchase price, together with the related acquisition costs and the acquired net cash and cash equivalents and overdrafts. There was also an outflow of £12 million in 2009 in respect of the acquisition of the Tekel assets, and a net cash inflow of £187 million from the disposal of ST trademarks. For 2008, the cash outflows of £873 million and £1,243 million respectively, on the purchase of Tekel assets and ST businesses, comprise the purchase price, the acquisition costs less acquired net cash and cash equivalents and overdrafts.

The other net flows principally reflect the impact of the level of shares purchased by the employee share ownership trusts, together with the impact of flows in respect of certain derivative financial instruments.

Net debt/financing

The Group defines net debt as borrowings, including related derivatives, less cash and cash equivalents and current available-for-sale investments. The maturity profile of net debt is as follows:

	2009 £m	2008 £m
Net debt due within one year		
Borrowings	**(1,370)**	(2,724)
Related derivatives	**33**	(91)
Cash and cash equivalents	**2,161**	2,309
Current available-for-sale investments	**57**	79
	881	(427)
Net debt due beyond one year		
Borrowings	**(9,712)**	(9,437)
Related derivatives	**(11)**	(27)
	(9,723)	(9,464)
Total net debt	**(8,842)**	(9,891)

FINANCIAL REVIEW CONTINUED

The above flows resulted in a net cash inflow of £433 million compared to an outflow of £1,532 million in 2008. After taking account of exchange rate movements of £672 million, acquired debt of £84 million with the Bentoel acquisition and changes in accrued interest and other, total net debt was £8,842 million at 31 December 2009, down £1,049 million from £9,891 million on 31 December 2008.

Retirement benefit schemes

The Group's subsidiaries operate around 160 retirement benefit arrangements globally. The majority of the scheme members belong to defined benefit schemes, most of which are funded externally and many are closed to new entrants. The Group also operates a number of defined contribution schemes.

The overall net liability for all pension and healthcare schemes in Group subsidiaries amounted to £1,024 million at the end of 2009, up from £773 million at the end of 2008. The present total value of funded scheme liabilities was £5,250 million (2008: £4,647 million), while unfunded scheme liabilities amounted to £282 million (2008: £248 million).

The increase in the scheme liabilities and deficits in the schemes were largely due to changes in assumptions, including lower discount rates for liabilities and higher expected inflation.

Contributions to the defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes, taking into account the regulatory environment.

Changes in the Group

The Group acquired Bentoel during 2009 and from 1 January 2010 BAT Indonesia was merged into Bentoel. There were a number of changes in the Group in 2008, described under adjusting items above. In January 2010, the Group announced the planned closure of the Tire factory in Turkey and the consolidation of all manufacturing in Turkey in the Samsum factory.

Share buy-back programme

In 2008, the Board decided to suspend the on-market share buy-back programme that the Group initiated in 2003, in order to preserve the Group's financial flexibility during the period of economic uncertainty. No shares were bought back during 2009.

Regional structure from 2009

The Group's regional structure was realigned from 1 January 2009 after the acquisitions of ST and the cigarette assets of Tekel. The Europe region was divided into Eastern Europe and Western Europe, the Americas region now includes Latin America, the Caribbean and Canada, while Asia-Pacific now includes Japan. The 2008 segmental information has been re-allocated on the basis of the new regional structure.

Non-GAAP measures

In the reporting of financial information, the Group uses certain measures that are not required under IFRS, the generally accepted accounting principles (GAAP) under which the Group reports. The Group believes that these additional measures, which are used internally, are useful to users of the financial information in helping them to understand the underlying business performance.

The principal non-GAAP measures which the Group use are adjusted profit from operations and adjusted diluted earnings per share, which is reconciled to diluted earnings per share. These measures remove the impact of adjusting items from earnings.

Management reviews current and prior year segmental adjusted profit from operations of subsidiaries and adjusted post-tax results of associates and joint ventures at constant rates of exchange. This allows comparison of the Group's results had they been translated at last year's rate of exchange. This does not adjust for the normal transactional gains and losses in operations which are generated by exchange movements.

The Group also prepares an alternative cash flow, which includes a measure of 'free cash flow', to illustrate the cash flow before transactions relating to borrowings, and provides gross turnover as an additional disclosure to indicate the impact of duty, excise and other taxes.

In accordance with the secondary listing of the ordinary shares of British American Tobacco p.l.c. on the main board of the JSE Limited (JSE) in South Africa, the Group is required to also present headline earnings per share.

Accounting developments

The Group has prepared its annual consolidated financial statements in accordance with International Financial Reporting Standards (IFRS), as endorsed by the EU. Generally, the move to IFRS has made the reporting of performance more complex.

The disclosure of segmental information has been updated to meet the requirements of IFRS 8 on Operating Segments. This standard, which requires segmental reporting to be on the same basis as is used for internal management reporting to the chief operating decision maker, has not required any changes to the segments reported. However, it has resulted in certain changes to the disclosures.

The Group has also amended the format of its financial statements in accordance with IAS1 Revised (Presentation of Financial Statements) and Improvements to IFRSs (issued in May 2008). These amendments have required certain changes in the format of the financial statements and a reclassification of derivatives held for trading from current to non-current on the balance sheet. The effect at 31 December 2008 has been to increase non-current assets and decrease current assets by £3 million, while increasing non-current liabilities and decreasing current liabilities by £23 million.

Other changes in accounting requirements that were implemented but had limited or no material impact on the results, are the clarification of vesting conditions in respect of share-based payments, the capitalisation of borrowing costs for acquisitions, construction or longer-term projects and the additional disclosures regarding fair value measurements and liquidity risks.

During 2008, the Group amended its accounting policy in respect of the recognition of actuarial gains and losses under IAS 19 and adopted IFRIC 14.

The next few years are likely to see more changes in the financial statements given the aims of standard setters and regulators.

Going concern

Given the Group's history of growth in profit from operations, the high cash conversion rate from profit into cash, the access to the £1.75 billion revolving credit facility which is used only as a back stop and the spread of banks providing the facilities, the Group remains confident in its ability to access the debt capital markets.

This, together with the maturity profile of debt, spread over a long period with only limited redemptions scheduled for 2010, provides confidence that the Group has sufficient working capital for the foreseeable future.

After reviewing the Group's budget, plans and refinancing arrangements, the Directors consider that the Group has adequate resources to continue operating for the forseeable future. The financial statements have therefore been prepared on a going concern basis. See the Corporate governance statement for full details.

Foreign currencies

The results of overseas subsidiaries and associates have been translated to sterling at the following exchange rates in respect of principal currencies:

	Average		Closing	
	2009	2008	**2009**	2008
US dollar	**1.566**	1.852	**1.615**	1.438
Canadian dollar	**1.779**	1.961	**1.693**	1.775
Euro	**1.123**	1.257	**1.126**	1.034
South African rand	**13.091**	15.132	**11.891**	13.292
Brazilian real	**3.108**	3.355	**2.815**	3.353
Australian dollar	**1.990**	2.187	**1.796**	2.062
Russian rouble	**49.535**	45.810	**48.952**	43.902

GOVERNANCE

PAGE

Board of Directors 62

A summary of the biographical details and responsibilities of the Board of Directors and Management Board members.

Corporate governance statement 64

The Chairman, Richard Burrows, introduces the statement that reports on how the principles of the UK Combined Code on Corporate Governance are applied by the Company and provides our formal report on compliance with the Code's provisions.

Remuneration report 78

Anthony Ruys, Chairman of the Remuneration Committee, outlines how the Group's focus on business sustainability and management of key risks is incorporated into remuneration policy and practice for Board members.

Other statutory and regulatory information 98

A summary of the Company's Articles of Association and other statutory and regulatory information.

BOARD OF DIRECTORS

1

2

3

4

5

6

7

8

9

10

11

1. Richard Burrows (Irish)
Chairman ▲
Appointed a Director in September 2009 and Chairman on 1 November 2009, having previously held the posts of Chief Executive at Irish Distillers and Co-Chief Executive at Pernod Ricard. He is currently a Non-Executive Director of Rentokil Initial and Carlsberg. He was Governor of the Bank of Ireland from 2005 until 2009 and Chairman of the Scotch Whisky Association 2006-2007. He is Chairman of the Nominations Committee. (64)

2. Sir Nicholas Scheele (British/US)
Non-Executive Director ▲■●◆
Appointed a Director in 2005 and Senior Independent Director in May 2008. He is Chairman of The Cambridge-MIT Institute and Key Safety Systems, Inc. (USA) and a Director of Pegasus Holdings Group (USA) and Grupo Proeza (Mexico). (66)

3. Paul Adams (British)
Chief Executive
Appointed a Director in March 2001 and Chief Executive in January 2004. He joined British American Tobacco in July 1991 and held senior appointments as Regional Director, Asia-Pacific and Regional Director, Europe prior to becoming Deputy Managing Director in June 2001 and Managing Director in January 2002. (56)

4. Ben Stevens (British)
Finance Director
Appointed a Director in March 2008 and Finance Director in April 2008. Since joining British American Tobacco in 1989 he has held a number of senior finance and general management roles particularly in western Europe, south Asia and Russia. He was appointed to the Management Board in 2001 as Development Director and was Director, Europe from January 2004. (50)

5. Nicandro Durante (Brazilian/Italian)
Chief Operating Officer
Appointed a Director and Chief Operating Officer on 1 January 2008 having previously been Regional Director for Africa and Middle East and a member of the Management Board since March 2006. He previously held senior general management roles in Brazil (including President of Souza Cruz) and also in the UK and Hong Kong. He was appointed a Director of Reynolds American Inc. in December 2008. (53)

6. Karen de Segundo (Dutch)
Non-Executive Director ▲●◆
Appointed a Director in October 2007. Karen retired as CEO Shell International Renewables and President Shell Hydrogen in 2005. She is currently a Non-Executive Director of Lonmin plc, Ensus Holding Limited, E.ON AG, Pöyry Oyj and Royal Ahold NV. She chairs the Corporate Social Responsibility Committee. (63)

7. Robert Lerwill (British)
Non-Executive Director ▲■●
Appointed a Director in 2005, he is Chairman of the Audit Committee. He is a Non-Executive Director of Synergy Health PLC and was formerly a Director of Cable & Wireless plc, WPP Group PLC, The Anthony Nolan Trust and Chief Executive of Aegis Group plc. (58)

8. Dr Ana Maria Llopis (Spanish)
Non-Executive Director ▲●◆
Appointed a Director in 2003. She is Founder and Executive Chairman of Global ideas4all, Executive Deputy Chairman of the J F Llopis Foundation and was a member of the Good Governance Working Group for Spanish listed companies. Ana Maria is also a Non-Executive Director of ABN AMRO Bank and a Director of Service Point Solutions, S.A. (Spain), chairing its Remuneration and Nominations Committees. (59)

9. Christine Morin-Postel (French)
Non-Executive Director ▲■●
Appointed a Director in October 2007. Christine is currently a Non-Executive Director of Royal Dutch Shell PLC, EXOR S.p.A. (Italy) and 3i Group plc. She previously held a number of executive positions including Chief Executive of Société Générale de Belgique, Executive Vice-President and member of the Executive Committee of Suez and Chairman and CEO of Crédisuez S.A. before her retirement. (63)

10. Dr Gerard Murphy (Irish)
Non-Executive Director ▲●◆
Appointed a Director on 13 March 2009. Gerry is a Senior Management Director (partner) at The Blackstone Group having previously been Chief Executive Officer of Kingfisher plc, Carlton Communications plc, Exel plc (formerly NFC plc) and Greencore Group plc. His previous non-executive appointments have included Reckitt Benckiser plc, Abbey National plc, Novar plc and PJ Carroll plc, an Irish subsidiary of British American Tobacco. (54)

11. Anthony Ruys (Dutch)
Non-Executive Director ▲■●
A Director from March 2006, he is a member of the Supervisory Board of JANIVO Holdings BV (NL) and a Non-Executive Director of Lottomatica S.p.A. (Italy). In April 2009 he became Chairman of the Supervisory Board of NV Luchthaven Schiphol (NL) and was appointed a Non-Executive Director of the Group's Indian associated undertaking, ITC Limited, in January 2009. He chairs the Remuneration Committee. (62)

Board Committees
Committee membership is indicated by the following symbols:
▲ Nominations Committee
■ Audit Committee
● Remuneration Committee
◆ Corporate Social Responsibility Committee

MANAGEMENT BOARD

The role of the Management Board
The Management Board, chaired by the Chief Executive, comprises the Executive Directors of British American Tobacco p.l.c. together with the executives shown on this page. The Management Board has delegated responsibility for overseeing the implementation by the Group's operating subsidiaries of the policies and strategy set by the Board of Directors, and for creating the conditions for their successful day-to-day operation.

1

2

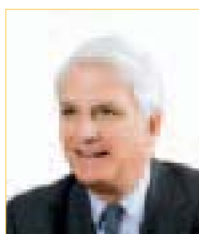
3

4

5

6

7


8

9

10

1. Jack Bowles (French)
Director, Western Europe
Joined the Management Board as Director, Western Europe in October 2009. He joined the Group in 2004 and became President of British American Tobacco France in 2005. Jack became Managing Director of the Company's publicly listed subsidiary company in Malaysia in 2007. (46)

2. Mark Cobben (Dutch)
Director, Americas
Joined British American Tobacco in 1993. He has held a number of senior roles across the Group including General Manager in Switzerland, Argentina, Russia and Germany. He has been a member of the Management Board since October 2007. (53)

3. John Daly (Irish)
Director, Asia-Pacific
Joined the Management Board as Regional Director for Asia-Pacific in October 2004. He held a number of senior management roles for Rothmans International in Europe and the Far East before becoming Area Director for the Middle East and North Africa in 2001. (53)

4. David Fell (British)
Director, Eastern Europe
Appointed Director, Eastern Europe in May 2008. He joined British American Tobacco in 1989 and has held a variety of marketing positions in Europe and South East Asia. He was appointed President of British American Tobacco Japan in 2000 before being made Area Director, BAT Australasia and Managing Director, BAT Australia in 2004. (49)

5. Andrew Gray (Brazilian/British)
Director, Africa and Middle East
Appointed Director, Africa and Middle East in January 2008. He joined British American Tobacco 23 years ago and has held a variety of senior marketing and general management roles in South America (including President of Souza Cruz) and also in Central America, the Caribbean and Malaysia. (45)

6. Rudi Kindts (Belgian)
Group Human Resources Director
Joined British American Tobacco in 1988. He has held a number of senior human resources roles in the Group and his responsibilities have covered Europe, Africa, the Middle East and central and south Asia. He has been Group Human Resources Director since July 2004. (52)

7. Jean-Marc Lévy (Swiss)
Group Marketing Director
Appointed Group Marketing Director on 1 January 2010 after joining the Management Board as Director, Western Europe in April 2008. Jean-Marc began his career with the Kraft-Jacobs-Suchard Group, joining British American Tobacco in 1994 as Marketing Director in Switzerland and going on to hold a variety of marketing and general management roles in Europe and South East Asia. (47)

8. Michael Prideaux (British)
Group Corporate and Regulatory Affairs Director
Appointed Group Corporate and Regulatory Affairs Director in 1998 following the demerger of B.A.T Industries. He joined B.A.T Industries in 1989 from Charles Barker, a leading financial and corporate public relations, advertising and design agency, where he was Chief Executive. (59)

9. Peter Taylor (British)
Group Operations Director
Joined British American Tobacco in 1980 and has worked in a variety of operational and general management roles across the Group. He was appointed Group Operations Director in 2003. (57)

10. Neil Withington (British)
Group Legal and Security Director and General Counsel
Appointed Group Legal and Security Director and General Counsel of British American Tobacco in 2000, having previously been the Group's Deputy General Counsel. He joined the Group in 1993 after a career at the Bar and in the chemical and pharmaceutical industries. He has been a Director of Reynolds American Inc. since July 2004. (53)

CORPORATE GOVERNANCE STATEMENT

CONTENTS

Chairman's introduction	64
Compliance statement	65
The Board	65
Shareholder engagement	68
Accountability and audit	70
Audit Committee	70
Internal control	72
Corporate social responsibility	74
CSR Committee	74
Appointments to the Board	76
Nominations Committee	76

Richard Burrows Chairman

CHAIRMAN'S INTRODUCTION

At British American Tobacco, we are committed to good corporate governance. We seek to achieve our business objectives in a manner which is responsible and consistent with our beliefs in honesty, transparency and accountability. We regard corporate governance not simply as an exercise in compliance, but as a key element underpinning the sustainable, long-term growth of our business.

I have therefore been following with interest the recent developments in corporate governance and, in particular, the Financial Reporting Council's review of the Combined Code, and the Code on the Responsibilities of Institutional Investors recently published by the Institutional Shareholders' Committee. British American Tobacco has been active in contributing to the debate, and will continue to put forward its views on good governance.

I see the Board's principal role as providing the leadership necessary to promote the success of the Company within the context of an effective framework of authority and accountability that promotes talent, innovation and best practice, while managing and mitigating risk. As Chairman, I am conscious that it is my responsibility to ensure that this is achieved and, in particular, to encourage the productive engagement of all members of the Board in overseeing delivery of the Group's strategy.

I am confident that British American Tobacco will continue to prosper through its effective mix of good governance, a clear and consistent corporate strategy and excellent management. Our aim as a Board is simply to ensure that this effective combination continues to return enhanced value to our shareholders.

Compliance statement

The principal governance rules applying to UK companies listed on the London Stock Exchange are contained in the Combined Code on Corporate Governance adopted in June 2008 (the Code). The Code is published by the Financial Reporting Council and is available from its website (www.frc.org.uk).

As required by the Code, this statement reports on how the principles of the UK Combined Code on Corporate Governance are applied by the Company and provides our formal report on compliance with the Code's provisions.

The Board considers that this statement provides the information necessary to enable shareholders to evaluate how the principles of the Code have been applied, that the Company has complied with the provisions of the Code throughout the year, and that it has therefore satisfied its obligations under the Code.

In the interests of further transparency, we have again prepared a report which summarises the matters addressed in this statement, as appropriate, by reference to each principle and provision of the Code. The updated report will be available on the corporate governance section of www.bat.com from the date of publication of the Annual Report.

The Board

The Board is responsible to the Company's shareholders for the success of the Group and for its overall strategic direction, its values and its governance. It provides the leadership necessary for the Group to meet its business objectives within the framework of its internal controls, while also discharging the Company's obligations to its shareholders.

Directors

The Company currently has a Board of 11 Directors:

Chairman
Richard Burrows

Executive Directors
Paul Adams (Chief Executive)
Ben Stevens (Finance Director)
Nicandro Durante (Chief Operating Officer)

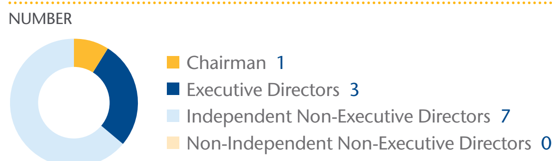
Non-Executive Directors
Sir Nicholas Scheele (Senior Independent Director)
Karen de Segundo
Robert Lerwill
Dr Ana Maria Llopis
Christine Morin-Postel
Dr Gerry Murphy
Anthony Ruys

Gerry Murphy was appointed as a Non-Executive Director on 13 March 2009. Thys Visser retired from the Board at the conclusion of the Annual General Meeting on 30 April 2009. Jan du Plessis stepped down as Chairman and retired from the Board on 31 October 2009, and Richard Burrows was appointed Chairman with effect from 1 November 2009, having joined the Board as a Non-Executive Director on 1 September 2009. On appointment, he met the independence criteria set out in the Code.

Biographical and related information about the Directors is given on the Board of Directors page.

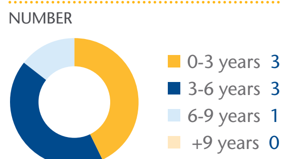
Balance of Non-Executive Directors and Executive Directors

NUMBER



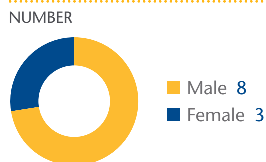
Length of tenure of Non-Executive Directors

NUMBER



Gender split of Directors

NUMBER



There is a mix of nationalities represented on the Board, comprising Brazilian, British, Dutch, French, Irish and Spanish.

Chairman and Chief Executive

The roles of the Chairman and Chief Executive are separate, with each having distinct and clearly defined responsibilities.

The Chairman is responsible for leadership of the Board and for ensuring its effectiveness. He sets the agenda for Board meetings in consultation with the Chief Executive and the Company Secretary. He is also responsible for ensuring that the interests of the Company's shareholders are safeguarded and that there is effective communication with them. The Chairman is accountable to the Board for leading the direction of the Group's corporate and financial strategy and for the overall supervision of the Group's policies governing the conduct of its business.

The Chief Executive provides leadership to the Group to enable the successful planning and execution of the objectives and strategies agreed by the Board. He is also responsible for stewardship of the Group's assets and, jointly with the Chairman, representation of the Group externally.

Senior Independent Director

Sir Nicholas Scheele is the Senior Independent Director. When required, he presides at meetings of the Board and shareholders in the absence of the Chairman. In 2009, he called and chaired an unscheduled Board

meeting to address Jan du Plessis' decision to take up the role of Chairman of Rio Tinto plc. He subsequently managed the process of identifying and recruiting a successor to Jan du Plessis, meeting with the Board's recruitment consultants and shortlisting and meeting a number of candidates. He is available should occasion arise where there is a need to convey concerns to the Board other than through the Chairman or Chief Executive.

Board balance and independence

The Board considers that all seven of the Non-Executive Directors are independent, in the sense that they are free from any business or other relationships which could materially interfere with or appear to affect the exercise of their judgment and have not previously been involved in the management of the Group. All Directors are aware of their responsibility to take decisions objectively which promote the success of the Company for the benefit of its members.

Meetings of the Board

The Board held eight meetings in 2009, seven of which were scheduled and one of which was convened at short notice to address Jan du Plessis' decision to take up the role of Chairman of Rio Tinto plc. It is scheduled to hold seven meetings in 2010.

Board meeting attendance

Name	Meetings attended	Meetings eligible to attend
Jan du Plessis[1]	7	7
Richard Burrows[2]	3	3
Sir Nicholas Scheele	7	8
Paul Adams	8	8
Ben Stevens	8	8
Nicandro Durante	8	8
Karen de Segundo	8	8
Robert Lerwill	8	8
Ana Maria Llopis	7	8
Christine Morin-Postel	7	8
Gerry Murphy[3]	6	6
Anthony Ruys	7	8
Thys Visser[4]	3	3

Notes:

1 Jan du Plessis stood down from the Board and as Chairman with effect from 31 October 2009.

2 Richard Burrows was appointed to the Board on 1 September 2009 and was appointed Chairman with effect from 1 November 2009.

3 Gerry Murphy was appointed to the Board on 13 March 2009.

4 Thys Visser retired from the Board on 30 April 2009.

The Chairman will always seek to obtain consensus at Board meetings but, where necessary, decisions will be taken by majority. If any Director has concerns about the running of the Company or a proposed action which cannot be resolved, such concerns will be recorded in the Board minutes. No such concerns arose in 2009. The Non-Executive Directors, led by the Chairman, meet, if required, prior to meetings of the Board without the Executive Directors present and also meet annually, led by the Senior Independent Director, without the Chairman present.

The Board's principal responsibilities include:

- approving the Group's business strategy and ensuring that an effective management team and the necessary financial and human resources are in place for the Group to meet its objectives;
- agreeing the Group Budget;
- approving the Company's Annual Report and reviewing its periodic financial reports;
- declaring an interim dividend and recommending the final dividend;
- agreeing the agenda for the Annual General Meeting;
- agreeing succession plans and evaluating the Board's performance over the preceding year; and
- reviewing the Company's internal controls and governance system and approving the Standards of Business Conduct and other Group policies.

Key activities of the Board in 2009

Growth

The Board regularly reviewed opportunities to grow the business including potential mergers and acquisitions activity. In 2009, the Group successfully acquired the Bentoel tobacco business in Indonesia. The Board also considered industry trends and the outlook for the Group's businesses in strategically important markets and consumer segments. The Group's innovation and new product development programmes were reviewed and prioritised.

Productivity

With a continued focus on costs in 2009, the Board looked at both short-term savings and the scoping of a longer-term initiative, the Global Integration Project, addressing structural costs. In consequence, a number of reorganisations within the Group's regions and functions were considered during the year, and are now in the process of being implemented, and the closure of the Group's factory in Denmark has been announced.

Responsibility

The Board monitored developments in tobacco regulation around the world, including the progress of the World Health Organisation's Framework Convention on Tobacco Control and the potential impact that regulation may have on the Group's businesses or products. This is reflected in the priorities for the Group's Research & Development function.

Winning organisation

The Board reviewed succession planning in consultation with the Nominations Committee, and a number of new appointments were made in 2009 at both Main Board and Management Board level. In addition, the position of the Group's major pension funds was reviewed including how the Group is managing future liabilities. The results and action plans arising from the global 'Your Voice' survey of employees conducted in 2008 were also considered.

In addition, in line with its practice of visiting one of the Group's key markets annually, the Board held one of its meetings in Turkey, where it received presentations from members of the British American Tobacco Turkey top team, participated in a market visit and visited the factory in Samsun.

Management Board

The Board delegates to the Management Board responsibility for overseeing the implementation by the Group's operating subsidiaries of the policies and strategy which it sets, and for creating the conditions for their successful day-to-day operation. The Management Board is chaired by the Chief Executive and its other members are the Finance Director, the Chief Operating Officer and the 10 senior Group executives, whose names appear on the Management Board page. It held 11 meetings in 2009, nine of which were scheduled and two of which were convened to consider specific initiatives, including the Global Integration Project. It is scheduled to hold nine meetings in 2010. Members of the Management Board are invited to attend meetings of the Board from time to time, in particular when the Group's strategy and budget are under discussion.

Board Committees

The Board has established four principal Board Committees, to which it has delegated certain of its responsibilities. They are the Audit Committee, the Corporate Social Responsibility (CSR) Committee, the Nominations Committee and the Remuneration Committee. The roles, membership and activities of these Committees are described in more detail later in this Corporate governance statement and, in the case of the Remuneration Committee, in the Remuneration report. The full terms of reference for each Committee are available from the Company Secretary and on www.bat.com.

Conflicts of interest

The Board has formal procedures for managing compliance with the conflicts of interest provisions of the Companies Act 2006. The Company's Articles of Association permit the Board to authorise actual and potential conflicts. Directors are required to give advance notice of any conflict issues to the Company Secretary, and these will then be considered either at the next Board meeting or, if the conflict or potential conflict is due to arise prior to the next scheduled Board meeting, at a meeting of the Board's Conflicts Committee. The full Board will be notified at its next meeting of any matters authorised by the Committee. Once a year, at its meeting in February, the Board reviews all conflict matters which have previously been authorised. The review will take the form of a fresh consideration of each matter. Directors are excluded from the quorum and the vote in respect of any matters in which they have an interest.

During 2009, a number of actual and potential conflicts were notified to the Company in accordance with these procedures. They were referred to, and, where appropriate, authorised by, the Board and recorded in the register of interests maintained by the Company Secretary. All were considered at meetings of the Board and none were sufficiently significant to warrant disclosure (although see Directors' interests and indemnities under Appointments to the Board below).

Information and professional development

All Directors receive induction on joining the Board, covering their duties and responsibilities as directors. Non-Executive Directors also receive a full programme of briefings on all areas of the Company's business from the Executive Directors, members of the Management Board and other senior executives, and they may request such further information as they consider necessary.

During 2009, both Richard Burrows and Gerry Murphy attended induction briefings subsequent to their respective appointments. These included sessions on the Group's strategy, its organisational structure and its business functions and activities, including its financing principles and statutory reporting cycle, Environmental Health & Safety issues, Research & Development activities and regulation issues. They also attended sessions addressing corporate governance issues and their duties as directors, the Group's internal control and risk management framework and the role of the external auditors.

As Chairman designate, Richard Burrows received a broader level of induction, which included more in-depth sessions on the above subjects, sessions with Jan du Plessis on the role and operation of the Board and the Board strategy review process, and visits to a manufacturing facility in Germany and the Group's Research & Development site in Southampton. His induction will continue into 2010 with visits to Group key markets and a number of meetings to enable him to introduce himself to institutional shareholders.

All Directors receive briefings designed to update their skills and knowledge on a regular basis, for example in relation to the business and on legal and regulatory requirements, and by visits to Company sites (see the key activities of the Board in 2009). They also make use of the opportunity to attend meetings of the Group's regional audit and CSR committees. In response to feedback received during the Board's 2009 evaluation (see below), the Board timetable will be extended with effect from 2011 to allow an additional day for training or briefings on relevant matters.

CORPORATE GOVERNANCE STATEMENT CONTINUED

The Board and its Committees receive high-quality, up-to-date information for review in good time ahead of each meeting, and the Company Secretary, under the direction of the Chairman, ensures good information flows within the Board and its Committees and between the Non-Executive Directors and senior management. The Company Secretary is also responsible for advising the Board, through the Chairman, on all governance matters. The appointment and removal of the Company Secretary is a matter for the Board.

All Directors have access to the advice and services of the Company Secretary, and a procedure is in place for them to take independent professional advice at the Company's expense should this be required. The Company has arranged appropriate insurance to provide cover in the event of legal action against its Directors.

Evaluation of Board performance

An evaluation of the performance of the Board, each of its Committees and of the Executive and Non-Executive Directors is conducted each year using a series of questionnaires. A broad range of standard topics is covered including the programme of regular Board or Committee business, Board behaviours, Group strategy and succession planning. Different questions are used for assessing the skills and contributions of each of the Chairman, the Non-Executive Directors and Executive Directors, given their different roles on the Board.

The survey is updated annually to ensure the process remains relevant to internal circumstances as well as the external environment. In 2009, given the debate around corporate governance generally, extra questions were included about the Group's approach to risk, Board training and Directors' ability to provide effective challenge. In addition, progress against the 2008 Board action plan was checked, in particular how the smaller Committee membership, introduced in late 2008, has impacted the effectiveness of the Audit and CSR Committees.

As it did in 2008, the Board considered whether to introduce an external facilitator to manage the evaluation. However, it concluded that the Company Secretary was well placed to devise updated questions that are relevant and appropriate to the Company and that, having attended Board and Committee meetings throughout the year, the Company Secretary would also understand, and ensure a full and frank discussion around, any concerns raised.

The responses to all questionnaires formed the basis for one-to-one, confidential, interviews conducted by the Company Secretary with each of the Directors and the Chairman. Following the interviews, the Company Secretary collated and analysed the results and prepared separate reports, summarising key points and including non-attributable comments given in individual responses. Board and Committee reports were initially discussed with the Chairman of the Board or relevant Committee before being presented by the Company Secretary at a Board or Committee meeting. The main points of discussion and Committee action points, if any, were also reported back to the Board. Reports on the individual performance of each Executive and Non-Executive Director (excluding the Chairman) were raised by the Chairman with that Director as appropriate, and the Chairman's performance was discussed initially with the Senior Independent Director before he provided feedback to the Chairman.

The outcome of the 2009 Board review has confirmed that the Directors consider that the Board has a good balance of skills, is working well and continues to be refreshed, with two further appointments in 2009. Acknowledging, however, that there is always room for improvement, the process also identified a number of areas for focus in the coming year, including:

- strategic risk management and the Group's overall approach to risk;
- a review of Board support processes to identify efficiencies and systems solutions;
- further changes to the arrangements for the Audit and CSR Committees. While smaller meetings have allowed for much more in-depth discussion, particularly around specific risks identified on the Group risk register, members believe that holding meetings simultaneously will relieve pressure on the timings of those Committees, allowing for more thorough debate or specific briefings of relevance to the Committees;
- additional non-executive appointments; and
- a revision to the Board calendar from 2011 onwards setting aside a further day in July each year to accommodate longer meetings and/or training.

The formal process in 2009 was also supplemented by an informal meeting in September 2009 for Audit Committee members to discuss proposals to improve the effectiveness of that Committee, and in December 2009 for Non-Executive Directors only and Richard Burrows, by then Chairman, at which the Board's action plan was considered in further detail.

In addition to the formal Board evaluation process the Chairman also discusses the effectiveness and performance of Directors immediately before they make themselves available for reappointment. The Notice for this year's Annual General Meeting confirms that the performance of the Directors being proposed for reappointment continues to be effective and that they continue to show commitment to their role.

Shareholder engagement

Relations with shareholders

The Board maintains a dialogue with shareholders directed towards ensuring a mutual understanding of objectives. Its primary contact with shareholders, facilitated by the Head of Investor Relations, is through the Executive Directors, but the Chairman also maintains contact with major shareholders in order to understand their views on the Company. In addition, the Senior Independent Director and the other Non-Executive Directors are available to meet with major shareholders in order to understand their views and any concerns which they may have.

During 2009, a wide range of business and corporate governance issues, including strategy and risk, dividend policy and the share buy-back programme, were discussed with a number of major institutional investors as part of the regular investor relations

programme. In addition, a focused schedule of visits to key institutional shareholders was undertaken following the appointment of Richard Burrows as Chairman, as part of his induction process.

Investor seminars and analyst presentations, including those following the announcement of the preliminary results and the half-year report, are available by webcast, and other presentations made to institutional investors are available on www.bat.com. There is a debt micro site on www.bat.com for debt investors, which includes comprehensive bondholder information on credit ratings, debt facilities, outstanding bonds and maturity profiles.

At least twice a year, the Head of Investor Relations presents a report to the Board on the various issues raised by institutional shareholders. In addition, the Board receives a report at each of its meetings on any changes to the holdings of the Company.

Communications with shareholders

As part of its continuing shareholder strategy, the Company recognises the benefits of electronic communications with its shareholders. During 2009, the Company contacted relevant shareholders to encourage them to move away from receiving paper copies of Company documentation and to register for email communication. In particular, shareholders were encouraged to use the dividend mandate instructions in preference to receiving individual cheques. Shareholders will benefit by receiving their dividend on the date of payment and the Company and the environment benefit from a reduction of paper and energy consumption. It is with this background that the Company is proposing to make the appropriate amendment to its Articles of Association at the forthcoming Annual General Meeting in order that it may, in the future, pay its dividends solely by the direct credit method. The Company has no immediate plans to implement this change but it is considered prudent to incorporate the necessary provision at this time, given that other changes are in any event being made to the Articles of Association.

Annual General Meeting

The Annual General Meeting will be held at The Mermaid Conference & Events Centre, Puddle Dock, Blackfriars, London EC4V 3DB at 11.30am on 28 April 2010. Details of the business to be proposed at the meeting are contained in the Notice of Annual General Meeting which is sent to all shareholders and is also published on www.bat.com.

The Annual General Meeting provides a useful opportunity for shareholder engagement and, in particular, for the Chairman to explain the Company's progress and receive questions from investors. The chairmen of the Audit, CSR and Remuneration Committees are normally available at the Annual General Meeting to take any relevant questions, and all other Directors attend, unless illness or another pressing commitment precludes them from doing so. All Directors attended the Annual General Meeting in April 2009.

The Company provides for the vote on each resolution to be by poll rather than by show of hands. This provides for greater transparency and allows the votes of all shareholders to be counted, including those cast by proxy. The Chairman announces the provisional voting results at the Meeting, and the final results are announced on the same day to the London Stock Exchange and the JSE Limited in South Africa, and also on www.bat.com. The Company appoints an independent assessor to scrutinise the Annual General Meeting and to produce a report of the meeting, covering the proxy voting process, attendance and an audit of the poll procedures. The report in 2009 confirmed the adequacy, accuracy and fairness of the proxy process and the voting procedures and systems.

Stock market listings

The ordinary shares of the Company (as British American Tobacco p.l.c.) have been listed on the Official List and traded on the main market of the London Stock Exchange for listed securities since 8 September 1998 (Share Code: BATS and ISIN: GB0002875804). The share registrar is Computershare Investor Services PLC.

Since 28 October 2008, the Company's ordinary shares have had a secondary listing on the JSE Limited in South Africa (JSE), under the abbreviated name BATS and the trading code BTI. As at 31 December 2009, 239,887,274 ordinary shares of the Company (being 12.02 per cent of the Company's issued ordinary share capital – excluding treasury shares) were on its South African branch register for which Computershare Investor Services (Pty) Ltd are share registrars.

The Company's ordinary shares are also traded on NYSE Alternext U.S. in the form of American Depositary Receipts (ADRs) under the symbol BTI with a CUSIP number 110448107. Each ADR represents two of the Company's ordinary shares and at 31 December 2009, 29,161,536 ADRs were outstanding, represented by 58,323,072 ordinary shares. Citibank, N.A. continues to act as depositary for the ADR programme.

The Company has unlisted trading privileges for the ADR programme and none of its securities are listed on any United States securities exchange or registered pursuant to the securities laws of the United States. As a result, the Company is subject to neither the NYSE Alternext US listing standards nor the corporate governance rules under the Sarbanes-Oxley Act of 2002. Nevertheless, the Board has chosen, in the interests of good governance, to make a voluntary statement explaining the principal differences and common areas between the Company's corporate governance practices (as explained above) and those that would be required if the Company were subject to those rules. The updated statement will be available on the corporate governance section of www.bat.com from the date of publication of the Annual Report.

Significant shareholders

At 24 February 2010, the following substantial interests (3 per cent or more) in the Company's ordinary share capital (voting securities) had been notified to the Company:

	Number of ordinary shares	% of issued share capital
BlackRock, Inc.	132,891,526	6.66
Legal & General Group Plc	89,640,900	4.49
Reinet Investments S.C.A.	84,303,670	4.22

Note:
The percentage of issued share capital excludes treasury shares.

Accountability and audit

Audit Committee

CURRENT MEMBERS
Robert Lerwill (Chairman)
Christine Morin-Postel
Anthony Ruys
Sir Nicholas Scheele

Attendance at meetings in 2009

Name	Meetings attended	Meetings eligible to attend
Robert Lerwill	5	5
Christine Morin-Postel	5	5
Anthony Ruys	5	5
Sir Nicholas Scheele	4	5

The Chief Operating Officer and the Finance Director attend meetings of the Committee by invitation but are not members. The Committee's meetings are also attended by the Head of Audit and Business Risk, the General Counsel to the Company and a representative of the external auditors.

As a matter of best practice, the Committee meets alone with the external auditors at the end of every meeting.

Summary terms of reference

The Audit Committee is responsible for:

- monitoring the integrity of the Company's financial statements and any formal announcements relating to the Company's performance, reviewing significant financial reporting judgments contained in them before their submission to the Board for approval;
- keeping under review the consistency of the accounting policies applied across the Group;
- reviewing the effectiveness of the accounting, internal control and business risk systems of the Company and its subsidiaries;
- reviewing and, when appropriate, making recommendations to the Board on business risks, internal controls and compliance;
- monitoring compliance with the Company's Standards of Business Conduct;
- monitoring and reviewing the effectiveness of the Company's internal audit function; and
- monitoring and reviewing the performance of the Company's external auditors, making recommendations as to their reappointment (or, where appropriate, making recommendations for change), and approving their terms of engagement and the level of audit fees payable to them.

The Committee's terms of reference were reviewed and updated in March 2009. The full terms of reference are available from the Company Secretary and on www.bat.com.

The Audit Committee is authorised by the Board to review any activity within the business. It is authorised to seek any information it requires from, and require the attendance at any of its meetings of, any Director or member of management, and all employees are expected to cooperate with any request made by the Committee. The Committee is authorised by the Board to obtain, at the Company's expense, outside legal or other independent professional advice and secure the attendance of outsiders with relevant experience and expertise if it considers this necessary.

The Chairman of the Committee reports to the subsequent meeting of the Board on the Committee's work and the Board receives a copy of the minutes of each meeting. The papers considered by the Committee are available to any Director who is not a member, should they wish to receive them.

Key activities of the Audit Committee in 2009

The Audit Committee met five times during 2009, including immediately before the Company's full year results were published. In addition to its standing items of business and periodic reports from the Head of Audit and Business Risk, the Head of Group Security and the Group's regional audit and CSR committees and corporate audit committee, the specific items considered by the Audit Committee during 2009 included:

- a twice yearly review of the Group risk register and consideration of specific key risks;
- a review of information technology security procedures and controls;
- governance and risk management in relation to major projects and programmes;
- compliance with the Group's Standards of Business Conduct and records management procedures;
- a review of the treatment of adjusting items in financial reporting;
- a review of the internal audit planning framework and consideration of the annual internal audit works plan;
- the form and content of the Company's Interim Management Statements, following the Board's decision in 2009 to cease quarterly reporting; and
- the annual review of the independence of the Company's external auditors and consideration of the forthcoming replacement of the lead external audit partner by rotation (see below).

The Audit Committee reviewed its effectiveness in 2009 as part of the Board evaluation process. The Committee concluded that it is operating effectively and, in particular, that it had benefited from the changes introduced late in 2008 which reduced the size of the Committee. In addition, the revised process for assessing Group risks has allowed for specific risks to be considered in much greater detail than previously. The Committee also recommended to the Board that the broad issue of the Group's attitude to risk be considered separately by the Board at least once a year.

Financial reporting

The Board is satisfied that it has met its obligation to present a balanced and understandable assessment of the Company's position and prospects in the Directors' report and financial statements and in periodic reports, reports to regulators and price-sensitive announcements. A summary of the Directors' responsibilities for the financial statements and their statement concerning relevant audit information is included at the end of this Governance section.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Performance and strategy section and the Regional review. The financial position of the Group, its cash flows, liquidity position, facilities and borrowing position are described in the Financial review. The key Group risk factors include an analysis of financial risk and the Group's approach to financial risk management and notes 21 and 24 in the Notes on the accounts provide further detail on the Group's borrowings and management of financial risks.

The Group has at the date of the report, sufficient existing financing available for its estimated requirements for at least the next 12 months. This, together with its proven ability to generate cash from trading activities, the performance of the Group's Global Drive Brands, its leading market positions in a number of countries and its broad geographical spread, as well as numerous contracts with established customers and suppliers across different geographic areas and industries, provides the Directors with the confidence that the Group is well placed to manage its business risks successfully in the context of current financial conditions and the general outlook in the global economy.

After reviewing the Group's annual budget, plans and financing arrangements, the Directors consider that the Group has adequate resources to continue operating for the foreseeable future. The financial statements have therefore been prepared on a going concern basis.

External auditors

The Audit Committee assesses annually the qualification, expertise and resources, and independence of the external auditors and the effectiveness of the audit process. The Committee's assessment is informed by an external audit satisfaction survey completed by members of senior management, which it reviews in detail.

PricewaterhouseCoopers LLP have been the Company's auditors since it listed on the London Stock Exchange in September 1998. The Audit Committee considers that the relationship with the auditors is working well and remains satisfied with their effectiveness. Accordingly, it has not considered it necessary to require the firm to tender for the audit work. There are no contractual obligations restricting the Company's choice of external auditor. The external auditors are required to rotate the audit partners responsible for the Group and subsidiary audits every five years and the current lead audit partner has been in place for five years. The Audit Committee, having considered the position, has determined that he will be replaced by rotation after completion of the 2009 Annual Report.

The Audit Committee has an established policy aimed at safeguarding and supporting the external auditors' independence and objectivity. Pursuant to this policy, it keeps under review the ratio of audit fees to non-audit fees charged by the external auditors to ensure that neither their independence nor their objectivity is put at risk. A breakdown of non-audit fees charged by the external auditors is disclosed in note 3(d) in the Notes on the accounts. The Committee also takes steps to ensure that the external auditors do not audit their own work.

The Audit Committee has completed its assessment of the external auditors for the financial period under review. It remains confident that the objectivity and independence of the external auditors are not in any way impaired by reason of the non-audit services which they provide to the Group. Moreover, the Committee is satisfied that their selection for such work is based upon an assessment of their abilities, taking into account their existing knowledge of the Group, with the majority of such work being awarded through a competitive tendering process. Having satisfied itself as to their qualification, expertise, resources and independence and the effectiveness of the audit process, it has recommended to the Board, for approval by shareholders, the reappointment of PricewaterhouseCoopers LLP as the Company's external auditors and approved their fees and terms of engagement.

Resolutions will be proposed at the Annual General Meeting on 28 April 2010 to reappoint PricewaterhouseCoopers LLP as the Company's auditors and to authorise the Directors to agree their remuneration for the 2010 audit.

Political contributions

The Audit Committee is responsible for reviewing donations made for political purposes throughout the Group. No donation was made in 2009 to any political party registered in the UK under the Political Parties, Elections and Referendums Act 2000. The aggregate figure for contributions made to non-EU political parties in 2009 was £76,969 (2008: £69,041). In 2009, this figure comprised solely of contributions made by the Group's subsidiary in Australia.

Standards of Business Conduct

The Audit Committee is responsible for monitoring compliance with the Company's Standards of Business Conduct, which underpin the Company's commitment to good corporate behaviour. The Standards of Business Conduct have been in place for many years, and require all staff to act with high standards of business integrity, to comply with all applicable laws and regulations and to ensure that business standards are never compromised for the sake of results. They were expanded and updated with effect from 1 January 2008 and continue to be kept under review in order to ensure that they remain at the forefront of best business practice. Every Group company and every employee worldwide is expected to live up to them and guidance on them is communicated regularly throughout the Group, including through training and awareness programmes. The Standards of Business Conduct are available from the Company Secretary and on www.bat.com.

Confidential reporting procedures

The Standards of Business Conduct also set out the Group's whistleblowing policy, which enables staff, in confidence, to raise concerns about possible improprieties in financial and other matters and to do so without fear of reprisal, provided that such concerns are not raised in bad faith. The policy is supplemented by local procedures throughout the Group and at the Group's London headquarters, which provide staff with additional guidance and enable them to report matters in a language with which they are comfortable. The Audit Committee receives regular reports on whistleblowing incidents. It remains satisfied that the policy and the procedures in place incorporate arrangements for the proportionate and independent investigation of matters raised and for the appropriate follow-up action.

Internal control

The Board is responsible for the overall system of internal control for the Company and its subsidiaries, and for reviewing the system's effectiveness. With the support of the Audit Committee, it carries out such a review annually, covering all material controls including financial, operational and compliance controls and risk management systems, and reports to shareholders that it has done so.

Overview

The Company maintains a sound system of internal control with a view to safeguarding shareholders' investment and the Company's assets. It is designed to identify, evaluate and manage risks that may impede the achievement of the Company's business objectives rather than to eliminate these risks and can therefore provide only reasonable, not absolute, assurance against material misstatement or loss. A description of the key risk factors that may affect the Group's business is provided in the section on Performance and strategy.

The main features of the risk management processes and system of internal control operated within the Group are described below. They do not cover the Group's associate undertakings. They have been in place throughout the year under review and up to date.

Audit and CSR committee framework

The Group's audit and CSR committee framework underpins the Board's Audit and CSR Committees. It provides a flexible channel for the structured flow of information throughout the organisation, with committees at various levels covering key individual markets, areas and the Group's regions, each referring matters to the next level as appropriate. This framework ensures that significant financial, social, environmental and reputational risks faced by the Company and its subsidiaries are appropriately managed, and that any failings or weaknesses are identified so that remedial action may be taken where necessary.

The Group's regional audit and CSR committees (which are each chaired by an Executive Director) focus on risks and the control environment within each region and are in turn supported by area

and/or individual market audit and CSR committees. A corporate audit committee sits at the same level as the regional committees and focuses on the risks and the control environment within the Group's operations which do not fall within the regional committees' remit, for example head office central functions, global programmes and above-region projects. It comprises members of the Management Board and is chaired by a Management Board member responsible for one of the Group's Regions to maximise its independence from central executive management. It is in turn supported by separate audit committees covering the Group's global IT and operations functions, which were introduced as separate committees in 2009.

The relevant external and internal auditors regularly attend meetings of these committees and have private audiences with members of the committees at least once each year. In addition, central, regional and individual market management, along with internal audit, supports the Board in its role of ensuring a sound control environment.

Risk management and internal control processes

Risk registers, based on a standardised methodology, are used at Group, regional, area and individual market level to identify, assess and monitor the key risks (both financial and non-financial) faced by the business at each level. Mitigation plans are required to be in place to manage the risks identified and the risk registers and mitigation plans are reviewed and, where appropriate, updated on a regular basis. They are also reviewed regularly by the relevant regional audit and CSR committee, the corporate audit committee and, in the case of the Group risk register, by the Board's Audit Committee.

Group companies and other business units are required at least annually to complete a checklist of the key controls which they are expected to have in place, called Control Navigator. Its purpose is to enable them to self-assess their internal control environment, assist them in identifying any controls which may require strengthening and support them in implementing and monitoring action plans to address control weaknesses. The Control Navigator checklist is reviewed annually to ensure that it remains relevant to the business and covers all applicable key controls. In addition, at each year end, Group companies and other business units are required to:

- review their system of internal control, confirm whether it remains effective and report on any material weaknesses and the action being taken to address them; and
- review and confirm compliance with the Standards of Business Conduct and identify any material instances of non-compliance or conflicts of interest identified.

The results of these reviews are reported to the relevant regional audit and CSR committee or to the corporate audit committee and, where appropriate, to the Board's Audit Committee to ensure that appropriate remedial action has been, or will be, taken where necessary.

The Group's internal audit function provides advice and guidance to the Group's businesses on best practice in risk management and control systems. It is also responsible for carrying out audit checks on Group companies and other business units, and does so against an audit plan presented annually to the Audit Committee, which focuses in particular on higher risk areas of the Group's business.

Review

The Turnbull Guidance (the Guidance) sets out best practice on internal control for UK-listed companies to assist them in assessing the application of the Code's principles and compliance with the Code's provisions with regard to internal control. The current version of the Guidance applies to listed companies for financial years beginning on or after 1 January 2006.

The processes described above, and the reports that they give rise to, enable the Board and the Audit Committee to monitor the internal control framework on a continuing basis throughout the year and to review its effectiveness at the year end. The Board, with advice from its Audit Committee, has completed its annual review of the effectiveness of the system of internal control for the period since 1 January 2009. No significant failings or weaknesses were identified and the Board is satisfied that, where specific areas for improvement have been identified, processes are in place to ensure that the necessary remedial action is taken and that progress is monitored. The Board is satisfied that the system of internal control is in accordance with the Guidance.

Corporate social responsibility

CSR Committee

CURRENT MEMBERS
Karen de Segundo (Chairman)
Dr Ana Maria Llopis
Dr Gerry Murphy
Sir Nicholas Scheele

Attendance at meetings in 2009

Name	Meetings attended	Meetings eligible to attend
Karen de Segundo (Chairman)	4	4
Ana Maria Llopis	4	4
Gerry Murphy[1]	3	4
Sir Nicholas Scheele	3	4
Thys Visser[2]	1	2

Notes:
1 Gerry Murphy became a member on 13 March 2009.
2 Thys Visser ceased to be a member on 30 April 2009.

The Chairman, Chief Executive and the Management Board member responsible for Corporate and Regulatory Affairs attend meetings by invitation but are not members.

Summary terms of reference

The CSR Committee is responsible for:

- reviewing and making appropriate recommendations to the Board as regards the Company's management of corporate social responsibility (CSR) and the conduct of business in accordance with the Statement of Business Principles;
- monitoring and reviewing the effectiveness of the Group's strategy for, and management of, significant social, environmental and reputational issues;
- reviewing and monitoring the Group's plans for, and progress towards, business sustainability; and
- monitoring the effectiveness of the CSR governance process.

The Committee's terms of reference were reviewed and updated in March 2009. The full terms of reference are available from the Company Secretary and on www.bat.com.

The CSR Committee is authorised by the Board to review activity within the business with respect to CSR. It is authorised to seek the information it requires from, and require the attendance at any of its meetings of, any Director or member of management, and all employees are expected to cooperate with any request made by the Committee. It is authorised by the Board to obtain independent professional advice and secure the attendance of outsiders with relevant experience and expertise if it considers this necessary.

The Chairman of the Committee reports to the subsequent meeting of the Board on the Committee's work and the Board receives a copy of the minutes of each meeting. The papers considered by the Committee are available to any Director who is not a member, should they wish to receive them.

The CSR Committee held three scheduled meetings and one unscheduled meeting in 2009. With effect from 2009, the number of scheduled CSR Committee meetings held annually was increased from two to three, with an additional full meeting being added in July in consequence of the Committee's expanded remit following the amendment of its terms of reference in December 2008, and in order to establish greater continuity between meetings. The unscheduled meeting took place at the beginning of April to approve the Group's annual Sustainability Report and will again take place in 2010.

Key activities of the CSR Committee in 2009

The CSR Committee met four times in 2009. The specific items considered by it included:

- approval of the Company's Sustainability Report for 2008;
- an improved approach to sustainability reporting, to be incorporated in the report for 2009, and progress against the targets and commitments set out in the 2008 Report;
- the management of key reputational risks and related risk mitigation plans;
- human rights and related issues, youth smoking prevention initiatives and environmental, health and safety measures;
- corporate social investment activities; and
- adherence to the Group's International Marketing Standards.

The Committee reviewed its effectiveness as part of the Board evaluation process. In 2009, the Committee concluded that there had been a significant improvement over the previous year as a result of changes to the Committee membership and the development of a more focused framework for agenda setting and debate. The Committee requested more in-depth briefings on CSR issues and will work in 2010 towards developing a better understanding of the benefits being delivered by the Group's CSR programme. Further changes will also be implemented to the meeting arrangements for the Committee aimed at allowing more time for discussion and training.

CSR governance

The CSR Committee is supported at regional and local levels through combined audit and CSR committees. The structure aims to support the embedding of CSR across the Group and to monitor performance against the Group's principles and standards. The regional audit and CSR committees meet three times annually, and they follow a standard agenda, in order that materials and issues which are presented and raised at regional level may feed into Board level discussions, and vice versa.

Statement of Business Principles

The principles set out within our Statement of Business Principles are designed to help meet the expectations placed on us by our various stakeholders, and they form the basis on which we expect our businesses to be run in terms of responsibility. Developed in consultation with stakeholders, the Statement comprises three principles – Mutual Benefit, Responsible Product Stewardship and Good Corporate Conduct – and 18 Core Beliefs which explain in more detail what each principle means for the Group. It is available from the Company Secretary and on www.bat.com.

Sustainability reporting

The Company's Sustainability Reports and, prior to 2008, its Social Reports have detailed its social, ethical and environmental performance and performance against its commitments each year since the Company's first Social Report in 2002. Sustainability reporting, like the social reporting that preceded it, is conducted using a robust methodology, including independent assurance conducted by Ernst & Young LLP, in line with the AA1000 Assurance Standard (2008). Engagement with key stakeholders is a major requirement of the Standard and we have continued to hold independently facilitated and assured dialogue with those stakeholders throughout the year.

In April 2009, the Company published its second Sustainability Report outlining progress in each of the five key elements of its sustainability agenda. In April 2010, it will be publishing its third Sustainability Report and, in response to feedback received from stakeholders, this will adopt a more global and Group-wide approach. Not only will this provide a more comprehensive report, but it will also allow a more efficient approach to be adopted throughout the Group.

The Company has been included in both the Dow Jones Sustainability World Index and the Dow Jones STOXX Sustainability Index for the eighth successive year. It received the highest (Platinum) rating in the Corporate Responsibility Index 2008 run by Business in the Community, the 700 member organisation established in the UK to help business improve its positive impact on society, and is the first tobacco company to reach Platinum status and one of only nine new entrants in the Platinum sector during 2009.

Corporate social investment

The Company recognises the role of business as a corporate citizen and Group companies have long supported local community and charitable projects. The Group's approach to corporate social investment (CSI) is to regard it as an end in itself, rather than as a means of promotion, and Group companies have always been closely identified with the communities where they operate.

Group companies are encouraged to focus their CSI activities around three themes:

- **Sustainable agriculture:** This includes activities such as efforts to improve biodiversity and access to water, afforestation, programmes to prevent child labour and grants for agricultural research or training to help farmers optimise land yields by growing additional (non-tobacco) crops. These initiatives are expected to compliment the Group's own agricultural, environmental and biodiversity conservation practices.
- **Civic life:** This encompasses activities that aim to enrich public and community life, including supporting the arts and educational institutions, conserving indigenous cultures and restoring public spaces.
- **Empowerment:** This focuses on communities where we operate, providing people with educational opportunities to help them develop, for example through scholarships and information technology training or programmes supporting small businesses and promoting entrepreneurship. Group companies also continue to make other important contributions to meet local needs, such as relief efforts after natural disasters or AIDS prevention.

The major activities currently supported by the Company are the British American Tobacco Biodiversity Partnership and the Eliminating Child Labour in Tobacco Growing Foundation.

Charitable contributions

Payments for charitable purposes in 2009 amounted to £14 million (2008: £18 million), £2 million of which was paid in the UK (2008: £2 million).

OECD Guidelines

The Group recognises its responsibilities to the countries in which it operates and in this context, notes the OECD Guidelines for Multinational Enterprises in their current form.

Appointments to the Board

Nominations Committee

CURRENT MEMBERS
Richard Burrows (Chairman)
Sir Nicholas Scheele
Karen de Segundo
Robert Lerwill
Dr Ana Maria Llopis
Christine Morin-Postel
Dr Gerry Murphy
Anthony Ruys

Attendance at meetings in 2009

Name	Meetings attended	Meetings eligible to attend
Jan du Plessis[1]	5	5
Richard Burrows[2]	1	1
Sir Nicholas Scheele	4	5
Karen de Segundo	5	5
Robert Lerwill	5	5
Ana Maria Llopis	5	5
Christine Morin-Postel	4	5
Gerry Murphy[3]	4	4
Anthony Ruys	5	5
Thys Visser[4]	2	2

Notes:
1 Jan du Plessis ceased to be a member on 31 October 2009.
2 Richard Burrows became a member on 1 September 2009.
3 Gerry Murphy became a member on 13 March 2009.
4 Thys Visser ceased to be a member on 30 April 2009.

The Chief Executive and Management Board member responsible for Human Resources attend meetings by invitation but are not members.

Summary terms of reference

The Nominations Committee is responsible for:

- reviewing the structure, size and composition of the Main Board and Management Board to ensure that both boards have an appropriate balance of expertise and ability;
- reviewing the succession plans for the Executive Directors and members of the Management Board;
- making recommendations to the Board on suitable candidates for appointment as Main Board Directors or as members of the Management Board;
- ensuring that the procedure for appointing new Directors is rigorous and transparent and that appointments are made on merit and against objective criteria for the purpose; and
- assessing the time needed to fulfil the roles of Chairman, Senior Independent Director and Non-Executive Director, and ensuring that Non-Executive Directors undertake that they will have sufficient time to fulfil their duties.

The Committee's terms of reference were reviewed and updated in March 2009. The full terms of reference are available from the Company Secretary and on www.bat.com.

The Nominations Committee reviews forthcoming retirements at least once a year and considers the need to identify candidates to fill vacancies on the Board. This process includes an evaluation of the skills and experience to be looked for in those candidates to ensure continuing Board balance. The selection process will generally involve interviews with a selection of candidates, using where appropriate the services of executive search firms specialising in board level recruitment.

Key activities of the Nominations Committee in 2009

The Nominations Committee met five times in 2009. The specific items considered by it included:

- the recruitment of Dr Gerry Murphy and his appointment to the Board as a Non-Executive Director;
- the announcement by Jan du Plessis of his intention to take up the role of Chairman of Rio Tinto p.l.c;
- an updated role profile identifying the skills required for the role of Chairman;
- the recruitment and appointment to the Board as a Non-Executive Director of Richard Burrows and his subsequent appointment as Chairman on Jan du Plessis' retirement;
- continuing measures to refresh the Board, including further non-executive appointments;
- succession planning for the Executive Directors and members of the Management Board; and
- changes in the composition of the Management Board.

In 2009, the Committee reviewed its effectiveness as part of the Board evaluation process. It concluded that it continues to operate effectively and, in particular, that early discussions around succession planning have helped by setting the context before decisions on timing and candidates are required. The Committee identified a need for additional non-executive appointments.

Terms of appointment to the Board

The Executive Directors have rolling contracts of one year. The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment. Details of the Company's policy on Executive Directors' service contracts and the terms of appointment for Non-Executive Directors are set out in the Remuneration report.

Directors' interests and indemnities

Further details of Directors' contracts and letters of appointment, remuneration and emoluments, and their interests in the shares of the Company (including interests in share options and deferred shares) as at 31 December 2009 are given in the Remuneration report. No Director had any material interest in a contract of significance (other than a service contract) with the Company or any subsidiary company during the year.

Prior to his appointment as a Non-Executive Director, and subsequently as Chairman, Richard Burrows disclosed to the Board that he is a director of Rentokil Initial plc. Although this gives rise to no current conflict of interest, the potential situational conflict was reviewed by the Board and approved in accordance with the Company's Articles of Association.

The Company's practice has always been to indemnify its Directors in accordance with the Company's Articles of Association and to the maximum extent permitted by law. As at the date of this report, such indemnities are in force covering any costs, charges, expenses or liabilities which they may incur in or about the execution of their duties to the Company or to any entity which is an associated company (as defined in Section 256 of the Companies Act 2006), or as a result of duties performed by the Directors on behalf of the Company or any such associated company.

Retirement by rotation and reappointment

Directors are submitted for reappointment at regular intervals by application of the Company's Articles of Association. These require that at each Annual General Meeting, all Directors shall retire from office by rotation who held office at the time of each of the two preceding Annual General Meetings and who (at either of those preceding Annual General Meetings): (1) did not previously retire by rotation, or (2) were reappointed following his/her appointment as an additional Director or to fill a vacancy. If the number of Directors retiring in this way is less than one-third of the Directors who are subject to retirement by rotation or if their number is not three or a multiple of three, then additional Directors shall retire by rotation provided that a number not exceeding one-third shall retire from office. Subject to the provisions of the Companies Act 2006 and the Articles of Association, the Directors to retire by rotation will be those who have been in office the longest since their appointment or last reappointment.

The Board has progressively refreshed its membership over a number of years. In this context, Non-Executive Directors who serve for a total of more than six years are subject to a particularly rigorous review, and additional service after that time is reviewed annually. This was done in the case of Ana Maria Llopis, given that she has been a Non-Executive Director since February 2003.

In accordance with the Articles of Association, and further to recommendations made by the Nominations Committee to the Board, the Directors named below will retire from the Board at the forthcoming Annual General Meeting and, being eligible, will offer themselves for reappointment:

Ana Maria Llopis
Christine Morin-Postel
Anthony Ruys

In addition, Richard Burrows, having been appointed as a Director on 1 September 2009, will also retire from the Board at the forthcoming Annual General Meeting and, being eligible, will offer himself for reappointment.

REMUNERATION REPORT

CONTENTS

Introduction	78
Remuneration Committee	79
Summary terms of reference	79
Key activities of the Remuneration Committee in 2009	80
Remuneration policy	80
Salary	81
Performance-related bonus	81
Long-term incentives	82
Share Option Scheme	85
All-employee share schemes	85
Options and awards outstanding	86
Shareholding guidelines	86
Executive Directors' pension benefits	86
Executive Directors' service contracts	87
Executive Directors' external appointments	88
Non-Executive Directors' terms of appointment	88
Non-Executive Directors' remuneration policy	88
Chairman's terms of appointment and remuneration	89
Appendices	90
Tables 1 to 7	90
Status of Remuneration report	97

CURRENT MEMBERS

Anthony Ruys (Chairman)
Karen de Segundo
Robert Lerwill
Dr Ana Maria Llopis
Christine Morin-Postel
Dr Gerry Murphy
Sir Nicholas Scheele

"As Chairman of the Remuneration Committee, I am committed to ensuring that the Committee is effective and that the proper incentives are in place in the context of the overall remuneration policy."

Anthony Ruys Remuneration Committee Chairman

INTRODUCTION

British American Tobacco's remuneration policy continues to focus on the delivery of the Group's strategy. In particular, in developing and maintaining a sustainable business by achieving growth, improving productivity, operating responsibly and building a winning organisation. The Remuneration Committee ensures that the relevant business objectives underpin all the performance-related bonus measures at both a corporate and individual level.

The Remuneration Committee adopted some time ago a simple and transparent approach for the remuneration packages of the senior executive team with the aim of providing full clarity for both shareholders and eligible participants about the required levels of performance. There is a real focus on business sustainability and the management of key risks which continues to be incorporated into the component parts of the remuneration policy which is detailed below.

The Remuneration Committee has decided to carry out a review in 2010 in connection with the International Executive Incentive Scheme (IEIS) and the Long-Term Incentive Plan (LTIP) to ensure that the total remuneration opportunity for the Executive Directors and senior management team is market competitive. This may lead to an approach to shareholders later in the year in the event that any changes are proposed.

Remuneration Committee

Attendance at meetings in 2009

Name	Meetings attended	Meetings eligible to attend
Anthony Ruys	3	3
Karen de Segundo	3	3
Robert Lerwill	3	3
Ana Maria Llopis	3	3
Christine Morin-Postel	1	3
Gerry Murphy	2	2
Sir Nicholas Scheele	2	3

At the date of this report, the Committee comprises the independent Non-Executive Directors of the Company set out in the table above. Gerry Murphy became a member of the Remuneration Committee upon his appointment as a Non-Executive Director on 13 March 2009. There were no other changes in the membership of the Remuneration Committee during 2009.

The Secretary to the Committee is Nicola Snook, the Company Secretary.

No Executive Director or Management Board member plays any part in determining his or her remuneration. During the year ended 31 December 2009, both the Chief Executive and the Chairman were consulted and invited to attend meetings of the Committee, except when their own remuneration was under consideration. In determining remuneration for the year, the Committee consulted the Chief Executive, and the Director, Human Resources and the Group Head of Reward. Richard Burrows, prior to taking up his role as Chairman, also attended a meeting of the Remuneration Committee.

The agenda for the meetings of the Remuneration Committee is agreed by the Chairman of the Remuneration Committee, taking into account the views of other members of the Committee, as appropriate.

Summary terms of reference

The Remuneration Committee is responsible for:

- determining an executive remuneration policy covering salary, performance-based variable rewards and pensions;
- determining, within the terms of the agreed policy, the specific remuneration packages for the Chairman, the Executive Directors and the members of the Management Board both on appointment and on review, having due regard to pay and employment conditions elsewhere in the Group;
- the setting and the review of targets applicable for the Company's short and long-term performance-based variable reward schemes and determining achievement against targets;
- exercising its discretion in relation to performance-based rewards (where appropriate and as provided by the applicable scheme rules); and
- monitoring and advising the Board on any major changes to the policy on employee benefit structures for the British American Tobacco Group.

The Committee's terms of reference were reviewed and updated in March 2009. The full terms of reference are available from the Company Secretary and on www.bat.com.

The Remuneration Committee is authorised by the Board to seek any information it requires from, and require the attendance at any of its meetings of, any Director or member of management, and all employees are expected to cooperate with any request made by the Committee. The Committee is authorised by the Board to obtain, at the Company's expense, outside legal or other independent professional advice if it considers this necessary. In particular, the Committee is responsible for the appointment of any remuneration consultants who may advise the Committee.

Deloitte LLP provided remuneration services and advice to the Remuneration Committee throughout the year. Deloitte is an international professional services firm which has also supported management in the development and delivery of remuneration proposals as well as the provision of tax, corporate finance and consulting services to British American Tobacco Group companies around the world. Herbert Smith LLP has also been retained by the Company to provide legal advice in respect of the Company's share schemes, as well as providing other legal services to British American Tobacco as a whole. Ernst & Young LLP provides tax advice to international assignees and in respect of the Company's share schemes.

REMUNERATION REPORT
CONTINUED

The Remuneration Committee reviewed its effectiveness in 2009 as part of the Board evaluation process. Changes to the scope of membership for the Remuneration Committee were considered but the current format was deemed appropriate for the time being. In addition, the Committee's review concluded that it is operating effectively internally and also externally with Deloitte LLP, its remuneration consultants.

Key activities of the Remuneration Committee in 2009

The Remuneration Committee met three times during 2009. The Committee followed its regular work programme designed around its two scheduled meetings in February and October each year at which it:

- benchmarked, reviewed and set the salaries for the Executive Directors and the Management Board members;
- assessed the achievement of the targets for the 2008 IEIS award and set the targets for the award made in 2009;
- assessed the measurement of the performance conditions for the vesting of the Long-Term Incentive Plan (LTIP) 2006 award;
- determined the LTIP award for March 2009 and its associated performance conditions;
- assessed the achievement of the targets for the 2008 Share Reward Scheme award and set the targets for the award made in 2009;
- monitored the application of the Company's shareholding guidelines for the Executive Directors and the Management Board members; and
- reviewed the Remuneration report for the year ended 2008 prior to its approval by the Board.

In addition, the Remuneration Committee dealt with the following:

- terms of appointment for Richard Burrows as Chairman of the Company;
- terms of appointment and termination for the Management Board appointments and departures during the year;
- a general update of the Company's shareholding guidelines and clarification of the position on shares held by spouses and the use of shares as security for loans; and
- the use of restricted shares in connection with the vesting of the May 2007 LTIP award.

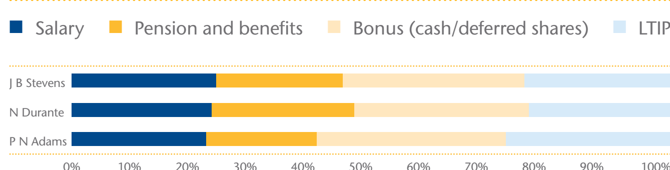
Remuneration policy

Fixed and variable remuneration

The Remuneration Committee has set a guideline that approximately 50 per cent of the remuneration package should be performance-related. The remuneration package comprises both core fixed elements (base salary, pension and other benefits) and performance-based variable elements (cash and share incentive annual bonus plans, and the LTIP).

The composition in the case of the current Executive Directors for 2009 is illustrated in the bar chart below:

Executive Directors' percentage of fixed and variable remuneration



Notes:

1 The above illustration of the current Executive Directors' percentage of fixed and variable remuneration for 2009 is based on a number of assumptions: (1) base salary represents annual salary; (2) pension represents the transfer value of net increase in pension to the UK Pension Fund as disclosed in Table 7 (Nicandro Durante's transfer value is based on constant exchange rates); (3) benefits are core benefits such as car allowance, private medical and personal accident insurance; (4) bonus is the amount received for performance in 2009 delivered in cash and deferred shares; and (5) LTIP represents the target annualised expected value of the long-term incentive award granted in 2009 expressed as a percentage of base salary.

2 Fixed remuneration comprises: salary, pension and benefits. Variable remuneration comprises: bonus (cash and deferred shares) and LTIP.

Pay Comparator Group

The setting of the reward opportunity for Executive Directors remains underpinned by responsible independent benchmarking. The approach is focused on a peer group which includes selected FTSE 100 companies and, from 2009, Philip Morris International (the Pay Comparator Group), which is supplemented by market data of FTSE 350 companies, with the relative scale and complexity, as well as the practice of the FTSE 30 companies. The Pay Comparator Group is made up of companies which meet the criteria of a consumer goods focus, an international spread of operations and a competitor for top management talent.

The constituent companies in the Pay Comparator Group as at 31 December 2009 are set out below:

Associated British Foods	Pearson
Astra Zeneca	Philip Morris International
BP	Reckitt Benckiser
BT Group	Reed Elsevier
British Sky Broadcasting	Royal Dutch Shell
Cadbury	SABMiller
Diageo	Tesco
GlaxoSmithKline	Unilever
Imperial Tobacco Group	Vodafone
Marks & Spencer	WPP Group

Salary

Purpose
– reward individual performance
– reflect skills and experience

Delivery
– monthly
– cash

Policy
– annual review in February (with salary changes effective from April) or ad hoc review on a significant change of responsibilities
– benchmarked for appropriate salary levels using a company size and complexity model coupled with (1) the Pay Comparator Group; and, for Executive Directors, (2) published salary data for FTSE 350 companies
– base salary is pensionable

The summary table above sets out the key policy principles for the salaries for the Executive Directors and the Management Board members. Similar principles are applied to the salaries of senior managers and other levels in the organisation, taking into account local market practices.

	Base salary from 1 April 2010 £	Base salary from 1 April 2009 £
Paul Adams (Chief Executive)	**1,290,000**	1,225,000
Nicandro Durante (Chief Operating Officer)	**670,000**	630,000
Ben Stevens (Finance Director)	**640,000**	590,000

The Management Board members will receive salary increases averaging around 4 per cent which are in line with the salary increases awarded to centre-based UK employees with effect from 1 April 2010. Actual rises have been based on each individual's contribution and performance and the external market competitiveness. The salary increase of the Chief Executive seeks to maintain the market competitive position and recognises the high level of Company performance currently being delivered.

The Chief Operating Officer and the Finance Director are relatively new to their roles, both having been appointed in early 2008. The Remuneration Committee identified that these two positions are behind the market at both the level of base salary and on-target total compensation. In order to ensure that the remuneration packages of these two roles are better aligned to the market, the Remuneration Committee agreed to increase their levels of base salary by an average of about 7 per cent.

The Remuneration Committee, while being clear that annual salary increases are not inevitable, considers that, in all cases, these revised salaries are appropriate as the Company has performed well over the review period.

In addition to basic salary, the Executive Directors receive certain benefits in kind, principally: a car or car allowance; the use of a driver; and private medical and personal accident insurance.

Performance-related bonus – International Executive Incentive Scheme (IEIS)

Purpose
– incentivise the attainment of corporate targets on an annual basis

Delivery
– annual award
– 50 per cent cash
– 50 per cent shares (deferred shares)
– dividend equivalent payment

Policy
– six common measures for performance: underlying operating profit, market share, Global Drive Brand volume, net revenue, cash flow and costs
– the annual 'on-target' bonus opportunity for the Chief Executive is 100 per cent of the base salary with a maximum award of 200 per cent of salary, and for the Chief Operating Officer and Finance Director the 'on-target' bonus opportunity is 90 per cent with a maximum award of 180 per cent
– for the Management Board the 'on-target' bonus opportunity is 67.5 per cent of the base salary with a maximum award of 135 per cent of salary
– awards are non-pensionable

The IEIS rewards short-term business performance within the context of longer-term sustainability and any resulting award is delivered as 50 per cent cash and 50 per cent deferred shares (through the Deferred Share Bonus Scheme). Appropriately, stretching targets are set by the Remuneration Committee at the beginning of each year and are measured in terms of both business and financial performance. The resulting award for senior managers is delivered in variable proportions according to grade, being usually 55 per cent cash and 45 per cent deferred shares.

For the Executive Directors and Management Board members, the annual bonus opportunity for 2010 (unchanged from 2009) will be as shown in the summary table above. The annual bonus opportunity for senior managers also remains unchanged with the annual 'on-target' bonus opportunity being 45 per cent of base salary with a normal maximum award of 90 per cent of salary rising to 135 per cent of base salary in cases of exceptional performance.

In 2009, the targets reflected the six common measures referred to above with each having an equal weighting of 16.67 per cent. Relevant performance points are: threshold (which must be exceeded to attract any payment of a bonus for that measure); target; and maximum amount (the level at which the bonus for that measure is capped) are set at the start of the year by reference to the projected performance for each target in the context of the Group's annual budget. No elements of the bonuses are guaranteed and, as in previous years, the specific targets are commercially sensitive and not made public.

While the current proposed bonus targets do not include any measures which directly reflect the Group's performance on corporate social responsibility (CSR) and governance issues, the Board continues to recognise the importance of this area. Governance is embedded in the organisation as evidenced by the Company's strong governance structure. In addition, the delivery of the strategic vision encompasses the business measure of Responsibility for which the Dow Jones Sustainability Indices (an external benchmark) have been used as one of the measures to assess the Company's successful performance to date – see CSR section of the Corporate governance statement.

The Committee receives reports from management to allow it to assess the extent to which performance measures have been achieved. Subject to the Committee exercising its judgment in the assessment of the quality of the Company's overall performance, the payout for each measure is determined by reference to performance relative to that measure's performance points, on a pro rata basis.

In respect of the year ended 31 December 2009, the total payouts under the IEIS were: Chief Executive 135.4 per cent (2008: 169.4 per cent); Finance Director and Chief Operating Officer 121.9 per cent (2008: 153.5 per cent); and Management Board 91.4 per cent (2008: 116.7 per cent), in each case paid 50 per cent in cash and 50 per cent in deferred shares. The actual performance-related pay values are shown in Table 4 – annual cash bonus and deferred share bonus. For senior managers, the total payouts reflect performance at a global, regional, area or end market level, as applicable to their roles. For senior managers whose bonus was linked to global performance, the total payout under the IEIS in respect of the year ended 31 December 2009 was 60.9 per cent (2008: 81.2 per cent), paid 55 per cent in cash and 45 per cent in deferred shares.

Awards made under the Deferred Share Bonus Scheme (the Deferred Scheme) are in the form of free ordinary shares in the Company which are normally held in trust for three years and no further performance conditions apply in that period. In certain circumstances, such as resigning before the end of the three year period, participants may forfeit the shares. The Remuneration Committee encourages a culture of 'ownership' of these awarded shares and participants receive a cash sum equivalent to the dividend on the after-tax position of all unvested ordinary shares held in the Deferred Scheme at the dividend record date.

Long-term incentives

Purpose	– incentivise growth in earnings per share and total shareholder return (TSR) over a three year period
Delivery	– discretionary annual award – awards of shares – variable due to performance over three year period – dividend equivalent payment
Policy	– maximum annual award of 300 per cent of salary – three year performance period – TSR performance (50 per cent of the total award) combines both the share price and dividend performance during the three year performance period as against two comparator groups (25 per cent for each measure): (1) constituents of the FTSE 100 Index; and (2) a peer group of FMCG companies – earnings per share measure (50 per cent of the total award) relates to earnings per share growth (on an adjusted diluted basis) relative to inflation

The long-term element of remuneration continues to be delivered through the Company's LTIP. All the Executive Directors, Management Board members and senior employees participate in the Long-Term Incentive Plan adopted in 2007 (the 2007 LTIP). This plan replaced the LTIP adopted in 1998 (1998 LTIP) under which no further awards have been made and which has now expired. The 2007 LTIP provides for awards of free ordinary shares, provided demanding and appropriately stretching performance conditions are met over a three year period. The first award under the 2007 LTIP was made in May 2007.

Award levels

The current award levels for Executive Directors and Management Board members (in place since 2008) are set out in the table below and will continue to apply to awards made in 2010. Senior managers receive awards over 75 per cent or 25 per cent of salary dependent on grade. The maximum annual award under the rules of the 2007 LTIP is 300 per cent of base salary. The Committee continues to review the application of this limit in the context of its policy overall.

LTIP awards	Multiple of base salary %
Chief Executive	300
Finance Director	250
Chief Operating Officer	250
Management Board	200

Since the award made in 2008, the performance schedule has been structured such that the same percentage of salary will vest for threshold performance for Executive Directors and the Management Board as for awards made prior to 2008. This was achieved by reducing the entry level vesting for median ranked performance for each portion of the TSR performance condition from 7.5 per cent to 6 per cent of the award; and reducing the entry level vesting for EPS growth from 10 per cent to 8 per cent of the award. This maintains the positioning of the total remuneration package for 'target' performance, and increases the opportunity for higher levels of performance. This approach will also apply to the LTIP award to be made in 2010.

Since 2005, participants have been entitled to receive a dividend equivalent payment to the value of the dividends that they would have received as shareholders on their vesting awards. The LTIP dividend equivalent payment continues to be important in aligning further the interests of senior management with those of shareholders. The values of the LTIP dividend equivalent payments for the Executive Directors are shown as individual emoluments in Tables 3 and 4.

To the extent that the performance conditions have been satisfied following assessment by the Remuneration Committee, awards are normally exercisable between three and 10 years after they have been made. An award of shares lapses to the extent that the performance conditions are not satisfied in accordance with the measures set out above at the end of the three year performance period. Further, any such proportion of the award that lapses as a result does not attract the payment of the LTIP dividend equivalent payment.

Performance

The percentage of award vesting is based on a combination of TSR and earnings per share (EPS) performance conditions measured over a three year period. The Remuneration Committee considers that both of these measures are appropriate benchmarks of a company's performance. This combination provides an important balance of measures relevant to the Group's business and market conditions as well as providing a common goal for the Executive Directors, the Management Board members and shareholders. These performance conditions are set out in the above table and are considered in more detail below.

TSR performance condition

A total of 50 per cent of the total award is based on the Company's TSR performance against two comparator groups (25 per cent for each measure): (1) the constituents of the London Stock Exchange's FTSE 100 Index at the beginning of the performance period; and (2) a peer group of international FMCG companies. In the event of upper quartile performance by the Company relative to the comparator groups above, 25 per cent of the total award vests in full. From 2008, 6 per cent of the total award vests for median performance (7.5 per cent for the 2006 and 2007 awards). There is pro rata vesting between these two points. The TSR portions of an LTIP award do not vest for below median performance.

These comparator groups, which are regularly reviewed to ensure that they will remain both relevant and representative, are chosen to reflect the Company's financial and business trading environments. The applicable FMCG peer groups for the outstanding LTIP awards are shown below.

FMCG Peer Group	Award: 27 March 2009	Award: 15 May 2008	Award: 15 May 2007
Altadis			✓
Altria Group[1]			✓
Anheuser-Busch		✓	✓
Anheuser-Busch InBev	✓		
Cadbury	✓		
Cadbury Schweppes		✓	✓
Campbell Soup	✓	✓	✓
Carlsberg	✓	✓	✓
Coca-Cola	✓	✓	✓
Colgate-Palmolive	✓	✓	✓
Danone (formerly Group Danone)	✓	✓	✓
Diageo	✓	✓	✓
The Gillette Company		✓	✓
Heineken	✓	✓	✓
HJ Heinz	✓	✓	✓
Imperial Tobacco Group	✓	✓	✓
InBev SA		✓	✓
Japan Tobacco	✓	✓	✓
Johnson & Johnson	✓	✓	✓
Kellogg	✓	✓	✓
Kimberly-Clark	✓	✓	✓
LVMH	✓	✓	✓
Nestle	✓	✓	✓
PepsiCo	✓	✓	✓
Pernod Ricard	✓	✓	✓
Philip Morris International[1]	✓	✓	
Procter & Gamble	✓	✓	✓
Reckitt Benckiser	✓	✓	✓
SABMiller	✓	✓	✓
Sara Lee	✓	✓	✓
Scottish & Newcastle			✓
Unilever	✓	✓	✓
Wrigley		✓	✓

Note:
1 Altria Group was tracked until the demerger of Philip Morris International on 17 March 2008, and a market cap weighted basket of Philip Morris International and Altria Group is tracked from March 2008. For the 2008 award, Philip Morris International is tracked from the point of the demerger.

TSR continues to be measured according to the return index calculated by Datastream and reviewed by the Company's independent advisers. It is measured on the basis that all companies' dividends are reinvested in the shares of those companies. The return is the percentage increase

in each company's index over the three year performance period. The opening and closing indices for this calculation are respectively the average of the index numbers for the last quarter preceding the performance period and for the last quarter of the final year of that performance period – this methodology is employed to reflect movements of the indices over that time as accurately as possible.

A local currency basis is used for the purposes of TSR measurement. This approach is considered to have the benefits of simplicity and directness of comparison with the performance of the comparator companies, and is in line with the historic approach taken by the Remuneration Committee for the purposes of TSR measurement.

EPS performance condition

Half of the award is based on earnings per share growth relative to inflation. This element of the award will vest in full if EPS growth over the three year performance period is an average of at least 8 per cent per annum in excess of inflation. Ten per cent of this element of the award (8 per cent for awards made since 2008) will vest if the EPS growth over the performance period is 3 per cent in excess of inflation. An award will vest on a pro rata basis between these two points. None of the EPS portion of an award vests if EPS growth is less than 3 per cent per annum in excess of inflation.

These EPS targets are consistent with and support the Company's strategy to deliver high single-digit EPS growth (on average) over the medium to long term and are considered to be very demanding. The Remuneration Committee keeps the targets under review to ensure that they continue to be appropriately stretching.

For awards made up to and including 2008, growth in EPS for these purposes is calculated on an adjusted diluted EPS basis using a formula which incorporates: (1) the adjusted diluted EPS for the year prior to the start of the first performance period and then for the first, second and third years of that performance period; and (2) retail price index (RPI) for the last month of the year immediately preceding the performance period and then the RPI for the respective first, second and third years of that performance period.

In 2009, the Remuneration Committee, following discussion with key shareholders, moved to a more standard approach for calculating EPS growth. Commencing with the LTIP award made on 27 March 2009, EPS performance is measured as an increase in adjusted diluted EPS between the base year and the final year of the performance period, expressed as an annual growth rate over the period.

Under this approach, only the base year and final year adjusted diluted EPS results are considered. However, on the basis that rolling annual awards are made, all years of performance ultimately will be taken into account in calculating EPS growth over time. This change was made in order to simplify the approach and to bring it into line with prevailing market practice. Where EPS grows at a relatively constant rate, the two methodologies will produce broadly similar results, although the outcome will differ for different growth profiles.

Both the previous approach and the new method of calculation introduced in 2009 are considered to be fair and reasonable measures of performance.

Vesting of LTIP award made in 2007

An LTIP award was made to Executive Directors and Management Board members on 15 May 2007 with the performance period being completed at 31 December 2009 (the 2007 Award). The Remuneration Committee has assessed the performance of the Company against the two performance conditions. On the TSR measure, the Company ranked eighth out of the FTSE 100 group of companies, giving a vesting of 25 per cent for performance at the upper quartile. A vesting of 25 per cent was also achieved for ranking second out of the peer group of international FMCG companies, this also being upper quartile. EPS growth was 12.1 per cent per annum in excess of inflation. The overall assessment of both LTIP measures, therefore resulted in a vesting of 100 per cent of the award.

As performance is based on the three year period to the end of December 2009 and it is therefore known what percentage of the award will vest, the Board has considered taking steps to enable the participants to elect to be taxed on these awards in the 2009/10 tax year. The majority of the LTIP population is not affected as their awards will vest in March 2010. As a result, the Company has agreed to offer the Executive Directors and certain Management Board members who are impacted the opportunity to enter into restricted share agreements in March 2010. Consequently, where a participant elects to receive the beneficial interest in the shares underlying the respective 2007 Awards (to the extent that the performance conditions have been met), the shares will continue to be held on behalf of the participants by the trustee of the British American Tobacco Group Employee Trust. Until the third anniversary of the date of grant (15 May 2010) the shares will continue to be subject to forfeiture/clawback, in particular in circumstances of leaving the Company, and any shares that would not have vested under the rules of the 2007 LTIP will be forfeited for no consideration.

Shares in which the beneficial interest only is transferred cannot be sold until the third anniversary of the making of the award and, in particular, none of the shares being transferred may be sold to cover the taxation and other statutory withholding obligations arising on the transfer of the beneficial interest in the shares. Each participant will pay their respective liabilities to the Company from their own funds. These arrangements are cost neutral to the Company and will not have an impact on the Company's corporation tax deduction treatment for LTIP exercises.

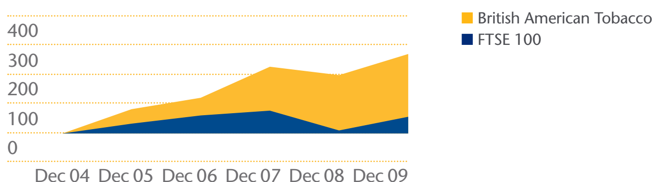
In accordance with the rules of the 2007 LTIP, the Remuneration Committee also resolved that the participants would be paid an amount equivalent to the dividends that they would have received over the period from the date the awards were made to the date they entered into their restricted share agreements. In the event that such dividend payments would not have been paid on the normal vesting date, participants have agreed to repay such amounts to the Company.

Performance graph

Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 requires that the Company must provide a graph comparing the TSR performance of a hypothetical holding of shares in the Company with a broad equity market index over a five year period. In this context, the Directors have again chosen to illustrate the performance of TSR against the FTSE 100 Index over a five year period, commencing on 1 January 2005. In the opinion of the Directors, the FTSE 100 Index is the most appropriate index against which TSR should be measured because it is a widely used and understood index of broadly similar sized UK companies to the Company. The performance graph is shown below.

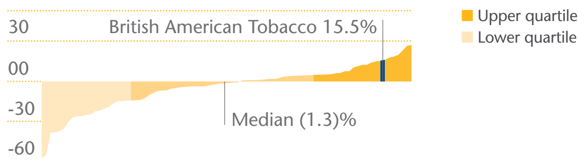
Historical total shareholder return performance

Growth in the value of a hypothetical £100 holding over five years
FTSE 100 comparison based on 30 trading day average values.

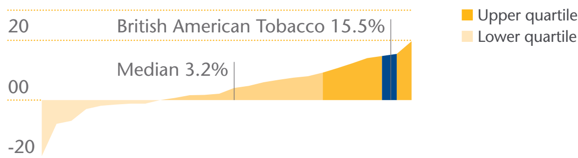


Total shareholder return (annual %)

FTSE 100 – 1 January 2007 to 31 December 2009
The FTSE 100 comparison is based on three months' average values.



FMCG group – 1 January 2007 to 31 December 2009
The FMCG group comparison is based on three months' average values.



LTIPs – change of control

The rules of the 1998 LTIP and the 2007 LTIP both provide that in the event of a change of control of the Company as a result of a takeover, reconstruction or winding up of the Company (not being an internal reorganisation), LTIP awards will become exercisable for a limited period based on the period of time which has elapsed since the date of the award and the achievement of the performance conditions at that date, unless the Remuneration Committee determines this not to be appropriate in the circumstances. In addition, the 2007 LTIP allows (as an alternative to early release) that participants may, if permitted, exchange their LTIP awards for new awards of shares in the acquiring company on a comparable basis.

Share Option Scheme

No options have been granted under the Share Option Scheme since March 2004 and no options have been granted to the current Executive Directors since September 1999. The Share Option Scheme expired in April 2008. As at 31 December 2009, no Executive Directors held outstanding options under the Share Option Scheme.

During the life of the Share Option Scheme, options granted were not issued at a discount to the market price at the time of grant, with the value of options for that grant being limited to 50 per cent of a participant's base salary. All outstanding options have matured and are exercisable up to March 2014.

All-employee share schemes

The Executive Directors, Management Board members and senior managers are also eligible to participate in the following all-employee share schemes which are designed to incentivise employees of the Group by giving them opportunities to build a shareholding in the Company: the British American Tobacco Sharesave Scheme (Sharesave Scheme) and the Employee Share Ownership Plan.

Sharesave Scheme

The Sharesave Scheme is approved by HM Revenue & Customs (HMRC). Eligible employees, including the Executive Directors and Management Board members, have been granted employee savings-related share options to subscribe for ordinary shares in the Company. In November 2009, the Company made a further grant of options under the Sharesave Scheme which allows for options granted to be exercisable in conjunction with either a three year or five year savings contract up to a monthly limit of £250. Options are normally granted at a discount of 20 per cent to the market price at the time of the invitation, as permitted under the rules of the Sharesave Scheme. At 31 December 2009, all the Executive Directors held options under the Sharesave Scheme.

Employee Share Ownership Plan

The Employee Share Ownership Plan is an HMRC approved share incentive plan, which incorporates a Partnership and Free Shares element. The Partnership Share Scheme is open to all eligible employees, including Executive Directors and Management Board members. Employees can allocate part of their pre-tax salary to purchase shares in the Company. The maximum amount that can be allocated in this way is £1,500 in any year. Shares purchased are held in a UK-based trust, normally capable of transfer to participants tax-free after a five year holding period. At 31 December 2009, of the Executive Directors, Paul Adams and Nicandro Durante, participated in the Partnership Share Scheme.

The Company also operates the Free Shares element of the plan, known as the Share Reward Scheme. Under this Scheme, eligible employees (including Executive Directors) receive an appropriation of shares in April of each year in which the Scheme operates in respect of performance in the previous financial year. An award of £2,030 will be made to Executive Directors and Management Board members on 1 April 2010 in respect of the year ended 31 December 2009. The performance conditions are aligned to those set for the IEIS in respect of the same performance period. The plan shares are held in a UK-based trust for a minimum period of three years and during that time the trust will exercise its voting rights as directed by the plan's participants. The maximum individual award under the Share Reward Scheme is £3,000.

Options and awards outstanding

To satisfy the future exercise of awards or options under the Group's employee share schemes, ordinary shares are acquired in the market by the Group's employee share ownership trusts or the Company issues new shares.

During the year, new ordinary shares were issued by the Company in relation to the Sharesave Scheme and to certain participants in the Share Option Scheme resident outside the UK.

Under the Sharesave Scheme, a total of 1,232,474 options over ordinary shares in the Company were outstanding at 31 December 2009. The options outstanding under the Sharesave Scheme are exercisable until June 2015 at option prices ranging from 663p to 1555p.

The British American Tobacco Group Employee Trust (BATGET)

BATGET is used to satisfy the vesting and exercise of awards of ordinary shares made under the Deferred Scheme, and the 1998 LTIP and the 2007 LTIP as well as the exercise of options under the Share Option Scheme. The number of shares held in BATGET to satisfy outstanding awards is consistently monitored by a committee of senior management that reports to a committee of the Board. BATGET is funded by interest-free loan facilities from the Company totalling £400 million, enabling the trust to facilitate the purchase of ordinary shares to satisfy the future vesting or exercise of options and awards. The loan to BATGET amounted to £273 million at 31 December 2009 (2008: £193 million). The loan is either repaid from the proceeds of the exercise of options or, in the case of ordinary shares acquired by BATGET to satisfy the vesting and exercise of awards, the Company will subsequently waive the loan provided over the life of the awards. If the options lapse, ordinary shares may be sold by BATGET to cover the loan repayment.

BATGET currently waives dividends on the ordinary shares held by it. As at 31 December 2009, BATGET held 14,679,045 ordinary shares with a market value of £296.0 million (1 January 2009: 14,137,074 ordinary shares; £254.5 million). BATGET waived payment of the final dividend for 2008 of £8.5 million in May 2009 and the interim dividend for 2009 of £4.3 million in September 2009.

While shares are held by BATGET, the trustee does not exercise any voting rights. However, as soon as shares held in BATGET are transferred out to share scheme participants, the participants may exercise the voting rights attaching to those shares.

Details of the Company's material share-based payment arrangements, reflecting both equity share-based and cash-settled share-based arrangements, are set out in note 27 to the accounts.

Shareholding guidelines

Executive Directors and Management Board members are encouraged to hold shares in the Company. The Remuneration Committee's guidelines require a holding equal to the value of a percentage of salary as set out below and excludes shares earned but not yet vested under Company share plans.

Shareholding guidelines	Multiple of base salary %
Chief Executive	200
Chief Operating Officer	150
Finance Director	150
Management Board	100

The Executive Directors, Paul Adams (Chief Executive), Nicandro Durante (Chief Operating Officer) and Ben Stevens (Finance Director), all meet the shareholding guidelines. There are transitional provisions for those Executive Directors and Management Board members who do not meet the requirements of the shareholding guidelines upon appointment. In such cases, individuals may, generally, only sell a maximum of up to 50 per cent of any shares vesting (after tax) under Company share plans until the threshold under the shareholding guidelines has been met.

The interests of the Directors of the Company in the ordinary shares of the Company are shown in Table 5.

Executive Directors' pension benefits

Purpose	– provision of competitive post-retirement benefits
Delivery	– British American Tobacco UK Pension Fund; defined benefit plan (up to April 2005) – monthly pension payment
Policy	– pension accrues at 1/40th of annual basic salary – normal pensionable age of 60 – maximum pension payable will not exceed 2/3 of base salary averaged over the preceding 12 months – UK Pension Fund retains a scheme-specific cap following the introduction of new UK pension regime in 2006 – excess benefits continue to be accrued within an unfunded unapproved retirement benefits scheme

Executive Directors (with the exception of Nicandro Durante) are, like other UK employees, eligible for membership of the British American Tobacco UK Pension Fund (Pension Fund).

The Pension Fund, for members who joined before 1 April 2005, is a non-contributory defined benefit scheme. The early retirement rules in the Pension Fund permit a member to draw the accrued retirement pension within five years of normal retirement age without actuarial reduction, subject to the employing company's agreement. Alternatively, an Executive Director may choose to leave and take a pension at any time on or after his or her 50th birthday without the employing company's agreement, subject to a reduction as determined by the Pension Fund trustee in conjunction with the Pension Fund actuary. Accrual rates differ according to individual circumstances but do not exceed one-fortieth of pensionable salary for each year of pensionable service.

Pensionable pay covers basic salary only and therefore bonus awards and the value of benefits in kind are not pensionable.

The Pension Fund includes provision for spouses' benefits on death in service or after retirement. In the event of death in service, a spouse's pension equal to half of the member's prospective pension at normal retirement age would be payable. A spouse's pension payable in the event of death after retirement is equal to half of the member's full pension, irrespective of any decision to exchange part of the benefit for a lump sum.

Paul Adams and Ben Stevens each joined the Pension Fund after 1989. As a result, prior to 6 April 2006, these individuals were subject to the HM Revenue & Customs cap on pensionable earnings (notionally £123,600 for the tax year 2009/10). In addition, each has an unfunded pension promise from the Company in respect of earnings above the cap on an equivalent basis to the benefits provided by the Pension Fund. This is provided through membership of an unfunded unapproved retirement benefit scheme (UURBS).

These unfunded commitments are included in note 12 to the accounts.

However, following the changes in pensions legislation in 2006, it was agreed that benefits up to £75,000 per annum (targeting the Lifetime Allowance) would be provided through the Pension Fund (subject to the consent of the member) with the remainder of benefits being provided through the UURBS. As a result, the Company paid an additional amount to the Pension Fund in 2006 to fund the additional benefits up to a maximum of £75,000 per annum. The overall pension entitlement for each of the Executive Directors remained unchanged. Members of the Pension Fund are entitled to receive increases in their pensions in line with price inflation (as measured by the Retail Price Index) up to 6 per cent per annum.

Nicandro Durante is a member of the Fundacao Albino Souza Cruz in Brazil. This is a non-contributory defined benefit scheme and includes a spouse's death in service benefit equal to 37.5 per cent of the member's prospective pension at normal retirement age. Accrual rates do not exceed 1.85 per cent of basic salary (excluding bonus) averaged over the 12 months to normal retirement age, for each year of pensionable service. Nicandro Durante's pensionable salary will be reviewed by the Company annually with reference to the salary of that of a General Manager of Souza Cruz SA which will increase annually in line with local practice. In addition, Nicandro Durante accrues a pension of 0.65 per cent for each year of service based on his 12 month average UK basic salary (excluding bonus) with effect from 1 March 2006, that being the date of his appointment as a member of the Management Board. This benefit is provided through the UURBS.

Executive Directors' service contracts

Each Executive Director has a one year rolling contract, executed at the time of his original appointment. The contract may be re-executed during the term of employment to take account of variations in terms and conditions as well as changes in best practice. Each contract incorporates a provision for a termination or compensation payment in lieu of notice.

The Remuneration Committee, however, maintains the discretion to vary the policy of one year rolling contracts in the event that an Executive Director is recruited externally or from overseas, when it may then be appropriate to offer a contract with an initial period of longer than one year, reducing to a one year rolling contract after the expiry of the initial period.

An Executive Director's compensation payment, in lieu of notice, would comprise: (1) 12 months' salary at his then current base pay; and (2) a cash payment in respect of other benefits under the contract such as medical insurance, or the Company may at its option continue those benefits for a 12 month period. The Committee maintains discretion as to how to deal with any grants or awards made prior to termination under the LTIPs, the IEIS and the Share Option Scheme (if appropriate). Pension entitlements are dealt with in accordance with the terms and conditions of the applicable pension scheme and do not form part of the contractual compensation payment.

The compensation payment is payable where the requisite 12 months' notice is not given to the Executive Director or when he terminates by giving 12 months' notice and the Company does not wish him to serve his notice. If a period of notice is served, the compensation payment is reduced pro rata. In the unlikely event that the contract is terminated for cause (such as gross misconduct), the Company may terminate the contract with immediate effect and no compensation would be payable.

Nicandro Durante has a service contract with the Company in the form outlined above. In addition, as a result of the application of local labour laws in Brazil, Nicandro Durante retains certain termination or compensation rights in respect of his former employment with Souza Cruz SA. In the event of any compensation being payable to Nicandro Durante pursuant to his service contract with the Company, these Souza Cruz rights will be taken into account first in arriving at a final compensation amount in order that he does not benefit twice from these dual arrangements.

Executive Directors' external appointments

Executive Directors and members of the Management Board are able to accept one substantive external Board appointment provided that permission is respectively sought from the Board or Chairman. The fees from such appointments are retained for a Director's own account, thereby recognising the increasing level of personal commitment and expertise required for non-executive roles. None of the Executive Directors or Management Board members currently holds such an appointment.

Nicandro Durante, an Executive Director of the Company, is a non-executive director of Reynolds American Inc (RAI) (an associated undertaking of the Company) having been designated by Brown & Williamson Holdings, Inc. (a wholly owned indirect subsidiary of the Company), as its nominee to sit on the board of RAI. In accordance with present arrangements, the Group received a fee of US$215,020 from RAI in respect of Nicandro Durante's service in that role during the year ended 31 December 2009.

Non-Executive Directors' terms of appointment

The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment. For Non-Executive Directors appointed before 1 October 2007, the terms of appointment of each such Director provide that he or she is appointed for a specified term, being an initial period to the next Annual General Meeting after appointment and, subject to reappointment at that meeting, for a further period ending at the Annual General Meeting held three years thereafter. Subsequent reappointment is subject to endorsement by the Board and the approval of shareholders.

Following the implementation of the relevant provisions of the Companies Act 2006, an appointment of a Non-Executive Director made by the Company from 1 October 2007 is made on the basis of a two year term; such appointment being subject to approval by shareholders in accordance with the terms of the provisions of the Company's Articles of Association relating to the rotation of Directors.

During 2009, the Board reviewed the terms of appointment for Non-Executive Directors. In order to bring full alignment with the Company's Articles of Association, and to ensure that all Non-Executive Directors (including those whose current terms are grandfathered under the Companies Act 2006) are appointed on the same terms, it was agreed by the Board that a new policy will be implemented during 2010. All Non-Executive Directors will be placed on terms of appointment of one year only. These would be considered for renewal around the time of the Company's Annual General Meeting each year, with the first appointments being presented to the Board for its approval at the Board meeting scheduled for 27 April 2010, to take effect immediately after the 2010 Annual General Meeting. This will become an annual exercise.

The date of appointment, the most recent reappointment and length of service for each Non-Executive Director is shown in the table below.

Non-Executive Directors' remuneration policy

The current fees structure for the Non-Executive Directors is shown below:

	£
Basic fee	90,000
Supplements	
– Senior Independent Director	25,000
– Audit Committee Chairman	25,000
– CSR Committee Chairman	20,000
– Remuneration Committee Chairman	20,000

The fees for the Non-Executive Directors are considered annually and are determined in light of market best practice and with reference to the time commitment and responsibilities associated with the roles. The basic annual fee reflects the Board's view of the inclusive nature of the duties of the Non-Executive Directors which is reflected in its

Non-Executive Director	Date of appointment	Date of last reappointment at AGM	Length of service as at 2010 Annual General Meeting (Years)
Karen de Segundo	1 October 2007	30 April 2008	2.7
Robert Lerwill	1 January 2005	30 April 2009	5.4
Ana Maria Llopis	24 February 2003	30 April 2008	7.2
Christine Morin-Postel	1 October 2007	30 April 2008	2.7
Gerry Murphy	13 March 2009	30 April 2009	1.1
Anthony Ruys	1 March 2006	30 April 2008	4.2
Sir Nicholas Scheele	28 February 2005	30 April 2009	5.2

On termination, at any time, a Non-Executive Director is entitled to any accrued but unpaid Director's fees but not to any other compensation.

policy that Non-Executive Directors do not receive additional fees for attendance at Board Committee meetings. It is expected that all Non-Executive Directors will sit on the Remuneration and the Nominations Committees and will either be a member of the Audit Committee or the Corporate Social Responsibility Committee.

Non-Executive Directors' fees (including those of the Chairman) are determined within the overall aggregate annual limit of £2,500,000 authorised by shareholders with reference to the Company's Articles of Association. The Board as a whole considers the policy and structure for the Non-Executive Directors' fees on the recommendation of the Chairman and the Chief Executive. The Non-Executive Directors do not participate in discussions on their specific levels of remuneration.

Non-Executive Directors receive no other pay or benefits (with the exception of reimbursement of expenses incurred in respect of their duties as Directors of the Company). It is the policy of the Board that the spouses of the Executive Directors and Non-Executive Directors may accompany the Directors for business purposes on designated trips and functions during the year.

Anthony Ruys is a non-executive director of ITC Limited (ITC) (an associated undertaking of the Company). During the year ended 31 December 2009, Anthony Ruys received INR196,712 (£2,475) in fees from ITC. This amount is the subject of an annual supplement from the Group so that he receives a total annual fee for this appointment of £75,000.

Chairman's terms of appointment and remuneration

The Remuneration Committee is responsible for determining the terms of engagement and fees payable to the Chairman. This process takes into account the breadth of that role coupled with its associated levels of commitment and expertise.

Jan du Plessis resigned as a Director and as Chairman of the Company on 31 October 2009. His terms of appointment provided that he held the office of Chairman with effect from 1 July 2007 for a period of three years unless terminated earlier by: (1) the Company giving three months' notice or a discretionary compensation payment in lieu of notice; or (2) by the Chairman giving one month's written notice with the Company having discretion to make a compensation payment in lieu of such notice. Any such compensation payment would have been limited to any fees which were payable for such part of the relevant notice period as the Board did not require the Chairman to perform his duties. Jan du Plessis did not receive any compensation payment upon his departure from the Company.

The terms of Jan du Plessis' appointment provided for: (1) an annual fee of £620,000 (from 1 April 2009); (2) the use of a driver; and (3) private medical insurance and personal accident insurance benefits. He did not participate in the British American Tobacco share schemes, bonus schemes or incentive plans and was not a member of any Group pension plan.

Richard Burrows was appointed as a Director and Chairman Designate of the Company with effect from 1 September 2009 and as Chairman of the Company from 1 November 2009. The terms of his appointment provide that he holds the appointment for an initial term of two years unless terminated earlier by: (1) the Company giving three months' notice or a discretionary compensation payment in lieu of notice; or (2) by him giving one month's written notice; with the Company having discretion to make a compensation payment in lieu of such notice. The compensation payment is limited to any fees which are payable for such part of the relevant notice period as the Board does not require him as Chairman to perform his duties.

As a Director of the Company, the Chairman is subject to the reappointment of Directors provisions contained in the Company's Articles of Association. A resolution for Richard Burrows' reappointment as a Director will be put to the Annual General Meeting to be held on 28 April 2010.

The terms of Richard Burrows' appointment provide for: (1) an annual fee of £525,000; (2) the use of a driver; (3) private medical insurance and personal accident insurance benefits; (4) the reimbursement by the Company of the cost of return airline tickets to London from Ireland in connection with his duties as Chairman; and (5) the provision by the Company of temporary accommodation in London for a maximum period of six months from the date of his appointment to the Board. In common with the Non-Executive Directors, Richard Burrows does not participate in the British American Tobacco share schemes, bonus schemes or incentive plans and is not a member of any Group pension plan.

The Remuneration Committee has concluded that, as his fees had been benchmarked immediately prior to his appointment, the next review of Richard Burrows' fees would not take place until February 2011.

Copies of service contracts and terms of appointment

Copies of the Executive Directors' service contracts and the details of the terms of appointment of each Non-Executive Director and the Chairman are available for inspection during normal business hours at the Company's registered office and will also be available for inspection at the Annual General Meeting on 28 April 2010.

Appendices to the Remuneration report

Table 1: Aggregate emoluments – audited

The emoluments of the Directors of British American Tobacco p.l.c. were as follows:

	2009 £	2008 £
Salaries and fees	3,807,417	3,261,829
Benefits: cash and non-cash	779,927	696,101
Performance-related pay		
– cash bonus	1,572,915	1,816,952
– deferred share bonus	1,572,915	1,816,952
– DSBS and LTIP dividend equivalents	459,222	429,705
– Share Reward Scheme	8,100	4,919
Former Directors	747,543	1,944,240
Total	**8,948,039**	9,970,698

Table 2: Individual fees of the Chairman and Non-Executive Directors – audited

	Fees £	Benefits £	Total 2009 £	Total 2008 £
Jan du Plessis (until 31 October 2009)	511,667	73,252	584,919	686,141
Richard Burrows (from 1 September 2009)[1]	175,000	3,317	178,317	–
Karen de Segundo	110,000	8,082	118,082	104,984
Robert Lerwill	115,000	1,331	116,331	117,435
Ana Maria Llopis	90,000	–	90,000	75,000
Christine Morin-Postel	90,000	–	90,000	75,000
Gerry Murphy (from 13 March 2009)	72,000	958	72,958	–
Anthony Ruys	110,000	–	110,000	108,096
Sir Nicholas Scheele	115,000	811	115,811	112,110
Former Non-Executive Directors				
Kenneth Clarke (until 30 April 2008)	–	–	–	101,450
Thys Visser (until 30 April 2009)	30,000	–	30,000	86,018
Total	**1,418,667**	**87,751**	**1,506,418**	1,466,234

Notes:

1 Richard Burrows was appointed as a Non-Executive Director on 1 September 2009. He succeeded Jan du Plessis as Chairman on 1 November 2009.

2 The Chairman's benefits comprise the use of a company driver and travel and other expenses incurred in connection with accompanied attendance at business functions.

3 Benefits for the Non-Executive Directors comprise those expenses incurred in connection with accompanied attendance at business functions.

4 In addition, Anthony Ruys received INR196,712 (£2,475) from ITC Limited, the Group's Indian associated undertaking, in respect of his services as a Non-Executive Director of that company from 20 January 2009. This was supplemented by a further £68,621 paid by the Group for services up to and including 31 December 2009.

Table 3: Summary individual emoluments of Executive Directors – audited

	Salary £	Benefits £	Performance-related pay £	Total 2009 £	Total 2008 £
Paul Adams	**1,213,750**	**146,761**	**1,956,237**	**3,316,748**	3,578,588
Nicandro Durante	**622,500**	**450,758**	**848,940**	**1,922,198**	1,728,299
Ben Stevens	**582,500**	**94,657**	**807,975**	**1,485,132**	1,354,787
Total	**2,418,750**	**692,176**	**3,613,152**	**6,724,078**	6,661,674

	Salary £	Benefits £	Performance-related pay £	Total 2009 £	Total 2008 £
Former Executive Directors					
Antonio Monteiro de Castro (until 31 December 2007)	–	**709,421**	–	**709,421**	309,041
Paul Rayner (until 30 April 2008)	–	**8,122**	–	**8,122**	1,533,749
Total		**717,543**		**717,543**	1,842,790

Notes:
1 Included in the total shown for Antonio Monteiro de Castro for 2008 are amounts which include outstanding holiday entitlement (£56,210) and an LTIP dividend payment (£116,956) on the vesting of his outstanding LTIP awards which were due to him at the date of his retirement.
2 The benefits shown for Antonio Monteiro de Castro comprise principally: (1) a tax payment of £607,041 in respect of outstanding liabilities that arose between 1996 and 2004 (this period covers both his service as a member of the Management Board and, from March 2002, as a Director of the Company) which have been agreed with HMRC subsequent to his retirement at the end of 2007; and (2) tax advice in connection with his relocation back to Brazil.
3 The Executive Directors' remuneration shown above does not include, in respect of the LTIP awards made in May 2007 and which will vest on 15 May 2010: (1) the illustrative values of those awards as at 22 February 2010 (reference should be made to the illustrative values shown for each Executive Director in Table 6); and (2) the values of the LTIP dividend equivalent payments to be made in respect of those awards which are: Paul Adams £397,386; Nicandro Durante £85,833; and Ben Stevens £95,370.

Table 4: Analysis of remuneration of Executive Directors – audited

Paul Adams

	2009 £
Salary	**1,213,750**
Benefits: cash	**16,780**
Benefits: non-cash	**129,981**
Annual cash bonus	**829,325**
Value of deferred share bonus	**829,325**
Cash dividend equivalent (DSBS)	**61,318**
Cash dividend equivalent (LTIP)	**233,569**
Share Reward Scheme: value of shares received during year	**2,700**
Total – see Table 3	**3,316,748**

	2008 £
Salary	1,157,500
Benefits: cash	15,840
Benefits: non-cash	105,104
Annual cash bonus	999,460
Value of deferred share bonus	999,460
Cash dividend equivalent (DSBS)	56,877
Cash dividend equivalent (LTIP)	242,560
Share Reward Scheme: value of shares received during year	1,787
Total – see Table 3	3,578,588

Notes:
1 Cash benefits comprise: (1) a car allowance (£15,840); and (2) the buy-out of a UK employee entitlement in May 2009.
2 Non-cash benefits comprise: (1) life and health insurance (£64,765); (2) the use of a company driver; and (3) other expenses incurred in connection with accompanied attendance at business functions and/or corporate hospitality events.
3 Cash dividend equivalent payments: (1) DSBS – these are cash sums equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share awards held by participants in the DSBS at each dividend record date; and (2) LTIP – this is a cash sum equivalent to the dividends that an LTIP participant would have received as a shareholder on the actual number of shares vesting under an LTIP award.

Table 4: Analysis of remuneration of Executive Directors – audited continued

Nicandro Durante

	2009 £		2008 £
Salary	**622,500**	Salary	473,496
Benefits: cash	**43,157**	Benefits: cash	9,725
Benefits: non-cash	**407,601**	Benefits: non-cash	279,144
Annual cash bonus	**383,985**	Annual cash bonus	460,500
Value of deferred share bonus	**383,985**	Value of deferred share bonus	460,500
Cash dividend equivalent (DSBS)	**13,690**	Cash dividend equivalent (DSBS)	11,364
Cash dividend equivalent (LTIP)	**64,580**	Cash dividend equivalent (LTIP)	32,225
Share Reward Scheme: value of shares received during year	**2,700**	Share Reward Scheme: value of shares received during year	1,345
Total – see Table 3	**1,922,198**	**Total – see Table 3**	1,728,299

Notes:
1 Nicandro Durante's salary for the year ended 2008 was £600,000. Salary overpayments totalling £126,504 made in 2006 and 2007 (at the time of Nicandro Durante's relocation from Brazil) were repaid in 2008 and were reflected in his salary disclosed for that year.

2 Cash benefits comprise: (1) a car allowance (£13,560); (2) an accommodation allowance (£25,424) and related allowances in respect of his relocation from Brazil (£3,234); and the buy-out of a UK employee entitlement in May 2009.

3 Non-cash benefits comprise: (1) life and health insurance (£17,428); (2) tax advice (£28,824); (3) the use of a company driver; (4) travel and related costs in respect of his relocation from Brazil (£146,298); (5) welfare tax payments, introduced in July 2009, payable by Souza Cruz in respect of Nicandro Durante's subsisting employment rights in Brazil (£153,829); and (6) other expenses incurred in connection with accompanied attendance at business functions and/or corporate hospitality events.

4 Cash dividend equivalent payments: (1) DSBS – these are cash sums equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share awards held by participants in the DSBS at each dividend record date; and (2) LTIP – this is a cash sum equivalent to the dividends that an LTIP participant would have received as a shareholder on the actual number of shares vesting under an LTIP award.

Ben Stevens

	2009 £		2008 £
Salary	**582,500**	Salary	446,667
Benefits: cash	**14,500**	Benefits: cash	9,105
Benefits: non-cash	**80,157**	Benefits: non-cash	96,565
Annual cash bonus	**359,605**	Annual cash bonus	356,992
Value of deferred share bonus	**359,605**	Value of deferred share bonus	356,992
Cash dividend equivalent (DSBS)	**17,896**	Cash dividend equivalent (DSBS)	15,337
Cash dividend equivalent (LTIP)	**68,169**	Cash dividend equivalent (LTIP)	71,342
Share Reward Scheme: value of shares received during year	**2,700**	Share Reward Scheme: value of shares received during year	1,787
Total – see Table 3	**1,485,132**	**Total – see Table 3**	1,354,787

Notes:
1 The 2008 figures have been apportioned to reflect the amounts received from his appointment on 3 March 2008.

2 Cash benefits comprise: (1) a car allowance (£13,560); and (2) the buy-out of a UK employee entitlement in May 2009.

3 Non-cash benefits comprise: (1) life and health insurance (£5,856); (2) the use of a company driver; and (3) other expenses incurred in connection with accompanied attendance at business functions and/or corporate hospitality events.

4 Cash dividend equivalent payments: (1) DSBS – these are cash sums equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share awards held by participants in the DSBS at each dividend record date; and (2) LTIP – this is a cash sum equivalent to the dividends that an LTIP participant would have received as a shareholder on the actual number of shares vesting under an LTIP award.

Table 5: Directors' interests in British American Tobacco p.l.c. ordinary shares of 25p

	At 1 Jan 2009 or date of appointment	At 31 Dec 2009	Changes from 31 Dec 2009	**At 22 Feb 2010**
Richard Burrows[1]	–	10,000	–	**10,000**
Paul Adams	144,147	164,617	12	**164,629**
Ben Stevens	35,196	49,983	–	**49,983**
Nicandro Durante	101,274	106,778	12	**106,790**
Karen de Segundo	4,050	4,050	–	**4,050**
Robert Lerwill	3,000	3,000	–	**3,000**
Ana Maria Llopis	2,200	2,200	–	**2,200**
Christine Morin-Postel	4,700	4,700	–	**4,700**
Gerry Murphy[1]	–	3,000	–	**3,000**
Anthony Ruys	3,000	3,000	–	**3,000**
Sir Nicholas Scheele	5,000	5,000	–	**5,000**

Notes:
1 Richard Burrows was appointed as a Director on 1 September 2009 and Gerry Murphy was appointed as a Director on 13 March 2009.

2 The changes in Directors' interests since 31 December 2009 relate to the purchase of shares pursuant to the Company's Partnership Share Scheme.

3 Based on the performance for 2009, the Executive Directors will each be awarded a number of ordinary shares to the value of £2,030 pursuant to an appropriation of shares under the Share Reward Scheme on 1 April 2010.

4 In addition to the shares shown above, the Executive Directors have the following interests in the ordinary shares of the Company set out in Table 6 below and which are held in trust pursuant to the British American Tobacco DSBS. The value of these shares has been included as Directors' emoluments in the prior year. Details of the DSBS are given in the Remuneration report.

5 On 31 December 2009, the Group's employee share ownership trust referred to in the Remuneration report held a total of 14,679,045 ordinary shares in the Company. All participating employees, including the Executive Directors, are deemed to have a beneficial interest in these shares.

Table 6: Executive Directors' (1) Long-Term Incentive Plan awards; (2) Deferred Share Bonus Scheme share interests; and (3) share options – ordinary shares of 25p in British American Tobacco p.l.c. – audited

Paul Adams

Shares – Long-Term Incentive Plan

LTIP plan	Performance period	Award date	At 1 Jan 2009 Number of shares	Awarded in 2009 Number of shares	Vested in 2009 Number of shares	Lapsed in 2009 Number of shares	At 31 Dec 2009 Number of shares	Value vested in 2009[2] £	Vesting date[a]	Illustrative value vesting 2010[3] £
1998	2006/2008	15 Mar 06	113,493	–	113,493	–	–	1,933,921	15 Mar 09	–
2007	2007/2009	15 May 07	159,337	–	–	–	159,337	–	15 May 10	3,505,414
2007	2008/2010	15 May 08	163,418	–	–	–	163,418	–	15 May 11	–
2007	2009/2011	27 Mar 09	–	224,192	–	–	224,192	–	27 Mar 12	–
Total			436,248	224,192	113,493	–	546,947	1,933,921		3,505,414

Note:
a The LTIP award that vested on 15 March 2009 was exercised by Paul Adams on 7 May 2009.

Shares – Deferred Share Bonus Scheme

	Award date	At 1 Jan 2009 Number of shares	Awarded in 2009 Number of shares	Released in 2009[2] Number of shares	At 31 Dec 2009 Number of shares
	15 Mar 06	34,858	–	34,858	–
	13 Mar 07	46,083	–	–	46,083
	13 Mar 08	25,603	–	–	25,603
	27 Mar 09	–	63,297	–	63,297
Total		106,544	63,297	34,858	134,983

Options – Sharesave Scheme

At 1 Jan 2009 Number of shares	Grant date	Grant price	Granted in 2009 Number of shares	Exercised in 2009[1,2] Number of shares	At 31 Dec 2009 Number of shares	Dates from which exercisable	Latest expiry date
2,492	25 Nov 04	663.0p	–	–	2,492	Jan 2010	Jun 2010

Table 6: Executive Directors' (1) Long-Term Incentive Plan awards; (2) Deferred Share Bonus Scheme share interests; and (3) share options – ordinary shares of 25p in British American Tobacco p.l.c. – audited continued

Ben Stevens

Shares – Long-Term Incentive Plan

LTIP plan	Performance period	Award date	At 1 Jan 2009 Number of shares	Awarded in 2009 Number of shares	Vested in 2009 Number of shares	Lapsed in 2009 Number of shares	At 31 Dec 2009 Number of shares	Value vested in 2009[2] £	Vesting date[a]	Illustrative value vesting 2010[3] £
1998	2006/2008	15 Mar 06	33,124	–	33,124	–	–	564,433	15 Mar 09	–
2007	2007/2009	15 May 07	38,240	–	–	–	38,240	–	15 May 10	841,280
2007	2008/2010	15 May 08	53,098	–	–	–	53,098	–	15 May 11	–
2007	2009/2011	27 Mar 09	–	88,663	–	–	88,663	–	27 Mar 12	–
Total			124,462	88,663	33,124	–	180,001	564,433		841,280

Note:
a The LTIP award that vested on 15 March 2009 was exercised by Ben Stevens on 26 March 2009.

Shares – Deferred Share Bonus Scheme

	Award date	At 1 Jan 2009 Number of shares	Awarded in 2009 Number of shares	Released in 2009[2] Number of shares	At 31 Dec 2009 Number of shares
	15 Mar 06	9,539	–	9,539	–
	13 Mar 07	12,293	–	–	12,293
	13 Mar 08	6,655	–	–	6,655
	27 Mar 09	–	26,114	–	26,114
Total		28,487	26,114	9,539	45,062

Options – Sharesave Scheme

	At 1 Jan 2009 Number of shares	Grant date	Grant price	Granted in 2009 Number of shares	Exercised in 2009[1,2] Number of shares	At 31 Dec 2009 Number of shares	Dates from which exercisable	Latest expiry date
	2,492	25 Nov 04	663.0p	–	–	2,492	Jan 2010	Jun 2010
	–	25 Nov 09	1,555.0p	1,000	–	1,000	Jan 2015	Jun 2015
Total	2,492			1,000	–	3,492		

Table 6: Executive Directors' (1) Long-Term Incentive Plan awards; (2) Deferred Share Bonus Scheme share interests; and (3) share options – ordinary shares of 25p in British American Tobacco p.l.c. – audited continued

Nicandro Durante

Shares – Long-Term Incentive Plan

LTIP plan	Performance period	Award date	At 1 Jan 2009 Number of shares	Awarded in 2009 Number of shares	Vested in 2009 Number of shares	Lapsed in 2009 Number of shares	At 31 Dec 2009 Number of shares	Value vested in 2009 £	Vesting date	Illustrative value vesting 2010 £
2007	2008/2010	15 May 08	74,962	–	–	–	74,962	–	15 May 11	–
2007	2009/2011	27 Mar 09	–	94,996	–	–	94,996	–	27 Mar 12	–
Total			74,962	94,996	–	–	169,958	–		–

Notes:

a In March 2006, Nicandro Durante received from the Company a cash-based award equivalent in value to 31,380 shares, subject to the same performance conditions and vesting terms as awards made under the 1998 LTIP plan. This award vested on 15 March 2009 and is now exercisable; it will be cash settled by the Company upon exercise.

b In May 2007, Nicandro Durante received from the Company a cash-based award equivalent in value to 34,416 shares, subject to the same performance conditions and vesting terms as awards made under the 2007 LTIP plan. This award will vest on 15 May 2010 and will be cash settled by the Company upon exercise. Based on the share price on 22 February 2010 (the latest practicable date prior to publication) of 2,200.0p, he will receive a cash payment of £757,152.

Shares – Deferred Share Bonus Scheme

	Award date	At 1 Jan 2009 Number of shares	Awarded in 2009 Number of shares	Released in 2009 Number of shares	At 31 Dec 2009 Number of shares
	13 Mar 07	10,566	–	–	10,566
	13 Mar 08	6,028	–	–	6,028
	27 Mar 09	–	29,164	–	29,164
Total		16,594	29,164	–	45,758

Note:

a In March 2006, Nicandro Durante received a cash-based award on equivalent terms to the DSBS with a value equivalent to 5,380 Deferred Shares from the Company's subsidiary, Souza Cruz S.A., a former employing company of Nicandro Durante. This award was released and cash settled by Souza Cruz S.A. during 2009.

Options – Sharesave Scheme

At 1 Jan 2009 Number of shares	Grant date	Grant price	Granted in 2009 Number of shares	Exercised in 2009[1,2] Number of shares	At 31 Dec 2009 Number of shares	Dates from which exercisable	Latest expiry date
1,421	24 Nov 06	1,152.0p	–	–	1,421	Jan 2012	Jun 2012

Long-Term Incentive Plan notes:

1 The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 15 March 2006 was 1,435.0p, on 15 May 2007 was 1,590.0p, on 15 May 2008 was 1,966.0p, on 16 March 2009 was 1,704.0p (the vesting date of 15 March 2009 not being a business day) and on 27 March 2009 was 1,534.0p.

2 The vesting of the awards on 15 March 2009 was reported in the Company's Directors' Report and Accounts 2008 showing illustrative vesting values based on the mid-market price of ordinary shares of 1,719.0p at 23 February 2009, being the latest practicable date prior to publication of that Report.

3 The May 2007 award will vest on 15 May 2010 at 100 per cent in the manner described in the Remuneration report. For illustrative purposes only, the share price on 22 February 2010, being the latest practicable date prior to publication, of 2,200.0p has been used to value the vesting awards.

4 The performance conditions applicable to the LTIP awards relate to an apportionment between measures relating to TSR and EPS-based criteria with reference to a three year performance period. TSR combines both the share price and dividend performance of the Company as set against two comparator groups: (a) the FTSE 100 Index at the beginning of the performance period; and (b) a peer group of FMCG companies. A total of 50 per cent of the total award is based upon each of two separate measures (25 per cent for each measure). In the event of upper quartile performance by the Company relative to the comparator groups referred to above, 25 per cent of the total award vests in full. From 2008, 6 per cent of the total award vests for median performance (7.5 per cent for the 2006 and 2007 awards). There is pro rata vesting between these two points. The TSR portions of an LTIP award do not vest for below median performance. 50 per cent of an award is based on EPS growth relative to inflation. This element of the award will vest fully if EPS growth over the three year performance period is an average of at least 8 per cent per annum in excess of inflation. 10 per cent (8 per cent for awards made since 2008) of this element will vest if the EPS growth over the performance period is 3 per cent in excess of inflation. An award will vest on a pro rata basis between these two points. The EPS portion of an award does not vest if EPS growth is less than 3 per cent in excess of inflation.

5 There have been no variations in the terms and conditions of the LTIP interests during the year.

6 The awards made in May 2008 and March 2009 are due to vest in May 2011 and March 2012 respectively. At 31 December 2009, the performance percentage reflecting performance to date, was 100 per cent for the May 2008 award and 50 per cent for the March 2009 award.

Deferred Share Bonus Scheme notes:

1 Each Executive Director has an interest in the ordinary shares of the Company, as shown in the DSBS tables, which are held in trust pursuant to the British American Tobacco DSBS.

2 The DSBS shares awarded on 15 March 2006 vested on 16 March 2009 (15 March 2009 not being a business day). The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 16 March 2009 was 1,704.0p.

Table 6: Executive Directors' (1) Long-Term Incentive Plan awards; (2) Deferred Share Bonus Scheme share interests; and (3) share options – ordinary shares of 25p in British American Tobacco p.l.c. – audited continued

Sharesave Scheme notes:

1 In respect of the Executive Directors, no options lapsed during the year ended 31 December 2009. There have been no variations in the terms and conditions of these interests in share options during the year. Options granted under the Sharesave Scheme are exercisable in conjunction with a three year or five year savings contract up to a monthly limit of £250. Options are normally granted at a discount of 20 per cent to the market price at the time of the invitation, as permitted under the rules of the Sharesave Scheme.

2 There were no Sharesave options exercised by Executive Directors during the year and therefore no aggregate gains were made (2008: £nil).

3 The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 31 December 2009 was 2,016.5p and the range during the year was 1,495.0p to 2,032.5p. The market price on 31 December 2009 exceeded the grant price of all the options detailed in the share options tables for the Executive Directors.

Table 7: Executive Directors' pension entitlements – audited

	Normal retirement age	Total accrued pension at 31 Dec 2009 £	Gross increase in accrued pension £	Increase in accrued pension net of inflation £	Transfer value of net increase in accrual over period £	Transfer value of accrued pension at 31 Dec 2008 £	Transfer value of accrued pension at 31 Dec 2009 £	Total change in transfer value during period £
Paul Adams	60	567,071	55,771	43,523	992,910	10,478,739	12,936,971	2,458,232
Nicandro Durante	60	384,449	97,344	90,466	1,875,855	5,245,580	7,971,698	2,726,118
Ben Stevens	60	157,464	28,659	25,574	500,557	2,173,058	3,082,063	909,005

Notes:

1 The amount of total accrued pension is the pension that would be paid annually on retirement based on service to the end of the year, excluding any increase granted under statute before retirement.

2 The value of net increase in accrued pension represents the incremental value to the Executive Director of his service during the year, calculated on the assumption that service terminated at the year end.

3 Changes in the transfer values reflect both individual Executive Director's circumstances such as the date of joining the Pension Fund and changes in salary during the year together with the application of market value adjustments in accordance with actuarial and legislative requirements. Following completion of the ongoing funding valuation of the Pension Fund in June 2009, the Trustee of the Pension Fund reviewed the method and assumptions used to calculate transfer values and decided to amend the transfer value basis. The Trustee's agreed transfer value basis was updated to remain consistent with that used for the ongoing funding of the Pension Fund. The transfer value at 31 December 2008 shown above has been calculated in line with the transfer value basis in force at that time, whereas the transfer value at 31 December 2009 has been calculated in line with the revised transfer value basis.

The transfer values of the accrued entitlement represent the value of assets that the Pension Fund would need to transfer to another pension provider on transferring the Pension Fund's liability in respect of Executive Directors' pension benefits. They do not represent sums payable to individual Executive Directors and, therefore, cannot be added meaningfully to annual remuneration. Further, although Nicandro Durante is not a member of the Pension Fund, the transfer values calculated above have been calculated in accordance with the method used for the Pension Fund. Although Paul Adams and Ben Stevens receive a significant element of their overall entitlement from an unfunded unapproved retirement benefit scheme, the transfer values calculated above have been calculated in accordance with the method used for the Pension Fund.

4 The Pension Fund is non-contributory. Voluntary contributions paid by Executive Directors and resulting benefits are not shown. No excess retirement benefits have been paid to or are receivable by any Executive Director or past Executive Director.

5 Nicandro Durante is entitled to a benefit promise of 0.65 per cent of final sterling pensionable salary (calculated as a 12 month average) in relation to service from 1 March 2006. In addition, he is entitled to a pension from the Souza Cruz Pension Scheme based on an accrual rate of 1.85 per cent of final Brazilian real pensionable salary (calculated as 12 month average) in relation to service from December 1981 (the value of this pension – in terms of £ sterling – has increased during 2009 due to a 21 per cent strengthening of the Brazilian real). The accrued pension amount and transfer values shown above are based on the sum of these promises (i.e. with accrual rate since 1 March 2006 being a total of 2.5 per cent). Nicandro Durante is entitled to receive that part of the promise from the Souza Cruz Pension Scheme (based on 1.85 per cent accrual rate) with immediate effect; this entitlement has been ignored for the purposes of the above transfer value.

Status of Remuneration report

This report has been prepared in accordance with the relevant provisions of the Companies Act 2006 and Schedule 5 and Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. The report also meets the relevant requirements of the Listing Rules of the UK Listing Authority and describes how the Board has applied the Principles of Good Governance relating to Directors' remuneration as set out in the Combined Code on Corporate Governance referred to in the Corporate governance statement. As required by the Companies Act 2006, a resolution to approve the Directors' Remuneration report (the Report) will be proposed at the Annual General Meeting of the Company on 28 April 2010, at which the financial statements will be presented for approval. The vote will have advisory status, will be in respect of the remuneration policy and overall remuneration packages and will not be specific to individual levels of remuneration. The Companies Act 2006 requires the auditors to report to the Company's shareholders on the 'audited information' within the Report and to state whether, in their opinion, those parts of the Report have been prepared in accordance with the Companies Act 2006. The report of the independent auditors, in respect of the Company, addresses those aspects of this Report and which have been subject to audit have been clearly marked: Table 1, Table 2, Table 3, Table 4, Table 6 and Table 7.

On behalf of the Board

Anthony Ruys
Chairman of the Remuneration Committee

24 February 2010

OTHER STATUTORY AND REGULATORY INFORMATION

CONTENTS

Companies Act 2006	98
Principal activities	98
Group results and dividends	98
Share capital	99
Purchase of own shares	99
Significant agreements – change of control	99
Contractual arrangements	99
Articles of Association	100
Creditor payment policy	104
Intra-Group pricing	104

Nicola Snook, Secretary

Companies Act 2006

The Companies Act 2006 requires the Company to set out in this report the development and performance of the business of the Group during the financial year ended 31 December 2009, including an analysis of the position of the Group at the end of the financial year, and a description of the principal risks and uncertainties facing the Group.

Principal activities

British American Tobacco p.l.c. is a holding company which owns, directly or indirectly, investments in the numerous companies constituting the British American Tobacco Group of companies. The principal subsidiaries and associates are listed on the Principal subsidiary undertakings and Principal associate undertakings pages. All subsidiary undertakings are involved in activities directly or indirectly related to the manufacture, distribution or sale of tobacco products.

Group results and dividends

The Group results are addressed fully in the financial statements and in the Directors' report: Business review. The Board recommends to shareholders a final dividend of 71.6p per ordinary share of 25p for the year ended 31 December 2009. If approved by shareholders at the Annual General Meeting to be held on 28 April 2010, the dividend will be payable on 6 May 2010 to shareholders registered on either the UK main register or the South African branch register on 12 March 2010, the record date. The ex-dividend trading dates are 8 March 2010 on the JSE Limited (JSE) and 10 March 2010 on the London Stock Exchange (LSE). As the Group reports in sterling, dividends are declared and payable in sterling except for shareholders on the branch register in South Africa whose dividends are payable in rand.

A rate of exchange of £:R = 12.03230 as at 23 February 2010 (the closing rate for that date as quoted on Bloomberg), results in an equivalent final dividend of 861.51268 SA cents per ordinary share.

From the close of business on 5 March 2010 until the close of business on 12 March 2010, no transfers between the UK main register and the South African branch register are permitted and no shares may be dematerialised or rematerialised between 8 March 2010 and 12 March 2010, both days inclusive.

Further details of the total amounts of dividends paid in 2009 (with 2008 comparatives) are given in note 8 on the accounts.

Share capital

As at 31 December 2009, the Company had an allotted and fully paid share capital of 2,025,364,622 ordinary shares of 25p each with an aggregate nominal value of £506 million (including treasury shares and shares owned by the employee share trusts).

Purchase of own shares

During the year ended 31 December 2009, the Company made no purchases of its own shares. In February 2009, the Directors discontinued the share buy-back programme until further notice.

The Directors sought fresh authority for the Company to purchase its ordinary shares in order that the appropriate mechanisms would be in place to enable the share buy-back programme to be reinstated at any time when, in the opinion of the Directors, the exercise of the authority would result in an increase in the Company's earnings per share and would be in the interests of its shareholders generally. At the 2009 Annual General Meeting, the Company was given authority to purchase up to 199,600,000 of its ordinary shares. The minimum price that may be paid for such shares is 25p and the maximum price is an amount equal to 105 per cent of the average of the middle market prices shown in the quotation for an ordinary share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the ordinary share is contracted to be purchased. This present authority for the Company to purchase its own shares will expire at the 2010 Annual General Meeting.

In accordance with the Company's policy, any repurchased shares are held as treasury shares and as at 31 December 2009 the number of treasury shares was 28,960,054. While treasury shares are held no dividends are paid on them and they have no voting rights. Treasury shares may be resold at a later date.

In order that the Directors may reinstate the share buy-back programme when appropriate, it is proposed that the authority for the Company to purchase its own shares is renewed with the applicable resolution to be put to shareholders at the 2010 Annual General Meeting. Details of the resolution and explanatory notes are contained in the Notice of Annual General Meeting which is sent to all shareholders and is also published on www.bat.com.

Significant agreements – change of control

The following significant agreements contain certain termination and other rights for our counterparties upon a change of control of the Company.

On 8 March 2005, the Company, B.A.T. International Finance p.l.c., B.A.T Capital Corporation and British American Tobacco Holdings (The Netherlands) B.V. (as borrowers and, in the case of the Company, as a borrower and guarantor) entered into a revolving credit facility agreement with HSBC Bank plc (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrowers £1.75 billion for general corporate purposes (the Facility). Pursuant to the Facility, should a borrower (other than the Company) cease to be a direct or indirect subsidiary of the Company, such borrower shall immediately repay any outstanding advances made to it. Where there is a change of control in respect of the Company, the lenders can require all amounts outstanding under the Facility to be repaid.

On 7 August 2007, British American Tobacco Mexico, S.A. de C.V. (as borrower) and the Company, B.A.T. International Finance p.l.c. and B.A.T Capital Corporation (as guarantors) entered into a term credit facility arrangement with Barclays Capital (as mandated lead arranger), HSBC Bank plc (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrower US$690 million to refinance existing facilities and for general corporate purposes (the Facility). Pursuant to the Facility, should the borrower cease to be a direct or indirect subsidiary of the Company, the borrower shall immediately repay any outstanding amounts. Where there is a change of control in respect of the Company, the lenders can require all amounts outstanding under the Facility to be repaid.

On 10 July 2009, British American Tobacco Tütün Mamulleri Sanayi ve Ticaret Anonim Şirketi (as borrower), the Company and B.A.T. International Finance p.l.c. (as guarantors) entered into a term credit facility agreement with Barclays Bank PLC (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrower €700 million to refinance existing facilities and for general corporate purposes (the Facility). Pursuant to the Facility, should the borrower cease to be a direct or indirect subsidiary of the Company, the borrower shall immediately repay any outstanding advances. Where there is a change of control in respect of the Company, the lenders can require all amounts outstanding under the Facility to be repaid.

Details of the change of control provisions contained in the Company's Long-Term Incentive Plans are given in the Remuneration report.

Contractual arrangements

Individual operating companies in the Group have contractual and other arrangements with many third parties in support of the Group's business activities covering input materials (filter tow, tobacco leaf and wrapping materials), logistics and distribution. Such contracts and arrangements may be deemed to be essential to one or more operating companies but there are no contracts or arrangements considered to be essential to the operation and understanding of the business or the Group as a whole.

OTHER STATUTORY AND REGULATORY INFORMATION CONTINUED

Articles of Association

The following description summarises certain provisions of the Company's current Articles of Association (as adopted by special resolution at the Annual General Meeting on 30 April 2009), applicable English law and the Companies Act 2006 (the Companies Act). This summary is qualified in its entirety by reference to the Companies Act and the Company's Articles of Association, a copy of which is available on www.bat.com.

Separate resolutions will be put to the Annual General Meeting to be held on 28 April 2010 to adopt new Articles of Association to: (1) reflect the implementation of the relevant provisions of the Companies (Shareholders' Rights) Regulations 2009 (the Shareholders' Rights Regulations) and (2) to incorporate an amendment to enable the Company to pay dividends solely by direct credit. If adopted, the substance of the new Articles of Association will be reflected in the summary of the articles which will appear in the 2010 Annual Report.

Share capital

All of the Company's ordinary shares are fully paid and, accordingly, no further contribution of capital may be required by the Company from the holders of such shares.

Objects and purposes

The Company is incorporated under the name of British American Tobacco p.l.c. and is registered in England and Wales under registered number 3407696. Under the Companies Act 2006, the Company's objects are unrestricted.

Directors: appointment and retirement

The Company's Articles of Association provide for a Board of Directors, consisting (unless otherwise determined by ordinary resolution of the shareholders) of not fewer than five Directors, not subject to any maximum, who shall manage the business of the Company.

The Directors and the Company (by ordinary resolution) may appoint a person who is willing to act as a Director, either to fill a vacancy or as an additional Director. A Director appointed by the Directors shall retire at the next Annual General Meeting and will put himself/herself forward to be reappointed by the shareholders.

At each Annual General Meeting, all Directors shall retire from office by rotation who held office at the time of each of the two preceding Annual General Meetings and who (at either of those preceding Annual General Meetings) (1) did not previously retire by rotation or (2) were reappointed following his/her appointment as an additional Director or to fill a vacancy. If the number of Directors so retiring is less than one-third of the Directors who are subject to retirement by rotation or, if their number is not three or a multiple of three, additional Directors shall retire by rotation provided that a number not exceeding one-third shall retire from office. Subject to the provisions of the Companies Act and the Articles of Association, the Directors to retire by rotation will be those who have been in office the longest since their appointment or last reappointment. A Director who retires at an Annual General Meeting and is not reappointed shall retain office until the meeting elects someone in his place or, if it does not do so, until the conclusion of the meeting.

In addition to any power of removal under the Companies Act, the Company may, by special resolution, remove a Director before the expiration of his period of office and, subject to the Articles of Association, may by ordinary resolution, appoint another person who is willing to act as a Director, and is permitted by law to do so, to be a Director instead of him. A person so appointed shall be subject to retirement by rotation as if he had become a Director on the day on which the Director in whose place he is appointed was last appointed or reappointed a Director.

Fees for Non-Executive Directors and the Chairman shall be determined by the Directors but shall not exceed in aggregate an annual sum of £2,500,000, unless determined otherwise by ordinary resolution of the shareholders. The remuneration of the Executive Directors is determined by the Remuneration Committee which is comprised of independent Non-Executive Directors.

Directors: meetings and voting

The quorum for meetings of Directors is two Directors. The Directors may delegate any of their powers which are conferred upon them under the Articles of Association to such person or committee as they consider appropriate.

The Articles of Association place a general prohibition on a Director voting at a meeting of the Directors on any resolution concerning a matter in which he has an interest other than by virtue of his interest in shares in the Company. However, in the absence of some other interest not indicated below, a Director is entitled to vote and to be counted in a quorum for the purpose of any vote relating to a resolution concerning the following matters:

1) the giving to him of a guarantee, security or indemnity in respect of money lent to, or an obligation incurred by him for the benefit of, the Company or any of its subsidiaries;

2) the giving to a third party of a guarantee, security or indemnity in respect of an obligation of the Company or any of its subsidiaries for which the Director has assumed responsibility (in whole or part and whether alone or jointly with others) under a guarantee or indemnity or by the giving of security;

3) the giving to him of any other indemnity which is on substantially the same terms as indemnities given, or to be given, to all of the other Directors and/or to the funding by the Company of his expenditure on defending proceedings of the doing by the Company of anything to enable him to avoid incurring such expenditure where all other Directors have been given, or are to be given, substantially the same arrangements;

4) any proposal concerning the purchase of Directors' and officers' liability insurance;

5) any proposal concerning his being, or intending to become, a participant in the underwriting or sub-underwriting of an offer of any such shares, debentures or other securities for subscription, purchase or exchange;

6) any arrangements which relate in any way to a retirement benefits scheme or any arrangement for the benefit of the employees of the Company or any of its subsidiaries including but without being limited to an employees' share scheme, which does not accord to any Director any privilege or advantage not generally accorded to the employees and/or former employees to whom the arrangement relates; and

7) any transaction or arrangement with any other company, being a company in which the Director is interested only as an officer, creditor or shareholder, provided that he is not the holder of or beneficially interested in one per cent or more of the equity share capital of that company (or of any other company through which his interest is derived) and not entitled to exercise one per cent or more of the voting rights available to members of the relevant company (disregarding, for the purposes of this proviso: (i) any shares held by a Director as bare or custodian trustee and in which he has no beneficial interest; (ii) any shares comprised in an authorised unit trust scheme in which the Director is interested only as a unit holder; and (iii) any shares of that class held as treasury shares).

The Company may by ordinary resolution suspend or relax to any extent, either generally or in respect of any particular matter, any provision of the Articles prohibiting a Director from voting at a meeting of the Directors or of a committee of the Directors.

Directors: borrowing powers

Without prejudice to their general powers, the Directors may exercise all the powers of the Company to borrow money and to mortgage or charge its undertaking, property, assets (present and future) and uncalled capital or any part thereof, and (subject to the provisions of the Articles of Association) to issue debentures, debenture stock and other securities whether outright or as security for any debt, liability or obligation of the Company or of any third party.

Directors: interests

Provided that the Director has disclosed to the other Directors the nature and extent of any material interest of his, a Director, notwithstanding his office:

1) may be a party to, or otherwise interested in, any transaction or arrangement with the Company or in which the Company is otherwise interested;

2) may be a Director or other officer of, or employed by or may be a party to, or otherwise interested in, any transaction or arrangement with any body corporate promoted by the Company or in which the Company is otherwise interested;

3) shall not, by reason of his office, be accountable to the Company for any benefit which he derives from any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate;

4) shall not infringe his duty to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or may possibly conflict, with the interests of the Company as a result of any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate;

5) shall not be required to disclose to the Company, or use in performing his duties as a Director of the Company, any confidential information relating to such office or employment if to make such a disclosure or use would result in a breach of duty or obligation of confidence owed by him in relation to or in connection with that office or employment;

6) may absent himself from discussions and exclude himself from information, which will or may relate to that office, employment, transaction, arrangement or interest; and

7) no such transaction or arrangement will be liable to be avoided because of any such interest or benefit.

For the purposes of the Articles, a general notice given to the Directors that he is to be regarded as having an interest of the nature and extent specified in the notice in any transaction or arrangement in which a specified person or class of persons is interested is deemed to be a disclosure that the Director has an interest in any such transaction of the nature and extent so specified; and an interest of which a Director has knowledge and of which it is unreasonable to expect him to have knowledge is not treated as an interest.

A Director will no longer be regarded as having an interest in a transaction by virtue of a person connected to the Director having a relevant interest. However, the Director and the Company must still take a view each time a matter is being considered as to whether the interests of the Director's connected persons mean that a Director should be treated as interested in a transaction.

The Directors may (subject to such terms and conditions, if any, as they may think fit to impose from time to time, and subject always to their right to vary or terminate such authorisation) authorise, to the fullest extent permitted by law:

1) any matter which would otherwise result in a Director infringing his duty to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the Company and which may reasonably be regarded as likely to give rise to a conflict of interest (including a conflict of interest and duty or conflict of duties);

2) a Director to accept or continue in any office, employment or position in addition to this office as a Director of the Company and may authorise the manner on which a conflict of interest arising out of such office, employment or position may be dealt with, either before or at the time that such a conflict of interest arises, provided that the authorisation is only effective if:

i) any requirement as to the quorum at the meeting at which the matter is considered is met without counting the Director in question or any other interested Director; and

ii) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

If a matter, or office, employment or position, has been authorised by the Directors then (subject to such terms and conditions, if any, as the Directors may think fit to impose from time to time, and subject always to their right to vary or terminate such authorisation or the permissions set out below):

1) the Director shall not be required to disclose any confidential information relating to such matter, or such office, employment or position, to the Company if to make such a disclosure would result in a breach of a duty or obligation of confidence owed by him in relation to or in connection with that matter, or that office, employment or position;

2) the Director may absent himself from discussions, whether in meetings of the Directors or otherwise, and exclude himself from information which will or may relate to that matter, or that office, employment or position; and

3) a Director shall not, by reason of his office as a Director of the Company, be accountable to the Company for any benefit which he derives from any such matter, or from any such office, employment or position.

Dividend rights

Holders of the Company's ordinary shares may, by ordinary resolution, declare dividends but may not declare dividends in excess of the amount recommended by the Directors. The Directors may also pay interim dividends if it appears that such dividends are justified by the profits available for distribution. No dividend shall be paid otherwise than out of profits available as specified under the provisions of the Companies Act.

The Directors may, with the sanction of an ordinary resolution of the shareholders, offer any holders of ordinary shares the right to elect to receive ordinary shares credited as fully paid instead of cash in respect of the whole or part of all such dividends as may be specified by the resolution. Any general meeting declaring a dividend may, upon the recommendation of the Directors, direct payment or satisfaction of such dividend to be wholly or partly by the distribution of specific assets. Where difficulty arises in regard to distribution, the Directors may ignore fractions or issue fractional certificates, fix the value for distribution of any assets and may determine that cash shall be paid to any shareholder in order to adjust the rights of such members.

Any dividend which has been unclaimed for 12 years from the date when it became due for payment shall, if the Directors so resolve, be forfeited and shall cease to be owed by the Company.

The Company can cease sending dividend warrants and cheques by post or otherwise if these have been returned undelivered to, or left uncashed by, the shareholder on at least two consecutive occasions, or, if following one such occasion, reasonable enquiries have failed to establish the member's new address. No dividend shall bear interest against the Company, unless provided by the rights attached to the share.

Voting rights

Voting at any general meeting of shareholders is by a show of hands unless a poll is demanded. On a show of hands, every shareholder who is present in person at a general meeting (and every proxy appointed by a shareholder and present at a general meeting) has one vote regardless of the number of shares held by the shareholder (or represented by the proxy). On a poll, every shareholder who is present in person or by proxy has one vote for every share held by the shareholder. A shareholder (or his duly appointed proxy) entitled to more than one vote need not use all his votes or cast all the votes he uses in the same way. A poll may be demanded by any of the following:

1) the chairman of the meeting;

2) the Directors;

3) not less than five shareholders having the right to vote at the meeting;

4) a shareholder or shareholders representing not less than one-tenth of the total voting rights of all shareholders having the right to vote at the meeting (excluding any voting rights attached to treasury shares); or

5) a shareholder or shareholders holding shares which confer a right to vote on the resolution at the meeting being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all shares conferring that right (excluding any voting rights attached to treasury shares).

Matters are transacted at general meetings of the Company by proposing and passing of two kinds of resolutions:

1) ordinary resolutions, which can include resolutions for the appointment, reappointment and removal of Directors, the receiving of the Annual Report, the declaration of final dividends, the appointment and reappointment of the external auditor, the authority for the Company to purchase its own shares and the grant of authority to allot shares; and

2) special resolutions, which can include resolutions amending the Company's Articles of Association and resolutions relating to certain matters concerning a winding-up of the Company.

An ordinary resolution requires the affirmative vote of a simple majority of the votes cast at a meeting at which there is a quorum in order to be passed. Special resolutions require the affirmative vote of not less than three-quarters of the votes cast at a meeting at which there is a quorum in order to be passed. The necessary quorum for a meeting of the Company is a minimum of two shareholders present in person or by proxy or by a duly authorised representative(s) of a corporation which is a shareholder and entitled to vote.

In the case of an equality of votes, whether on a show of hands or on a poll, the chairman of the meeting is entitled to a casting vote in addition to any other votes he may have.

Winding-up

If the Company is wound up, the liquidator may, with the sanction of a special resolution and any other sanction required by law, subject to the provisions of the Companies Act, divide among the shareholders the whole or any part of the assets of the Company, and may, for that purpose, value any assets and determine how the division is to take place as between the shareholders or different classes of shareholders. Alternatively, with the same sanction, the liquidator may vest the whole or any part of the assets in trustees upon trusts for the benefit of the shareholders, but no shareholder will be compelled to accept any asset upon which there is a liability.

Transfer of shares

Shares may be transferred by an instrument of transfer in any usual form or in any other form which the Directors may approve and shall be executed by or on behalf of the transferor and, where the share is not fully paid, by or on behalf of the transferee. The Directors can, in their absolute discretion, refuse to register the transfer of a share in certificated form which is not fully paid, provided that such a refusal would not prevent dealings in shares in certificated form which are not fully paid from taking place on a proper basis. The Directors may also refuse to register a transfer of a share in certificated form (whether fully paid or not) unless the instrument of transfer:

1) is lodged, duly stamped, and is deposited at the registered office of the Company or such other place as the Directors may appoint and is accompanied by a certificate for the shares to which it relates and such other evidence as the Directors may reasonably require to show the right of the transferor to make the transfer;

2) is in respect of only one class of share; and

3) is in favour of not more than four transferees.

In the case of uncertificated shares, transfers shall be registered only in accordance with the terms of the Uncertificated Securities Regulations 2001 so that Directors may refuse to register a transfer which would require shares to be held jointly by more than four persons.

If the Directors refuse to register a transfer of shares, they must give the transferee notice of this refusal as soon as practicable and in any event within two months of the instrument of transfer being lodged with the Company. No fees may be charged for the registration of a transfer of shares.

Pre-emptive rights and new issues of shares

While holders of ordinary shares have no pre-emptive rights under the Articles of Association, the ability of the Directors to cause the Company to issue shares, securities convertible into shares or rights to shares, otherwise than pursuant to an employee share scheme, is restricted. Under the Companies Act, the Directors of a company are, with certain exceptions, unable to allot any equity securities without express authorisation, which may be contained in a company's Articles of Association or given by its shareholders in general meeting, but which in either event cannot last for more than five years. Under the Companies Act, a company may also not allot shares for cash (otherwise than pursuant to an employee share scheme) without first making an offer to existing shareholders to allot such shares to them on the same or more favourable terms in proportion to their respective shareholdings, unless this requirement is waived by a special resolution of the shareholders.

Alteration of share capital

The Company may, from time to time, by ordinary resolution:

1) consolidate and divide all or any of its shares into shares of a larger amount than its existing shares;

2) sub-divide any of its shares into shares of smaller amount than its existing shares; and

3) determine that, as between the shares resulting from such a sub-division, any of them may have any preference or advantage as compared with the others.

Subject to the provisions of the Companies Act:

1) the Company may reduce its share capital, its capital redemption reserve and any share premium account in any way; and

2) the Company may purchase its own shares, including redeemable shares, and may hold such shares as treasury shares or cancel them.

Disclosure of interests in the Company's shares

There are no provisions in the Articles of Association whereby persons acquiring, holding or disposing of a certain percentage of the Company's shares are required to make disclosure of their ownership percentage, although there are such requirements under statute and regulation. The basic disclosure requirement under Part 6 of the Financial Services and Markets Act 2000 and Rule 5 of the Disclosure and Transparency Rules made by the Financial Services Authority imposes a statutory obligation on a person to notify the Company and the Financial Services Authority of the percentage of the voting rights in the Company he directly or indirectly holds or controls, or has rights over, through his direct or indirect holding of certain financial instruments, if the percentage of those voting rights:

1) reaches, exceeds or falls below 3 per cent and/or any subsequent whole percentage figure as a result of an acquisition or disposal of shares or financial instruments; or

2) reaches, exceeds or falls below any such threshold as a result of any change in the number of voting rights attached to shares in the Company.

OTHER STATUTORY AND REGULATORY INFORMATION CONTINUED

The Disclosure and Transparency Rules set out in detail the circumstances in which an obligation of disclosure will arise, as well as certain exemptions from those obligations for specified persons.

Under Section 793 of the Companies Act, the Company may, by notice in writing, require a person that the Company knows or has reasonable cause to believe is or was during the three years preceding the date of notice interested in the Company's shares, to indicate whether or not that is the case and, if that person does or did hold an interest in the Company's shares, to provide certain information as set out in that Act. The Disclosure and Transparency Rules further deal with the disclosure by persons of interests in shares or debentures of the companies of which they are Directors and certain associated companies.

The City Code on Takeovers and Mergers also imposes strict disclosure requirements with regard to dealings in the securities of an offeror or offeree company on all parties to a takeover and also on their respective associates during the course of an offer period.

General meetings and notices

An Annual General Meeting and all other general meetings of the Company must be called by at least 21 clear days' written notice. However, the Companies Act (as amended by the Shareholders' Rights Regulations) allows for this period of notice for meetings other than Annual General Meetings to be reduced to 14 clear days notice provided that two conditions are met: (1) a company must allow shareholders to make proxy appointments via a website (such as that hosted by its share registrars); and (2) shareholders must pass a special resolution at the Annual General Meeting every year approving that shortening of the notice period to 14 days. A special resolution enabling the Company to hold general meetings (other than Annual General Meetings) on 14 days' notice will be proposed at the Annual General Meeting to be held on 28 April 2010.

Variation of rights

If the capital of the Company is divided into different classes of shares, the rights attached to any class of shares may only be varied, either in such a manner as provided by those rights or in the absence of any provision, with the consent in writing of three-quarters in nominal value of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of holders of such shares. At any separate meeting, the necessary quorum is two persons together holding or representing by proxy at least one-third in nominal amount of the issued shares of the class (but at an adjourned meeting shall be any one person holding shares of the class or his proxy).

Unless otherwise expressly provided by the rights attached to any shares, those rights shall be deemed to be varied by the reduction of the capital paid up on those shares and by the creation or issue of further shares ranking in priority for payment of a dividend or in respect of capital or which confer on the holders voting rights more favourable than those conferred by the first-mentioned shares, but shall not otherwise be deemed to be varied by the creation or issue of further shares ranking pari passu with them or subsequent to them.

Repurchase of shares

Subject to authorisation by shareholder resolution, the Company may purchase its own shares in accordance with the Companies Act. Any shares which have been bought back may be held as treasury shares or, if not so held, must be cancelled immediately upon completion of the purchase, thereby reducing the amount of the Company's issued share capital.

Creditor payment policy

Given the international nature of the Group's operations, there is not a global standard code for the Group in respect of payments to suppliers. In the UK, the operating subsidiaries have signed up to the Better Payment Practice Code under which each company undertakes to: (1) seek agreement on payment terms with its suppliers at the outset of each transaction; (2) explain its payment procedures to its suppliers; (3) pay bills in accordance with the agreed terms and all legal requirements; and (4) inform suppliers without delay when contesting an invoice and settle disputes quickly. Details of the Code are available on the website, www.payontime.co.uk.

Non-UK operating subsidiaries are responsible for agreeing terms and conditions for their business transactions when orders for goods and services are placed, ensuring that suppliers are aware of the terms of payment and including the relevant terms in contracts where appropriate. These arrangements are adhered to provided that suppliers meet their contractual commitments.

Creditor days have not been calculated for the Company as it is an investment holding Company and had no trade creditors at 31 December 2009.

Intra-Group pricing

The prices agreed between Group companies for Intra-Group sales of materials, manufactured goods, charges for royalties, commissions, services and fees are based on the normal commercial practices which would apply between independent businesses.

On behalf of the Board

Nicola Snook
Secretary

24 February 2010

British American Tobacco p.l.c.
Registered in England and Wales No. 3407696

RESPONSIBILITY OF DIRECTORS

Directors' responsibilities in relation to the financial statements
The following statement sets out the responsibilities of the Directors in relation to the financial statements of both the Group and the Company. The reports of the independent auditors for the Group and the Company set out their responsibilities in relation to those financial statements.

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss of the Group and the Company for the financial year. In preparing those financial statements, the Directors are required to:

- select appropriate accounting policies and apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures being disclosed and explained; and
- prepare the financial statements on the going concern basis, unless they consider that to be inappropriate.

The applicable accounting standards referred to above are: (a) United Kingdom Generally Accepted Accounting Principles (UK GAAP) for the Company; and (b) International Financial Reporting Standards (IFRS) as adopted by the European Union and implemented in the UK for the Group.

The Directors are responsible for ensuring that the Company keeps sufficient accounting records to disclose with reasonable accuracy the financial position of the Company and the Group and to enable them to ensure that the Group financial statements comply with the Companies Act 2006 and Article 4 of the IAS Regulation, and that the Company financial statements and the Directors' Remuneration report comply with the Companies Act 2006. They are also responsible for taking reasonable steps to safeguard the assets of the Company and the Group and, in that context, having proper regard to the establishment of appropriate systems of internal control with a view to the prevention and detection of fraud and other irregularities.

The Directors are required to prepare financial statements and to provide the auditors with every opportunity to take whatever steps and undertake whatever inspections the auditors consider to be appropriate for the purpose of enabling them to give their audit report.

The Directors are responsible for the maintenance and integrity of the Annual Report on www.bat.com in accordance with the UK legislation governing the preparation and dissemination of financial statements. Access to the website is available from outside the UK, where comparable legislation may be different.

The Directors consider that they have pursued the actions necessary to meet their responsibilities as set out in this statement.

Directors' declaration in relation to relevant audit information
Having made enquiries of fellow Directors and of the Company's auditors, each of the Directors confirms that:

- to the best of his or her knowledge and belief, there is no relevant audit information of which the Company's auditors are unaware; and
- he or she has taken all steps that a Director might reasonably be expected to have taken in order to make himself or herself aware of relevant audit information and to establish that the Company's auditors are aware of that information.

Directors' responsibility statement
The Directors confirm to the best of their knowledge and belief that:

- the financial statements, prepared in accordance with IFRS, as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the Group; and
- the Directors' report (which incorporates the Business review) includes a fair review of the development and performance of the business and the position of the Group and the Company, together with a description of the principal risks and uncertainties that they face.

The names of the Directors are listed in this Directors' report and their details appear on the Board of Directors page.

Neither the Company nor the Directors accept any liability to any person in relation to this Annual Report except to the extent that such liability could arise under English law. Accordingly, any liability to a person who has demonstrated reliance on any untrue or misleading statement or omission shall be determined in accordance with section 90A of the Financial Services and Markets Act 2000.

The responsibility statement was approved by the Board of Directors on 24 February 2010 and signed on its behalf by:

Richard Burrows
Chairman

Ben Stevens
Finance Director

GROUP FINANCIAL STATEMENTS

PAGE

Report of the independent auditors 108
Independent auditors' report on the Group financial statements.

Group income statement 109
Summary of the Group's turnover, revenue and profits.

Group statement of comprehensive income 110
Summary of the Group's comprehensive income.

Group statement of changes in equity 111
Summary of the Group's changes in equity.

Group balance sheet 112
Summary of the Group's assets, equity and liabilities.

Group cash flow statement 114
Summary of the Group's cash flows.

Notes on the accounts 115
Detailed notes on the Group accounts.

Five year summary 191
Summary of financial data from 2004-2009.

Half-yearly analyses of profit 192
2009 profit figures broken down by half year.

Principal subsidiary undertakings 193
List of the Principal subsidiary undertakings of the Group.

Principal associate undertakings 194
List of the Principal associate undertakings of the Group.

INDEPENDENT AUDITORS' REPORT
TO THE MEMBERS OF BRITISH AMERICAN TOBACCO p.l.c.

We have audited the Group financial statements of British American Tobacco p.l.c. for the year ended 31 December 2009 which comprise the Group income statement, the Group statement of comprehensive income, the Group statement of changes in equity, the Group balance sheet, the Group cash flow statement, the notes on the accounts and the Principal subsidiary undertakings and the Principal associate undertakings. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of Directors and auditors

As explained more fully in the Responsibility of Directors statement set out on page 105, the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the Group financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2009 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' report for the financial year for which the Group financial statements are prepared is consistent with the Group financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the Directors' statement, set out on page 71, in relation to going concern; and
- the part of the Corporate governance statement relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

Other matter

We have reported separately on the Parent Company financial statements of British American Tobacco p.l.c. for the year ended 31 December 2009 and on the information in the Remuneration report that is described as having been audited.

Richard Hughes (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom

24 February 2010

GROUP INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER

	Notes	2009 £m	2008 £m
Gross turnover (including duty, excise and other taxes of £26,505 million (2008: £21,799 million))		**40,713**	33,921
Revenue	2	**14,208**	12,122
Raw materials and consumables used		**(3,983)**	(3,335)
Changes in inventories of finished goods and work in progress		**35**	19
Employee benefit costs	3a	**(2,317)**	(1,907)
Depreciation and amortisation costs	3b	**(611)**	(430)
Other operating income	3c	**196**	281
Other operating expenses	3d	**(3,427)**	(3,178)
Profit from operations	2	**4,101**	3,572
Analysed as:			
– adjusted profit from operations	2	**4,461**	3,717
– restructuring and integration costs	3e	**(304)**	(160)
– Canadian settlement	3f		(102)
– amortisation of trademarks	3g	**(58)**	(24)
– gains on disposal of businesses and trademarks	3h	**2**	141
		4,101	3,572
Finance income		**77**	267
Finance costs		**(581)**	(658)
Net finance costs	4	**(504)**	(391)
Share of post-tax results of associates and joint ventures	5	**483**	503
Analysed as:			
– adjusted share of post-tax results of associates and joint ventures	2	**541**	477
– trademark impairments	5	**(65)**	(20)
– additional ST income	5		13
– termination of joint venture	5		45
– health plan credit	5	**16**	
– restructuring costs	5	**(9)**	(12)
		483	503
Profit before taxation		**4,080**	3,684
Taxation on ordinary activities	6	**(1,124)**	(1,025)
Profit for the year		**2,956**	2,659
Attributable to:			
Shareholders' equity		**2,713**	2,457
Minority interests		**243**	202
		2,956	2,659
Earnings per share			
Basic	7	**137.0p**	123.3p
Diluted	7	**136.3p**	122.5p

All of the activities during both years are in respect of continuing operations.

The accompanying notes are an integral part of the Group financial statements.

GROUP STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER

	Notes	2009 £m	2008 £m
Profit for the year *(page 109)*		**2,956**	2,659
Other comprehensive income			
Differences on exchange			
– subsidiaries		**166**	213
– associates		**(258)**	724
Differences on exchange reclassified and reported in profit for the year			(22)
Cash flow hedges			
– net fair value (losses)/gains		**(72)**	180
– reclassified and reported in profit for the year		**67**	(173)
– reclassified and reported in net assets		**(1)**	1
Available-for-sale investments			
– net fair value gains		**3**	1
– reclassified and reported in profit for the year		**(3)**	(6)
Net investment hedges			
– net fair value gains/(losses)		**238**	(672)
– differences on exchange on borrowings		**12**	(178)
Revaluation of existing business	26c		179
Retirement benefit schemes			
– actuarial losses in respect of subsidiaries	12	**(295)**	(547)
– surplus recognition and minimum funding obligations in respect of subsidiaries	12	**(76)**	
– actuarial gains/(losses) in respect of associates net of tax	11	**61**	(396)
Tax on items recognised directly in other comprehensive income	6d	**(71)**	184
Total other comprehensive income for the year		**(229)**	(512)
Total comprehensive income for the year		**2,727**	2,147
Attributable to:			
– shareholders' equity		**2,476**	1,913
– minority interests		**251**	234
		2,727	2,147

The accompanying notes are an integral part of the Group financial statements.

GROUP STATEMENT OF CHANGES IN EQUITY
AT 31 DECEMBER

2009

	Notes	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Shareholders' funds £m	Minority interests £m	Total equity £m
Total comprehensive income for the year *(page 110)*				77	2,399	2,476	251	2,727
Employee share options								
– value of employee services					61	61		61
– proceeds from shares issued			2		5	7		7
Dividends and other appropriations								
– ordinary shares					(1,798)	(1,798)		(1,798)
– to minority interests							(240)	(240)
Purchase of own shares								
– held in employee share ownership trusts					(94)	(94)		(94)
Minority interests in Bentoel	26						1	1
Minority interests – capital injection	29						16	16
Other movements					17	17		17
Total changes in equity for the year			2	77	590	669	28	697
Balance at 1 January		506	3,905	955	1,578	6,944	271	7,215
Balance at 31 December		506	3,907	1,032	2,168	7,613	299	7,912

2008

	Notes	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Shareholders' funds £m	Minority interests £m	Total equity £m
Total comprehensive income for the year *(page 110)*				297	1,616	1,913	234	2,147
Employee share options								
– value of employee services					51	51		51
– proceeds from shares issued			3		7	10		10
Dividends and other appropriations								
– ordinary shares					(1,393)	(1,393)		(1,393)
– to minority interests							(176)	(176)
Purchase of own shares								
– held in employee share ownership trusts					(116)	(116)		(116)
– share buy-back programme					(400)	(400)		(400)
Acquisition of minority interests							(5)	(5)
Other movements					8	8		8
Total changes in equity for the year			3	297	(227)	73	53	126
Balance at 1 January		506	3,902	658	1,805	6,871	218	7,089
Balance at 31 December		506	3,905	955	1,578	6,944	271	7,215

The accompanying notes are an integral part of the Group financial statements.

GROUP BALANCE SHEET
AT 31 DECEMBER

	Notes	31 Dec 2009 £m	31 Dec 2008 restated £m	1 Jan 2008 restated £m
Assets				
Non-current assets				
Intangible assets	9	**12,232**	12,318	8,105
Property, plant and equipment	10	**3,010**	3,076	2,378
Investments in associates and joint ventures	11	**2,521**	2,552	2,316
Retirement benefit assets	12	**105**	75	37
Deferred tax assets	13	**350**	392	264
Trade and other receivables	14	**171**	193	123
Available-for-sale investments	15	**26**	27	22
Derivative financial instruments	16	**93**	179	154
Total non-current assets		**18,508**	18,812	13,399
Current assets				
Inventories	17	**3,261**	3,177	1,985
Income tax receivable	18	**97**	137	85
Trade and other receivables	14	**2,344**	2,395	1,845
Available-for-sale investments	15	**57**	79	75
Derivative financial instruments	16	**156**	417	81
Cash and cash equivalents	19	**2,161**	2,309	1,258
		8,076	8,514	5,329
Assets classified as held-for-sale	26	**30**	225	36
Total current assets		**8,106**	8,739	5,365
Total assets		**26,614**	27,551	18,764

	Notes	31 Dec 2009 £m	31 Dec 2008 restated £m	1 Jan 2008 restated £m
Equity				
Capital and reserves				
Share capital		**506**	506	506
Share premium, capital redemption and merger reserves		**3,907**	3,905	3,902
Other reserves		**1,032**	955	658
Retained earnings		**2,168**	1,578	1,805
Shareholders' funds		**7,613**	6,944	6,871
after deducting				
– cost of treasury shares		**(772)**	(745)	(296)
Minority interests		**299**	271	218
Total equity	20	**7,912**	7,215	7,089
Liabilities				
Non-current liabilities				
Borrowings	21	**9,712**	9,437	6,062
Retirement benefit liabilities	12	**1,129**	848	360
Deferred tax liabilities	13	**527**	599	336
Other provisions for liabilities and charges	22	**144**	186	165
Trade and other payables	23	**180**	166	149
Derivative financial instruments	16	**94**	222	59
Total non-current liabilities		**11,786**	11,458	7,131
Current liabilities				
Borrowings	21	**1,370**	2,724	861
Income tax payable	18	**364**	300	227
Other provisions for liabilities and charges	22	**312**	295	263
Trade and other payables	23	**4,727**	4,718	2,976
Derivative financial instruments	16	**127**	841	215
		6,900	8,878	4,542
Liabilities directly associated with assets classified as held-for-sale	26	**16**		2
Total current liabilities		**6,916**	8,878	4,544
		26,614	27,551	18,764

The balance sheet as at 31 December 2008 has been restated for the reclassification of certain derivatives, as explained in note 16. In accordance with IAS 1 Revised, an additional balance sheet comparative has been presented as at 1 January 2008.

The accompanying notes are an integral part of the Group financial statements.

On behalf of the Board

Richard Burrows
Chairman

24 February 2010

GROUP CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER

	Notes	2009 £m	2008 £m
Cash flows from operating activities			
Cash generated from operations	25	**4,645**	4,156
Dividends received from associates		**328**	326
Tax paid		**(1,095)**	(943)
Net cash from operating activities		**3,878**	3,539
Cash flows from investing activities			
Interest received		**83**	125
Dividends received from investments		**2**	2
Purchases of property, plant and equipment		**(450)**	(448)
Proceeds on disposal of property, plant and equipment		**39**	62
Purchases of intangibles		**(104)**	(96)
Proceeds on disposal of intangibles	25		17
Purchases and proceeds on disposals of investments	25	**37**	9
Proceeds from associates' share buy-backs	25		42
Purchase of Bentoel	25	**(370)**	
Purchase of Tekel cigarette assets	25	**(12)**	(873)
Proceeds from ST trademark disposals and purchase of ST businesses	25	**187**	(1,243)
Purchases of other subsidiaries, associates and minority interests	25	**(1)**	(9)
Proceeds on disposal of subsidiaries	25		26
Net cash from investing activities		**(589)**	(2,386)
Cash flows from financing activities			
Interest paid		**(576)**	(400)
Interest element of finance lease rental payments		**(2)**	(3)
Capital element of finance lease rental payments		**(35)**	(30)
Proceeds from issue of shares to Group shareholders		**2**	3
Proceeds from the exercise of options over own shares held in employee share ownership trusts		**5**	7
Proceeds from increases in and new borrowings	25	**1,447**	3,518
Movements relating to derivative financial instruments	25	**(267)**	(656)
Purchases of own shares			(400)
Purchases of own shares held in employee share ownership trusts		**(94)**	(116)
Reductions in and repayments of borrowings	25	**(1,853)**	(731)
Dividends paid to shareholders	8	**(1,798)**	(1,393)
Dividends paid to minority interests		**(234)**	(173)
Net cash from financing activities		**(3,405)**	(374)
Net cash flows from operating, investing and financing activities		**(116)**	779
Differences on exchange		**(125)**	261
(Decrease)/increase in net cash and cash equivalents in the year		**(241)**	1,040
Net cash and cash equivalents at 1 January		**2,220**	1,180
Net cash and cash equivalents at 31 December	19	**1,979**	2,220

The accompanying notes are an integral part of the Group financial statements.

NOTES ON THE ACCOUNTS

1 Accounting policies

Basis of Accounting

The Group financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The financial statements have been prepared under the historical cost convention except as described in the accounting policy below on financial instruments.

The Group has adopted the following new and amended IFRSs and IFRIC interpretations with effect from 1 January 2009:

- IFRS 8 (Operating Segments). This standard requires segmental reporting in the financial statements to be on the same basis as is used for internal management reporting to the chief operating decision maker. This has not required any changes to the segments reported by the Group. However, it has resulted in certain changes to the disclosures;
- Amendment to IFRS 2 (Share-based Payment – Vesting Conditions and Cancellations). This interpretation clarifies that vesting conditions are service conditions and performance conditions only, and specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. This change has had no material effect on the Group's reported profit or equity;
- IAS 1 Revised (Presentation of Financial Statements). This standard requires certain changes in the format of the financial statements including the separate disclosure of owner and non-owner changes in equity as primary statements, and permits some changes in terminology, but does not affect the measurement of reported profit or equity. The Group has chosen to show other comprehensive income in a separate statement from the income statement and hence all owner changes in equity are presented in the consolidated statement of changes in equity, whereas non-owner changes in equity are shown in the consolidated statement of comprehensive income;
- IAS 23 Revised (Borrowing Costs). This standard requires borrowing costs directly attributable to the acquisition, construction or production of an asset that takes a substantial period of time to get ready for its intended use or sale to be capitalised as part of the cost of the asset. The Group's previous policy was to expense such borrowing costs as they were incurred. In accordance with the transitional provisions of the amended IAS 23, the Group has adopted the standard on a prospective basis. Therefore, borrowing costs are capitalised on qualifying assets with a commencement date on or after 1 January 2009. This change has not materially affected the Group's reported profit or equity;
- Improvements to IFRSs (issued in May 2008). These amendments have varying application dates commencing on or after 1 January 2009. The main effect has been a reclassification of derivatives held for trading with a settlement date greater than one year from current to non-current on the balance sheet. The balance sheets of prior reporting periods have been amended to reflect this reclassification and, in accordance with IAS 1 Revised (Presentation of Financial Statements), an additional balance sheet comparative has been presented as at 1 January 2008. The only comparative amounts affected are those shown in note 16. The effect of the reclassification has been to increase non-current assets and decrease current assets at 31 December 2008 by £3 million (1 January 2008: £1 million) and to increase non-current liabilities and decrease current liabilities at 31 December 2008 by £23 million (1 January 2008: £10 million);
- IFRIC 16 (Hedges of a Net Investment in a Foreign Operation). This interpretation clarifies the specific hedge accounting requirements for net investment hedges. This change has not materially affected the Group's reported profit or equity; and
- Amendment to IFRS 7 (Financial Instruments – Disclosures). The amendment requires additional disclosures regarding fair value measurements and liquidity risk, including disclosure of fair value measurements by level of a fair value measurement hierarchy, and has had no effect on reported profit or equity.
- In addition, a number of other interpretations and revisions to existing standards have been issued and endorsed which had no effect on reported profit or equity or on the disclosures in the financial statements.

The preparation of the Group financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities at the date of the financial statements. The key estimates and assumptions are set out in the accounting policies below, together with the related notes to the accounts.

The most significant items include:

- the exemptions taken under IFRS 1 on the first time adoption of IFRS at 1 January 2004 and, in particular, those relating to goodwill on business combinations which are explained in the accounting policies below;
- the review of asset values, especially goodwill and impairment testing. The key assumptions used in respect of goodwill and impairment testing are the determination of cash-generating units, the long-term growth rate for cash flow projections and the rate used to discount the cash flow projections. These are described in note 9;
- the estimation of and accounting for retirement benefit costs. The determination of the carrying value of assets and liabilities, as well as the charge for the year, and amounts recognised in other comprehensive income, involves judgments made in conjunction with independent actuaries. These involve estimates about uncertain future events based on the environment in different countries, including life expectancy of scheme members, salary and pension increases, inflation and expected returns on assets, as well as discount rates and asset values at the year end. The assumptions used by the Group and sensitivity analysis are described in note 12;

1 Accounting policies continued

- the estimation of amounts to be recognised in respect of taxation and legal matters, and the estimation of other provisions for liabilities and charges are subject to uncertain future events, may extend over several years and so the amount and/or timing may differ from current assumptions. The accounting policy for taxation is explained below and the recognised deferred tax assets and liabilities, together with a note of unrecognised amounts, are shown in note 6(b) and note 13. Other provisions for liabilities and charges are as set out in note 22. The accounting policy on contingent liabilities, which are not provided for, is set out below and the contingent liabilities of the Group are explained in note 30;
- the definition of adjusting items, which are separately disclosed as memorandum information, is explained below and the impact of these on the calculation of adjusted earnings is described in note 7; and
- the estimation of the fair values of acquired net assets arising in a business combination under IFRS 3 and the allocation of the purchase consideration between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair values. These estimates are prepared in conjunction with the advice of independent valuation experts where appropriate. The relevant transactions for 2008 and 2009 are described in note 26.

Such estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable in the circumstances and constitute management's best judgment at the date of the financial statements. In the future, actual experience may deviate from these estimates and assumptions, which could affect the financial statements as the original estimates and assumptions are modified, as appropriate, in the year in which the circumstances change.

Basis of consolidation

The consolidated financial information includes the financial statements of British American Tobacco p.l.c. and its subsidiary undertakings, together with the Group's share of the results of its associates and joint ventures.

A subsidiary is an entity controlled by the Group, where control is the power to govern the financial and operating policies of the entity so as to obtain benefit from its activities.

Associates and joint ventures comprise investments in undertakings, which are not subsidiary undertakings, where the Group's interest in the equity capital is long term and over whose operating and financial policies the Group exercises a significant influence and, in the case of joint ventures, has joint control. They are accounted for using the equity method.

The results of Group undertakings acquired during the period are included from the date of acquisition of a controlling interest at which date, for the purposes of consolidation, the purchase consideration is allocated between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair value.

The results of Group undertakings which have been sold during the year are included up to the date of disposal. The profit or loss on sale is calculated by reference to the net asset value at the date of disposal, adjusted for purchased goodwill previously consolidated in the balance sheet.

Where accumulated losses applicable to a minority exceed the minority's interest in the equity of a subsidiary, the excess is allocated to the Group's interest in the subsidiary, except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Inter-company balances and transactions, and any unrealised gains arising from inter-company transactions, are eliminated in preparing the consolidated financial statements.

Foreign currencies

The functional currency of the Parent Company is sterling and this is also the presentation currency of the Group. The income and cash flow statements of Group undertakings expressed in currencies other than sterling are translated to sterling at average rates of exchange in each year provided that the average rate approximates the exchange rate at the date of the underlying transactions. Assets and liabilities of these undertakings are translated at rates of exchange at the end of each year. For hyperinflationary countries, the financial statements in local currency are adjusted to reflect the impact of local inflation prior to translation into sterling.

The differences between retained profits of overseas subsidiary and associated undertakings translated at average and closing rates of exchange are taken to reserves, as are differences arising on the retranslation to sterling (using closing rates of exchange) of overseas net assets at the beginning of the year. Any differences that have arisen since 1 January 2004 are presented as a separate component of equity. As permitted under IFRS 1, any differences prior to that date are not included in this separate component of equity. On the disposal of an overseas undertaking, the cumulative amount of the related exchange differences deferred in the separate component of equity are recognised in the income statement when the gain or loss on disposal is recognised.

Foreign currency transactions are initially recognised in the functional currency of each entity in the Group using the exchange rate ruling at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of foreign currency assets and liabilities at year end rates of exchange are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges, on inter-company net investment loans and qualifying net investment hedges. Foreign exchange gains or losses recognised in the income statement are included in profit from operations or net finance costs depending on the underlying transactions that gave rise to these exchange differences.

Revenue

Revenue principally comprises sales of cigarettes, cigars, leaf and other tobacco products to external customers. Revenue excludes duty, excise and other taxes and is after deducting rebates, returns and other similar

discounts. Revenue is recognised when the significant risks and rewards of ownership are transferred to a third party.

Retirement benefit costs

The Group operates both defined benefit and defined contribution schemes. The net deficit or surplus for each defined benefit pension scheme is calculated in accordance with IAS 19, based on the present value of the defined benefit obligation at the balance sheet date less the fair value of the scheme assets adjusted, where appropriate, for the effect of any surplus restrictions and recognition of minimum funding requirements.

Actuarial gains and losses, changes in unrecognised scheme surpluses and minimum funding requirements are recognised in full through other comprehensive income.

Past service costs resulting from enhanced benefits are expensed over the period to vesting and if they vest immediately, then they are recognised at that time in the income statement.

The Group also has certain post-retirement health care schemes and they are accounted for on a similar basis to the defined benefit pension schemes.

For defined benefit schemes, the actuarial cost charged to profit from operations consists of current service cost, interest cost, expected return on plan assets, past service cost and the impact of any settlements or curtailments.

Some benefits are provided through defined contribution schemes and payments to these are charged as an expense as they fall due.

Share-based payments

The Group has equity-settled and cash-settled share-based compensation plans.

Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed over the vesting period, based on the Group's estimate of awards that will eventually vest. For plans where vesting conditions are based on total shareholder returns, the fair value at date of grant reflects these conditions, whereas earnings per share vesting conditions are reflected in the calculation of awards that will eventually vest over the vesting period. For cash-settled share-based payments, a liability equal to the portion of the services received is recognised at its current fair value determined at each balance sheet date. Fair value is measured by the use of the Black-Scholes option pricing model, except where vesting is dependent on market conditions when the Monte-Carlo option pricing model is used. The expected life used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

Research and development

Research expenditure is charged to income in the year in which it is incurred. Development expenditure is charged to income in the year it is incurred, unless it meets the recognition criteria of IAS 38 (Intangible Assets).

Taxation

Taxation is that chargeable on the profits for the period, together with deferred taxation.

The current income tax charge is calculated on the basis of tax laws enacted or substantially enacted at the balance sheet date in the countries where the Group's subsidiaries, associates and joint ventures operate and generate taxable income.

Deferred taxation is provided in full using the liability method for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for taxation purposes. Deferred tax is provided on temporary differences arising on investments in Group undertakings, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that it will not reverse in the foreseeable future. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. As required under IAS 12, deferred tax assets and liabilities are not discounted.

Deferred tax is determined using the tax rates that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or deferred tax liability is settled.

Tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income or directly in changes in equity, in which case it is recognised in other comprehensive income or changes in equity.

The Group has exposures in respect of the payment or recovery of a number of taxes. Liabilities or assets for these payments or recoveries are recognised at such time as an outcome becomes probable and when the amount can reasonably be estimated.

Goodwill

Goodwill arising on acquisitions is capitalised and is considered to have an indefinite life subject to impairment reviews. Any impairment of goodwill is recognised immediately in the income statement and is not subsequently reversed.

Goodwill represents the excess of the cost of acquisition of a subsidiary, associate or joint venture over the Group's share of the fair value of identifiable net assets acquired. Goodwill is stated at cost less accumulated impairment losses and amortisation prior to 1 January 2004.

The Group's policy up to and including 1997 was to eliminate goodwill against reserves. Goodwill acquired from 1998 to 31 December 2003 was capitalised and amortised over its useful economic life. As permitted under IFRS 1, in respect of acquisitions prior to 1 January 2004, the classification and accounting treatment of business combinations was not amended on transition to IFRS. Goodwill previously written off direct to reserves is not recycled to the income statement on the disposal of the subsidiary or associate to which it relates.

1 Accounting policies continued

Goodwill in respect of subsidiaries is included in intangible assets. In respect of associates, goodwill is included in the carrying value of the investment in the associated company. On disposal of a subsidiary or associate, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Intangible assets other than goodwill

The intangible assets shown on the Group balance sheet consist mainly of trademarks acquired by the Group's subsidiary undertakings and computer software.

Acquired trademarks are carried at cost less accumulated amortisation and impairment. Trademarks with indefinite lives are not amortised but are reviewed annually for impairment. Intangible assets other than goodwill classified as held-for-sale are not amortised. Other trademarks are amortised on a straight-line basis over their remaining useful lives, consistent with the pattern of economic benefits expected to be received, which do not exceed 20 years. Any impairments of trademarks are recognised in the income statement but increases in trademark values are not recognised.

Computer software is carried at cost less accumulated amortisation and impairment, and is amortised on a straight-line basis over a period ranging from three to five years.

The investments in associates shown in the Group balance sheet include trademarks arising from the combination of Brown & Williamson (B&W) and R J Reynolds (RJR) in 2004 to form Reynolds American Inc. (RAI), as well as those arising on the acquisition of Conwood by RAI in 2006. As the combination of B&W and RJR for the Group involved the partial disposal of B&W and an investment in RAI, fair values were assigned to trademarks formerly owned by RJR but not to those formerly owned by B&W. Most of the carrying value of the trademarks relates to trademarks which are deemed to have indefinite lives and each trademark is subject to an annual impairment test. Certain minor trademarks are being amortised over their remaining lives.

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and impairment. Depreciation is calculated on a straight-line basis to write off the assets over their useful economic life. No depreciation is provided on freehold land or assets classified as held-for-sale. Freehold and long leasehold property are depreciated at rates between 2.5 per cent and 4 per cent per annum, and plant and equipment at rates between 7 per cent and 25 per cent per annum.

Capitalised interest

Borrowing costs which are directly attributable to the acquisition, construction or production of intangible assets or plant, property and equipment that takes a substantial period of time to get ready for its intended use or sale, and for which the commencement date for capitalisation is on or after 1 January 2009, are capitalised as part of the cost of the asset, in accordance with the revised IAS 23 (Borrowing costs). The Group's previous policy was to expense such borrowing costs as they were incurred.

Leased assets

Where the Group has substantially all the risks and rewards of ownership of the leased asset, these assets are classified as finance leases and are included as part of property, plant and equipment. Finance lease assets are initially recognised at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, then depreciated over the shorter of the lease term and their estimated useful lives. Leasing payments consist of capital and finance charge elements and the finance element is charged to the income statement.

Rental payments under operating leases are charged to the income statement on a straight-line basis over the lease term.

Where arrangements are entered into which, while they are not in the legal form of a lease, are in substance a lease under IFRIC 4, then they are recognised on the same basis as the leased assets above.

Impairment of non-financial assets

Assets are reviewed for impairment whenever events indicate that the carrying amount of a cash-generating unit may not be recoverable. In addition, assets that have indefinite useful lives are tested annually for impairment. An impairment loss is recognised to the extent that the carrying value exceeds the higher of the asset's fair value less costs to sell and its value in use.

A cash-generating unit is the smallest identifiable group of assets that generates cash flows which are largely independent of the cash flows from other assets or groups of assets. At the acquisition date, any goodwill acquired is allocated to the relevant cash-generating unit or group of cash-generating units expected to benefit from the acquisition for the purpose of impairment testing of goodwill.

Impairment of financial assets

Financial assets are reviewed at each balance sheet date, or whenever events indicate that the carrying amount may not be recoverable. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the investment below its cost is considered as an indicator that the investment is impaired.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is based on the average cost incurred in acquiring inventories and bringing them to their existing location and condition, which will include raw materials, direct labour and overheads, where appropriate. Net realisable value is the estimated selling price less costs to completion and sale. Tobacco inventories which have an operating cycle that exceeds 12 months are classified as current assets, consistent with recognised industry practice.

Financial instruments

Financial assets and financial liabilities are recognised when the Group becomes a party to the contractual provisions of the relevant instrument and derecognised when it ceases to be a party to such provisions. Such assets and liabilities are classified as current if they are expected to be realised or settled within 12 months after the balance sheet date. If not, they are classified as non-current.

Financial assets and financial liabilities are initially recognised at fair value, plus directly attributable transaction costs where applicable, with subsequent measurement as set out below.

Non-derivative financial assets are classified on initial recognition as available-for-sale investments, loans and receivables or cash and cash equivalents as follows:

- available-for-sale investments: available-for-sale investments are those non-derivative financial assets that cannot be classified as loans and receivables or cash and cash equivalents;
- loans and receivables: these are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market; and
- cash and cash equivalents: cash and cash equivalents include cash in hand and deposits held on call, together with other short-term highly liquid investments including investments in certain money market funds. Cash equivalents normally comprise instruments with maturities of three months or less at date of acquisition. In the cash flow statement, cash and cash equivalents are shown net of bank overdrafts, which are included as current borrowings in the liabilities section on the balance sheet.

Apart from available-for-sale investments, non-derivative financial assets are stated at amortised cost using the effective interest method, subject to reduction for allowances for estimated irrecoverable amounts. These estimates for irrecoverable amounts are recognised when there is objective evidence that the full amount receivable will not be collected according to the original terms of the asset. Such evidence might include financial difficulties of the debtor, defaults of payment or significant overdue balances. For interest-bearing assets, their carrying value includes accrued interest receivable. Available-for-sale investments are stated at fair value, with changes in fair value being recognised directly in equity. When such investments are derecognised (e.g. through disposal) or become impaired, the accumulated gains and losses, previously recognised in equity, are recognised in the income statement within 'finance income'. Dividend and interest income on available-for-sale investments are included within 'finance income' when the Group's right to receive payments is established.

Fair values for quoted investments are based on observable market prices. If there is no active market for a financial asset, the fair value is established by using valuation techniques principally involving discounted cash flow analysis.

Non-derivative financial liabilities are stated at amortised cost using the effective interest method. For borrowings, their carrying value includes accrued interest payable, as well as unamortised issue costs.

Derivative financial assets and liabilities are initially recognised, and subsequently measured, at fair value, which includes accrued interest receivable and payable where relevant. Changes in their fair values are recognised as follows:

- for derivatives that are designated as cash flow hedges, the changes in their fair values are recognised directly in equity, to the extent that they are effective, with the ineffective portion being recognised in the income statement. Where the hedged item results in a non-financial asset, the accumulated gains and losses, previously recognised in equity, are included in the initial carrying value of the asset (basis adjustment) and recognised in the income statement in the same periods as the hedged item. Where the underlying transaction does not result in such an asset, the accumulated gains and losses are recognised in the income statement in the same periods as the hedged item;
- for derivatives that are designated as fair value hedges, the carrying value of the hedged item is adjusted for the fair value changes attributable to the risk being hedged, with the corresponding entry being made in the income statement. The changes in fair value of these derivatives are also recognised in the income statement;
- for derivatives that are designated as hedges of net investments in foreign operations, the changes in their fair values are recognised directly in equity, to the extent that they are effective, with the uneffective portion being recognised in the income statement. Where non-derivatives, such as foreign currency borrowings, are designated as net investment hedges, the relevant exchange differences are similarly recognised. The accumulated gains and losses are recognised in the income statement when the foreign operation is disposed of; and
- for derivatives that do not qualify for hedge accounting or are not designated as hedges, the changes in their fair values are recognised in the income statement in the period in which they arise.

In order to qualify for hedge accounting, the Group is required to document prospectively the relationship between the item being hedged and the hedging instrument. The Group is also required to demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is reperformed periodically to ensure that the hedge has remained, and is expected to remain, highly effective.

Hedge accounting is discontinued when a hedging instrument is derecognised (e.g. through expiry or disposal), or no longer qualifies for hedge accounting. Where the hedged item is a highly probable forecast transaction, the related gains and losses remain in equity until the transaction takes place, when they are removed from equity in the same manner as for cash flow hedges as described above. When a hedged future transaction is no longer expected to occur, any related gains and losses, previously recognised in equity, are immediately recognised in the income statement.

Derivative fair value changes recognised in the income statement are either reflected in arriving at profit from operations (if the hedged item is similarly reflected) or in finance costs.

Dividends

Final dividend distributions to the Company's shareholders are recognised as a liability in the Group financial statements in the period in which the dividends are approved by the Company's shareholders at the Annual General Meeting, while interim dividend distributions are recognised in the period in which the dividends are declared and paid.

1 Accounting policies continued

Segmental analysis

The Group is organised and managed on the basis of five geographic regions. These are the reportable segments for the Group as they form the focus of the Group's internal reporting systems and are the basis used by the Management Board, as the chief operating decision maker, for assessing performance and allocating resources.

The Group is a single product business providing cigarettes and other tobacco products. While the Group has clearly differentiated brands, global segmentation between a wide portfolio of brands is not part of the regular internally reported financial information.

The prices agreed between Group companies for Intra-Group sales of materials, manufactured goods, charges for royalties, commissions, services and fees, are based on normal commercial practices which would apply between independent businesses. Royalty income, less related expenditure, is included in the region in which the licensor is based.

Adjusting items

Adjusting items are significant items in the profit from operations and the Group's share of the post-tax results of associates and joint ventures which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. These items are separately disclosed either as memorandum information on the face of the income statement and in the segmental analyses, or in the notes to the accounts as appropriate, and are used to derive the Group's principal non-GAAP measure which is adjusted diluted earnings per share.

Provisions

Provisions are recognised when either a legal or constructive obligation as a result of a past event exists at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and a reasonable estimate can be made of the amount of the obligation.

Contingent liabilities

Subsidiaries and associate companies are defendants in tobacco-related and other litigation. Provision for this litigation would be made at such time as an unfavourable outcome became probable and the amount could be reasonably estimated.

Contingent assets are possible assets whose existence will only be confirmed by future events not wholly within the control of the entity and are not recognised as assets until the realisation of income is virtually certain.

The Group records its external legal fees and other external defence costs for tobacco-related and other litigation as these costs are incurred.

Repurchase of share capital

When share capital is repurchased, the amount of consideration paid, including directly attributable costs, is recognised as a deduction from equity. Repurchased shares which are not cancelled, or shares purchased for the employee share ownership trusts, are classified as treasury shares and presented as a deduction from total equity.

Future changes to accounting policies

Certain changes to IFRS will be applicable to the Group financial statements in future years. Set out below are those which are considered to affect the Group.

The revised IFRS 3 (Business Combinations) and IAS 27 (Consolidated and Separate Financial Statements) have been endorsed by the EU and change the accounting for business combinations and transactions with minorities. While these revised standards are applicable for periods beginning on or after 1 July 2009, with early adoption permitted on or after 30 June 2007, these are only to be applied prospectively and so there is no restatement of transactions prior to the effective date.

The Annual Improvements to IFRS (issued in April 2009), have varying application dates commencing with annual periods beginning on or after 1 July 2009. The main effect of these amendments include revised disclosures under IFRS 8. These changes have not been endorsed by the EU and will only become applicable once that endorsement has occurred.

IFRS 9 Financial Instruments has been issued. This standard represents the first phase of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement, and has mandatory application for accounting periods beginning on or after 1 January 2013. In its current form, it requires all financial assets, including assets currently classified under IAS 39 as available-for-sale, to be measured at fair value through profit and loss unless the assets can be classified as held at amortised cost. Qualifying equity investments held at fair value may have their fair value changes taken through other comprehensive income by election. The effect of applying the standard in its current form is not considered to have a material impact on the Group's reported profit or equity. These changes have not been endorsed by the EU and will only become applicable once that endorsement has occurred.

In addition, a number of other interpretations and revisions to existing standards have been issued which will be applicable to the Group financial statements in future years, which will have no material effect on reported profit or equity or on the disclosures in the financial statements.

2 Segmental analyses

As the chief operating decision maker, the Management Board reviews external revenues and adjusted profit from operations to evaluate segment performance and allocate resources. Interest income, interest expense and taxation are centrally managed and accordingly such items are not presented by segment as they are excluded from the measure of segment profitability.

The Management Board reviews current and prior year information of subsidiaries and associates and joint ventures at constant rates of exchange which provides an approximate guide to performance in the current year if exchange rates had not changed from the prior year. The constant rate comparison provided for reporting segment information is based on a retranslation, at prior year exchange rates, of the current year results of the Group's overseas entities. It does not adjust for the normal transactional gains and losses in operations which are generated by exchange rate movements. As a result, the 2009 segmental results are translated using the 2008 average rates of exchange. The 2008 comparative figures are also stated at the 2008 average rates of exchange.

The tables below represent the new regional structure effective from 1 January 2009, as previously disclosed in the Annual Report for the year ended 31 December 2008.

The analyses of revenue for the 12 months to 31 December 2009 and 31 December 2008, based on location of sales, are as follows:

	2009			2008
	Revenue Constant rates £m	**Translation exchange £m**	**Revenue Current rates £m**	Revenue £m
Asia-Pacific	**2,877**	**393**	**3,270**	2,717
Americas	**2,991**	**165**	**3,156**	2,863
Western Europe	**3,523**	**361**	**3,884**	3,218
Eastern Europe	**1,744**	**(116)**	**1,628**	1,594
Africa and Middle East	**2,145**	**125**	**2,270**	1,730
Revenue	**13,280**	**928**	**14,208**	12,122

The analyses of profit from operations and the Group's share of the post-tax results of associates and joint ventures, reconciled to profit before taxation, are as follows:

	2009					2008		
	Adjusted* segment result Constant rates £m	**Translation exchange £m**	**Adjusted* segment result Current rates £m**	**Adjusting items £m**	**Segment result Current rates £m**	Adjusted* segment result £m	Adjusting items £m	Segment result £m
Asia-Pacific	**1,015**	**133**	**1,148**	**(59)**	**1,089**	924	(2)	922
Americas	**1,120**	**66**	**1,186**	**(51)**	**1,135**	1,052	(96)	956
Western Europe	**879**	**115**	**994**	**(188)**	**806**	760	5	765
Eastern Europe	**433**	**(24)**	**409**	**(16)**	**393**	468		468
Africa and Middle East	**659**	**65**	**724**	**(46)**	**678**	513	(52)	461
Profit from operations	**4,106**	**355**	**4,461**	**(360)**	**4,101**	3,717	(145)	3,572
Net finance costs					**(504)**			(391)
Asia-Pacific	**140**	**8**	**148**		**148**	121		121
Americas	**332**	**59**	**391**	**(58)**	**333**	328	13	341
Western Europe						26	13	39
Eastern Europe								
Africa and Middle East	**2**		**2**		**2**	2		2
Share of post-tax results of associates and joint ventures	**474**	**67**	**541**	**(58)**	**483**	477	26	503
Profit before taxation					**4,080**			3,684

*The adjustments to profit from operations and the Group's share of the post-tax results of associates and joint ventures are explained in notes 3(e) to 3(h) and in note 5, respectively.

2 Segmental analyses continued

Adjusted profit from operations at constant rates of £4,106 million (2008: £3,717 million) includes depreciation, amortisation and impairment of intangibles and property, plant and equipment, as follows:

	2009					2008		
	Adjusted* depreciation, amortisation and impairment Constant rates £m	Translation exchange £m	Adjusted* depreciation, amortisation and impairment Current rates £m	Adjusting items £m	Depreciation, amortisation and impairment Current rates £m	Adjusted* depreciation, amortisation and impairment £m	Adjusting items £m	Depreciation, amortisation and impairment £m
Asia-Pacific	97	15	112	21	133	100		100
Americas	98	6	104	18	122	95		95
Western Europe	117	7	124	96	220	102	20	122
Eastern Europe	56	(3)	53	7	60	56		56
Africa and Middle East	50	3	53	23	76	48	9	57
	418	28	446	165	611	401	29	430

*Adjusted depreciation, amortisation and impairment is after taking account of depreciation, amortisation and impairment included within adjusting items as explained in note 3(e) and note 3(g).

Additions to non-current assets other than financial instruments, deferred tax assets and retirement benefit assets are as follows:

	2009		2008	
	Property, plant and equipment	Intangible assets	Property, plant and equipment	Intangible assets
Asia-Pacific	190	299	96	6
Americas	113	29	90	28
Western Europe	61	19	318	1,494
Eastern Europe	73	6	46	7
Africa and Middle East	92	15	130	697
Unallocated assets	20	42	69	34
	549	410	749	2,266

Although information on assets and liabilities is not reported to the Management Board, IFRS 8 requires a measure of total assets for each reportable segment to be reported. This is provided as follows:

	Segment assets		Investments in associates and joint ventures		Assets classified as held-for-sale		Unallocated assets		Total assets	
	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m
Asia-Pacific	3,751	3,252	693	644	1	4			4,445	3,900
Americas	4,411	4,079	1,811	1,890	1	3			6,223	5,972
Western Europe	7,193	8,543			15	201			7,208	8,744
Eastern Europe	2,141	2,109							2,141	2,109
Africa and Middle East	2,860	2,735	17	18	13	17			2,890	2,770
Eliminations	(1,734)	(1,089)							(1,734)	(1,089)
Unallocated assets							5,441	5,145	5,441	5,145
	18,622	19,629	2,521	2,552	30	225	5,441	5,145	26,614	27,551

The 2008 comparatives have been restated for the new regional structure effective from 1 January 2009.

2 Segmental analyses continued

Total assets are reconciled to segment assets as follows:

	2009 £m	2008 £m
Total assets per the Group balance sheet	**26,614**	27,551
Less:		
– investments in associates and joint ventures	**2,521**	2,552
– available-for-sale investments *(note 15)*	**83**	106
– deferred tax assets	**350**	392
– interest receivable *(note 14)*	**1**	9
– income tax receivable	**97**	137
– dividends receivable from associates *(note 14)*	**68**	72
– derivatives in respect of net debt *(note 16)*	**149**	436
– loans	**59**	111
– interest bearing cash and cash equivalents	**2,011**	2,268
– assets classified as held-for-sale	**30**	225
– corporate assets	**2,623**	1,614
Segment assets	**18,622**	19,629

External revenue and non-current assets other than financial instruments, deferred tax assets and retirement benefit assets are analysed between the UK and all foreign countries at current rates of exchange as follows:

	United Kingdom		All foreign countries		Group	
Revenue is based on location of sale	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m
External revenue	**83**	76	**14,125**	12,046	**14,208**	12,122

	United Kingdom		All foreign countries		Group	
Assets	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m
Intangible assets	**65**	76	**12,167**	12,242	**12,232**	12,318
Property, plant and equipment	**130**	131	**2,880**	2,945	**3,010**	3,076
Investments in associates and joint ventures			**2,521**	2,552	**2,521**	2,552
Non-current assets	**195**	207	**17,568**	17,739	**17,763**	17,946

Included in the external revenue from foreign countries is £1,529 million (2008: £1,361 million) attributable to Brazil, being the only subsidiary contributing more than 10 per cent of the Group's external revenue in 2009 and 2008. Included in non-current assets are amounts of £1,805 million (2008: £1,884 million) attributable to the investment in Reynolds American and £682 million (2008: £638 million) attributable to the investments in the Indian associates ITC and VST. Further information can be found in note 11.

3 Profit from operations

(a) Employee benefit costs

	2009 £m	2008 £m
Wages and salaries	**1,880**	1,577
Social security costs	**225**	196
Other pension and retirement benefit costs *(note 12)*	**137**	71
Share-based payments *(note 27)*	**75**	63
	2,317	1,907

(b) Depreciation and amortisation costs

		2009 £m	2008 £m
Intangibles	– amortisation of trademarks *(note 3(g))*	**58**	24
	– amortisation of other intangibles	**67**	56
	– impairment	**53**	
Property, plant and equipment	– depreciation	**379**	345
	– impairment	**54**	5
		611	430

Impairment in respect of intangibles and property, plant and equipment arose in relation to the restructuring costs (see note 3(e)).

(c) Other operating income

This represents income arising from the Group's activities which falls outside the definition of revenue and includes gains on the disposal of businesses and trademarks, property disposals, service fees and other shared costs charged to third parties, manufacturing fees and trademark income.

3 Profit from operations continued

(d) Other operating expenses include:

	2009 £m	2008 £m
Research and development expenses (excluding employee benefit costs and depreciation)	**51**	50
Exchange differences	**17**	(63)
Rent of plant and equipment (operating leases)		
– minimum lease payments	**37**	31
– contingent rents	**2**	1
– sublease payments	**3**	
Rent of property (operating leases)		
– minimum lease payments	**83**	80
– contingent rents	**1**	
– sublease payments	**3**	4
Fees payable for audit services pursuant to legislation:		
– fees payable to PricewaterhouseCoopers LLP for parent company and Group audit	**1.7**	1.6
– fees payable to other PricewaterhouseCoopers firms and associates for local statutory and Group reporting audits	**8.6**	8.5
Audit fees payable to PricewaterhouseCoopers firms and associates	**10.3**	10.1
Audit fees payable to other firms	**0.5**	0.6
Total audit fees payable	**10.8**	10.7
Fees payable to PricewaterhouseCoopers firms and associates for other services:		
– other services pursuant to statutory legislation	**0.2**	0.7
– tax advisory services	**4.3**	3.5
– tax compliance	**1.2**	1.4
– services relating to information technology	**1.2**	0.8
– other non-audit services	**0.9**	0.6
	7.8	7.0

The total fees payable to PricewaterhouseCoopers firms and associates included above are £18.1 million (2008: £17.1 million).

Total research and development costs including employee benefit costs and depreciation were £112.1 million (2008: £105.1 million).

(e) Restructuring and integration costs

Restructuring costs reflect the costs incurred as a result of initiatives to improve the effectiveness and the efficiency of the Group as a globally integrated enterprise. These initiatives include a review of the Group's manufacturing operations, overheads and indirect costs, organisational structure and systems and software used. The costs of these initiatives together with the costs of integrating acquired businesses into existing operations, are included in profit from operations under the following headings:

	2009 £m	2008 £m
Employee benefit costs	**143**	92
Depreciation and amortisation costs	**107**	5
Other operating expenses	**61**	82
Other operating income	**(7)**	(19)
	304	160

3 Profit from operations continued

Restructuring and integration costs in 2009 principally relate to costs in respect of the planned closure of the Soeborg factory in Denmark, the planned downsizing of the manufacturing plant in Australia, the continued integration of ST and Tekel and the merger of Bentoel with existing Indonesian operations, as well as other restructuring initiatives directly related to improving the efficiency and effectiveness of the Group as a globally integrated enterprise. The costs for these other initiatives include redundancies, principally in respect of restructuring activities in the Group's subsidiary in Canada, and impairment charges for certain software assets where the development of global software solutions has resulted in these assets having minimal or limited future economic benefits.

Restructuring costs in 2008 principally relate to costs in respect of the integration of ST and Tekel into existing operations, the reorganisation of the business in the Netherlands, as well as further costs in respect of restructurings announced in 2007 and earlier years.

Other operating income in 2009 includes a gain on disposal of a property related to restructuring announced in prior years and the release of deferred income from a disposal in 2007. In 2008, other operating income includes gains on property disposals and a gain on disposal of a non-core business in the Asia-Pacific region arising from the restructuring exercises.

(f) Canadian settlement

On 31 July 2008, the Group's subsidiary in Canada (Imperial Tobacco Canada) announced that it had reached a resolution with the federal and provincial governments with regard to the investigation related to the export to the United States of Imperial Tobacco Canada tobacco products in the late 1980s and early 1990s. The subsidiary entered a plea of guilty to a regulatory violation of a single count of Section 240(i)(a) of the Excise Act and paid a fine of £102 million which was treated as an adjusting item and included in other operating expenses in profit from operations for the year ended 31 December 2008.

At the same time, Imperial Tobacco Canada also entered into a 15 year civil agreement with the federal and provincial governments. In order, amongst other things, to assist the governments in their future efforts against illicit trade, Imperial Tobacco Canada agreed to pay a percentage of annual net sales revenue each year for 15 years, up to a maximum of Can$350 million, which is expensed as it is incurred. These payments are not treated as adjusting items.

(g) Amortisation of trademarks

The acquisitions of Bentoel, Tekel and ST resulted in the capitalisation of trademarks which are amortised over their expected useful lives, which do not exceed 20 years. The amortisation charge of £58 million is included in depreciation and amortisation costs in the profit from operations for the year ended 31 December 2009 (2008: £24 million).

(h) Gains on disposal of businesses and trademarks

The acquisition of the cigarette and snus businesses of ST (as described in note 26(c)) was subject to regulatory approval which was received on the condition that the Group divest a small number of local trademarks, primarily in Norway. The disposal of the trademarks was dealt with in two packages, with the first package sold and completed in February 2009. In March 2009, contracts were exchanged in respect of the second package with completion in May 2009. The total proceeds from the two packages resulted in a gain of £2 million which is included in other operating income in profit from operations for the year ended 31 December 2009.

The gain on disposal of businesses and trademarks for the year ended 31 December 2008 was £141 million, of which £139 million arose on 2 July 2008 with the disposal of the Group's 32.35 per cent holding in the non-cigarette and snus businesses of ST. The gain was included in other operating income in profit from operations for the year ended 31 December 2008.

4 Net finance costs

	2009		2008	
	£m	£m	£m	£m
Finance costs				
– interest payable	602		535	
– fair value changes	4		521	
– exchange differences	(25)		(398)	
		581		658
Finance income				
– interest and dividend income	(85)		(131)	
– exchange differences	8		(136)	
		(77)		(267)
Net finance costs		504		391
Net finance costs comprise:				
Interest payable				
– bank borrowings	80		83	
– finance leases	2		4	
– facility fees	4		4	
– other	516		444	
		602		535
Interest receivable	(83)		(129)	
Dividend income	(2)		(2)	
		(85)		(131)
Fair value changes				
– cash flow hedges transferred from equity	86		(201)	
– fair value changes on hedged items	(7)		168	
– fair value hedges	(65)		(22)	
– ineffective portion of fair value hedges	(13)		(2)	
– instruments not designated as hedges	3		578	
	4		521	
Exchange differences	(17)		(534)	
		(13)		(13)
		504		391

Other interest payable includes interest on the bonds and notes detailed in note 21. Facility fees relate principally to the Group's central banking facility of £1.75 billion, as well as the Group's €700 million term loan facility entered into in July 2009 (2008: facilities to fund the Tekel acquisition).

Included within interest receivable is £3 million (2008: £1 million) in respect of available-for-sale investments. Included within dividend income is £2 million (2008: £1 million) in respect of available-for-sale investments.

Included within exchange differences is a loss of £25 million (2008: £133 million gain) in respect of items subject to fair value hedges.

IFRS requires fair value changes for derivatives, which do not meet the tests for hedge accounting under IAS 39, to be included in the income statement. In addition, certain exchange differences are required to be included in the income statement under IFRS and, as they are subject to exchange rate movements in a period, they can be a volatile element of net finance costs. These amounts do not always reflect an economic gain or loss for the Group and, accordingly, the Group has decided that, in calculating adjusted diluted earnings per share, it is appropriate to exclude certain amounts.

The adjusted diluted earnings per share for the year ended 31 December 2008 (note 7) excludes, in line with previous practice, an £11 million loss relating to exchange losses in net finance costs where there is a compensating exchange gain reflected in differences in exchange taken directly to other comprehensive income. There are no similar gains or losses in the year ended 31 December 2009.

Although the Group has adopted IAS 23 Revised (Borrowing Costs) effective from 1 January 2009, the standard does not have a material impact on the Group in 2009.

NOTES ON THE ACCOUNTS CONTINUED

5 Associates and joint ventures

	2009		2008	
	Total £m	**Group's share £m**	Total £m	Group's share £m
Gross turnover (including duty, excise and other taxes)	**11,506**	**4,477**	11,279	4,205
Duty, excise and other taxes	**(3,687)**	**(1,431)**	(2,935)	(1,045)
Revenue	**7,819**	**3,046**	8,344	3,160
Profit from operations	**2,183**	**843**	2,201	850
Net finance costs	**(159)**	**(66)**	(140)	(58)
Profit on ordinary activities before taxation	**2,024**	**777**	2,061	792
Taxation on ordinary activities	**(759)**	**(291)**	(736)	(284)
Profit on ordinary activities after taxation	**1,265**	**486**	1,325	508
after (charging)/crediting				
– trademark impairments	**(154)**	**(65)**	(46)	(20)
– additional ST income			42	13
– termination of joint venture			107	45
– health plan credit	**38**	**16**		
– restructuring costs	**(22)**	**(9)**	(29)	(12)
Attributable to:				
British American Tobacco's shareholders		**483**		503
Minority interests		**3**		5
		486		508
Dividends				
– listed investments		**(328)**		(278)
– unlisted investments		**(3)**		(48)
		(331)		(326)

The share of post-tax results of associates and joint ventures is after trademark impairments, additional ST income, the gain on termination of a joint venture, a health plan credit and restructuring costs. These items have been treated as adjusting items and excluded from the calculation of adjusted earnings per share as set out in note 7.

In the year ended 31 December 2009, Reynolds American recognised a trademark impairment charge of US$394 million, triggered by the increase in federal excise taxes on tobacco products and changes in pricing. It also has an amortisation charge of US$5 million in respect of brands. The Group's share of this charge amounted to £65 million (net of tax).

During 2009, Reynolds American reviewed its post-retirement medical plans, resulting in a past service credit which is amortised under US GAAP, but under IFRS is required to be recognised in the income statement in 2009. The Group's share of this credit amounts to £16 million (net of tax).

Reynolds American also recognised a charge of US$56 million in 2009 in connection with severance and related costs of around 400 employees in order to better align staffing levels with business requirements and enable Reynolds American's manufacturing operations to phase in new productivity programmes. The Group's share of this charge amounted to £9 million (net of tax).

In the year ended 31 December 2008, Reynolds American modified the previously anticipated level of support between certain trademarks and the projected net sales of certain trademarks, resulting in a trademark impairment charge of which the Group's share amounted to £20 million (net of tax).

5 Associates and joint ventures continued

On 21 February 2008, Reynolds American announced that it would receive a payment from Gallaher Limited resulting from the termination of a joint venture agreement. While the payment will be received over a number of years, in the year ended 31 December 2008, Reynolds American recognised a pre-tax gain of US$328 million. The Group's share of this gain amounts to £45 million (net of tax).

On 9 September 2008, Reynolds American further announced planned changes in the organisational structure at Reynolds American Inc. and its largest subsidiary, R.J. Reynolds Tobacco Company. The charge for the year ended 31 December 2008 amounted to US$90 million. The Group's share of this charge included in the results for the year ended 31 December 2008 amounted to £12 million (net of tax).

The year end of ST, an associate of the Group until 2 July 2008, was 30 June, and, for practical reasons, the Group had previously equity accounted for its interest based on the information available from ST which was three months in arrears to that of the Group. The Group acquired 100 per cent of ST's cigarette and snus businesses on 2 July 2008. In order to account for the Group's share of the net assets of ST at the date of the acquisition, the results of ST for the period up to 2 July 2008 were included in the results from associates for 2008, resulting in one additional quarter's income in 2008. This contributed an additional £13 million to the share of post-tax results of associates and joint ventures.

6 Taxation on ordinary activities

(a) Summary of tax on ordinary activities

	2009 £m	2008 £m
UK corporation tax	**16**	
comprising		
– current year tax expense	**594**	1,103
– adjustments in respect of prior periods	**16**	
– double taxation relief	**(594)**	(1,103)
Overseas tax	**1,147**	945
comprising		
– current year tax expense	**1,104**	959
– adjustments in respect of prior periods	**43**	(14)
Total current tax	**1,163**	945
Deferred tax	**(39)**	80
comprising		
– deferred tax relating to origination and reversal of temporary differences	**(42)**	77
– deferred tax relating to changes in tax rates	**3**	3
	1,124	1,025

(b) Franked Investment Income Group Litigation Order

British American Tobacco is the principal test claimant in an action in the United Kingdom against HM Revenue and Customs in the Franked Investment Income Group Litigation Order (FII GLO). There are 27 corporate groups in the FII GLO. The case concerns the treatment for UK corporate tax purposes of profits earned overseas and distributed to the UK. The claim was filed in 2003 and the case was heard in the European Court of Justice (ECJ) in 2005 and a decision of the ECJ received in December 2006. In July 2008, the case reverted to a trial in the UK High Court for the UK Court to determine how the principles of the ECJ decision should be applied in a UK context.

The High Court judgment in November 2008 concluded, amongst many other things, that dividends received from EU subsidiaries should be, and should have been, exempt from UK taxation. It also concluded that certain dividends received before 5 April 1999 from the EU and, in some limited circumstances after 1993 from outside the EU, should have been treated as franked investment income with the consequence that advance corporation tax need not have been paid. Claims for the repayment of UK tax incurred where the dividends were from the EU can be made back to 1973. The tentative conclusion reached by the High Court would, if upheld, produce an estimated receivable of about £1.2 billion for British American Tobacco.

6 Taxation on ordinary activities continued

The case was heard by the Court of Appeal in October 2009 and the judgment handed down on 23 February 2010. The Court of Appeal has determined that various questions should be referred back to the European Court of Justice for further clarification. In addition, the Court determined that the claim should be restricted to six years and not cover claims dating back to 1973. This time restriction would, if upheld, reduce the value of the claim to between zero and £10 million. Based on advice received, the Company believes it has realistic prospects of success on further appeal and the Company has resolved to seek permission to appeal accordingly.

No potential receipt has been recognised in prior years, nor in the current year, in the results of the Group due to the uncertainty of the amounts and eventual outcome.

(c) Factors affecting the tax charge

The taxation charge differs from the standard 28 per cent rate of corporation tax in the UK. The major causes of this difference are listed below:

	2009		2008	
	£m	%	£m	%
Profit before tax	4,080		3,684	
Less: share of associates post-tax profit	(483)		(503)	
	3,597		3,181	
Tax at 28% on the above	1,007	28.0	891	28.0
Factors affecting the tax rate:				
Tax at standard rates other than UK corporation tax rate	(47)	(1.3)	(74)	(2.3)
Other national tax charges	26	0.7	15	0.5
State and local taxes	52	1.4	48	1.5
Permanent differences	(22)	(0.6)	(35)	(1.1)
Overseas withholding taxes	91	2.5	79	2.5
Double taxation relief on UK profits	(10)	(0.3)	(11)	(0.3)
Unutilised tax losses	15	0.4	42	1.3
Adjustments in respect of previous periods	59	1.6	(14)	(0.4)
Deferred tax (credits)/charges at other tax rates	(50)	(1.4)	81	2.5
Deferred tax attributable to a (decrease)/increase in the rate of domestic income tax	3	0.1	3	0.1
	1,124	31.1	1,025	32.3

The tax charge for 2009 includes a one-off tax charge of £24 million following an adverse decision by the Federal Court of Australia in December 2009. This was in respect of a tax case pursued by the Australian Tax Office concerning the utilisation of capital losses. The judgment has been appealed.

The tax charge for 2008 includes a one-off deferred tax charge of £26 million as a result of the acquisition of the cigarette assets of Tekel. This has been excluded from the adjusted earnings per share calculation as set out in note 7.

(d) Tax on items recognised directly in other comprehensive income

	2009 £m	2008 £m
Current tax	(43)	28
Deferred tax	(28)	156
(Charged)/credited to other comprehensive income	(71)	184

The tax relating to each component of other comprehensive income is disclosed in note 20.

7 Earnings per share

Basic earnings per share are based on profit for the year attributable to ordinary shareholders of £2,713 million (2008: £2,457 million) and 1,980 million (2008: 1,993 million) ordinary shares of 25p each, being the weighted average number of shares in issue during the year (excluding shares held as treasury shares).

For the calculation of diluted earnings per share, the weighted average number of shares in issue is increased to 1,991 million (2008: 2,005 million) to reflect the potential dilutive effect of employee share schemes.

	2009			2008		
	Earnings £m	**Weighted average number of shares m**	**Earnings per share pence**	Earnings £m	Weighted average number of shares m	Earnings per share pence
Basic earnings per share	**2,713**	**1,980**	**137.0**	2,457	1,993	123.3
Share options		**11**	**(0.7)**		12	(0.8)
Diluted earnings per share	**2,713**	**1,991**	**136.3**	2,457	2,005	122.5

Earnings have been affected by a number of adjusting items, which are described in notes 3, 4, 5 and 6. To illustrate the impact of these items, an adjusted earnings per share is shown below.

Adjusted earnings per share calculation

		Diluted				Basic			
		2009		2008		**2009**		2008	
	Notes	**Earnings £m**	**Earnings per share pence**	Earnings £m	Earnings per share pence	**Earnings £m**	**Earnings per share pence**	Earnings £m	Earnings per share pence
Unadjusted earnings per share		**2,713**	**136.3**	2,457	122.5	**2,713**	**137.0**	2,457	123.3
Effect of restructuring and integration costs	3e	**304**	**15.3**	160	8.0	**304**	**15.4**	160	8.1
Tax and minority interests on restructuring and integration costs		**(71)**	**(3.6)**	(38)	(1.9)	**(71)**	**(3.6)**	(38)	(1.9)
Effect of Canadian settlement	3f			102	5.1			102	5.1
Amortisation of trademarks	3g	**58**	**2.9**	24	1.2	**58**	**2.9**	24	1.2
Tax on amortisation of trademarks		**(15)**	**(0.8)**	(6)	(0.3)	**(15)**	**(0.8)**	(6)	(0.3)
Effect of disposal of businesses and trademarks	3h	**(2)**	**(0.1)**	(141)	(7.0)	**(2)**	**(0.1)**	(141)	(7.1)
Tax relating to disposal of businesses and trademarks		**1**	**0.1**	13	0.6	**1**	**0.1**	13	0.7
Net finance cost adjustment	4			11	0.5			11	0.6
Effect of associates' trademark impairments, restructuring costs, termination of joint venture and health plan credit	5	**58**	**2.9**	(13)	(0.6)	**58**	**2.9**	(13)	(0.7)
Effect of additional ST income	5			(13)	(0.6)			(13)	(0.7)
Effect of deferred tax adjustment	6c			26	1.3			26	1.3
Adjusted earnings per share		**3,046**	**153.0**	2,582	128.8	**3,046**	**153.8**	2,582	129.6

NOTES ON THE ACCOUNTS CONTINUED

7 Earnings per share continued

Headline earnings per share as required by the JSE Limited

The presentation of headline earnings per share, as an alternative measure of earnings per share, is mandated under the JSE Listing Requirements. It is calculated in accordance with Circular 8/2007 'Headline Earnings', as issued by the South African Institute of Chartered Accountants. Headline earnings per share are calculated as shown below:

	Diluted				Basic			
	2009		2008		**2009**		2008	
	Earnings £m	**Earnings per share pence**	Earnings £m	Earnings per share pence	**Earnings £m**	**Earnings per share pence**	Earnings £m	Earnings per share pence
Unadjusted earnings per share	**2,713**	**136.3**	2,457	122.5	**2,713**	**137.0**	2,457	123.3
Effect of impairment of intangibles and property, plant and equipment	**107**	**5.4**	5	0.2	**107**	**5.5**	5	0.3
Tax and minority interests on impairment of intangibles and property, plant and equipment	**(21)**	**(1.1)**			**(21)**	**(1.1)**		
Effect of gains on disposal of property, plant and equipment	**(4)**	**(0.2)**	(11)	(0.5)	**(4)**	**(0.2)**	(11)	(0.6)
Tax and minority interests on gains on disposal of property, plant and equipment			2	0.1			2	0.1
Effect of disposal of businesses and trademarks	**(5)**	**(0.3)**	(149)	(7.4)	**(5)**	**(0.3)**	(149)	(7.5)
Tax and minority interests on disposal of businesses and trademarks	**1**	**0.1**	15	0.7	**1**	**0.1**	15	0.8
Effect of gains reclassified from the available-for-sale reserve	**(3)**	**(0.2)**	(6)	(0.3)	**(3)**	**(0.2)**	(6)	(0.3)
Share of associates' trademark impairments and termination of joint venture	**107**	**5.4**	(42)	(2.0)	**107**	**5.4**	(42)	(2.1)
Tax and minority interests on share of associates' trademark impairments and termination of joint venture	**(42)**	**(2.1)**	17	0.8	**(42)**	**(2.1)**	17	0.8
Headline earnings per share	**2,853**	**143.3**	2,288	114.1	**2,853**	**144.1**	2,288	114.8

8 Dividends and other appropriations

	2009		2008	
	Pence per share	**£m**	Pence per share	£m
Ordinary shares				
Interim				
2009 paid 29 September 2009	**27.9**	**557**		
2008 paid 17 September 2008			22.1	440
Final				
2008 paid 6 May 2009	**61.6**	**1,241**		
2007 paid 7 May 2008			47.6	953
	89.5	**1,798**	69.7	1,393

The Directors have recommended to shareholders a final dividend of 71.6 pence per share for the year ended 31 December 2009. If approved, this dividend will be paid to shareholders on 6 May 2010. This dividend is subject to approval by shareholders at the Annual General Meeting and therefore, in accordance with IAS 10, it has not been included as a liability in these Group financial statements. The total estimated dividend to be paid is £1,418 million which takes the total dividends declared in respect of 2009 to £1,975 million (2008: £1,661 million) representing 99.5 pence per share (2008: 83.7 pence per share).

9 Intangible assets

	Goodwill £m	Computer software £m	Trademarks and licences £m	Assets in the course of development £m	Total £m
1 January 2009					
Cost	**11,391**	**388**	**758**	**85**	**12,622**
Accumulated amortisation		**(251)**	**(53)**		**(304)**
Net book value at 1 January 2009	**11,391**	**137**	**705**	**85**	**12,318**
Differences on exchange	**(260)**	**(11)**	**(49)**	**6**	**(314)**
Additions					
– internal development		**30**		**10**	**40**
– acquisitions of subsidiaries and minority interests	**200**	**1**	**95**		**296**
– separately acquired		**24**	**7**	**43**	**74**
Reallocations		**81**		**(81)**	
Amortisation charge		**(65)**	**(61)**		**(126)**
Impairment		**(54)**			**(54)**
Disposals		**(2)**			**(2)**
31 December 2009					
Cost	**11,331**	**502**	**806**	**63**	**12,702**
Accumulated amortisation		**(361)**	**(109)**		**(470)**
Net book value at 31 December 2009	**11,331**	**141**	**697**	**63**	**12,232**
1 January 2008					
Cost	7,942	305	29	48	8,324
Accumulated amortisation		(201)	(18)		(219)
Net book value at 1 January 2008	7,942	104	11	48	8,105
Differences on exchange	1,895	23	118	4	2,040
Additions					
– internal development		5		28	33
– acquisitions of subsidiaries and minority interests	1,553		606	1	2,160
– separately acquired	1	22	2	48	73
Reallocations		44		(44)	
Amortisation charge		(59)	(32)		(91)
Disposals		(2)			(2)
31 December 2008					
Cost	11,391	388	758	85	12,622
Accumulated amortisation		(251)	(53)		(304)
Net book value at 31 December 2008	11,391	137	705	85	12,318

Included in computer software and assets in the course of development are internally developed assets with a carrying value of £138 million (2008: £137 million). The costs of internally developed assets include capitalised expenses of third party consultants as well as software licence fees from third party suppliers.

Acquisitions of subsidiaries and minority interests in 2009 relate to the acquisition of Bentoel as explained in note 26. In 2008, the principal acquisitions were in respect of the Tekel cigarette assets and the cigarette and snus businesses of ST as explained in note 26, as well as a number of smaller acquisitions of minority interests in Group companies in Africa and Middle East and Europe.

The 2009 impairment charges are explained in note 3(e).

9 Intangible assets continued

Impairment testing for intangible assets with indefinite lives including goodwill

Goodwill of £11,331 million (2008: £11,391 million) included in intangible assets in the balance sheet is mainly the result of the following acquisitions: Rothmans Group £4,833 million (2008: £4,974 million); Imperial Tobacco Canada £2,370 million (2008: £2,261 million); ETI (Italy) £1,463 million (2008: £1,591 million); ST (principally Scandinavia) £1,103 million (2008: £1,200 million); Tekel (Turkey) £579 million (2008: £619 million) as well as £205 million relating to the Bentoel (Indonesia) acquisition in 2009. The principal allocations of goodwill in the Rothmans' acquisition are to the cash-generating units of Eastern and Western Europe, and South Africa (2008: Europe and South Africa), with the remainder mainly relating to operations in the domestic and export market in the United Kingdom and operations in Asia-Pacific.

As a consequence of the Group's new regional structure effective 1 January 2009, goodwill allocated to the Europe cash-generating unit (2008: £2,293 million) has been apportioned between the new cash-generating units of Western Europe and Eastern Europe. The goodwill on the ST transaction has been allocated between the cash-generating units of ST and Western Europe.

In 2009, goodwill has been allocated for impairment testing purposes to 16 individual cash-generating units – four in Western Europe, one in Eastern Europe, two in Africa and Middle East, five in Asia-Pacific and four in the Americas. In 2008, goodwill was allocated for impairment testing purposes to 15 individual cash-generating units – five in Europe, two in Africa and Middle East, three in Asia-Pacific, three in Latin America and two in America-Pacific.

In 2009, the carrying amounts of goodwill allocated to the cash-generating units of Canada £2,370 million, Italy £1,471 million, Western Europe (includes Rothmans and other acquisitions) £1,208 million, Eastern Europe (includes Rothmans and other acquisitions) £1,062 million, ST (principally Scandinavia) £991 million, South Africa £932 million, Australia (includes Rothmans and other acquisitions) £746 million, Turkey £579 million, Singapore £471 million and Malaysia £426 million are considered significant in comparison with the total carrying amount of goodwill.

In 2008, the carrying amounts of goodwill allocated to the cash-generating units of Europe (includes Rothmans and other acquisitions) £2,293 million, Canada £2,261 million, Italy £1,600 million, South Africa £833 million, Australia (includes Rothmans and other acquisitions) £650 million, Singapore £516 million, Malaysia £474 million and in respect of the acquisitions made during 2008, ST (principally Scandinavia) £1,200 million and Turkey £619 million are considered significant in comparison with the total carrying amount of goodwill.

The recoverable amount of all cash-generating units has been determined on a value-in-use basis. The key assumptions for the recoverable amount of all units are the long-term growth rate and the discount rate. The long-term growth rate used is purely for the impairment testing of goodwill under IAS 36 (Impairment of Assets) and does not reflect long-term planning assumptions used by the Group for investment proposals or for any other assessments. The discount rate is based on the Group's weighted average cost of capital, taking into account the cost of capital and borrowings, to which specific market-related premium adjustments are made. These assumptions have been applied to the individual cash flows of each unit as compiled by local management in the different markets.

The valuation uses cash flows based on detailed financial budgets prepared by management covering a one year (2008: two year) period, with growth in year 2 of 6 per cent. Cash flows for the years 3 to 10 are extrapolated from year 2 cash flows at 5 per cent per annum (2008: 3 per cent), including 2 per cent inflation, whereafter a total growth rate of 2 per cent per annum (2008: zero per cent) has been assumed.

The amendments to the approach in 2009 reflect changes in the Group's management reporting processes and greater consistency between the basis for the projected cash flows and the related discount rates.

The extrapolated growth rates are considered conservative given the Group's history of growth, its well balanced portfolio of brands and the industry in which it operates. The long-term real growth does not exceed the expected long-term average growth rate for the combined markets in which the cash-generating units operate. In some instances, such as recent acquisitions or start-up ventures, the valuation is expanded to reflect the medium-term plan of management, spanning five years or beyond, with the cash flow beyond these years to year 10, extrapolated by growth of 5 per cent, as above.

Pre-tax discount rates of between 7.9 per cent and 18.7 per cent (2008: 7.9 per cent to 18.7 per cent) were used, based on the Group's weighted average cost of capital, together with any premium applicable for economic and political risks.

The pre-tax discount rates used for the cash-generating units which are significant in comparison with the total carrying amount of goodwill are 9.7 per cent for Canada (2008: 9.7 per cent), 11.4 per cent for Italy (2008: 9.8 per cent), 9.3 per cent for Western Europe, 10.6 per cent for Eastern Europe (2008: combined Europe 9.3 per cent), 8.7 per cent for ST (principally Scandinavia) (2008: 8.7 per cent), 11.5 per cent for South Africa (2008: 11.5 per cent), 9.3 per cent for Australia (2008: 9.3 per cent), 13.1 per cent for Turkey (2008: 13.1 per cent), 7.9 per cent for Singapore (2008: 7.9 per cent) and 10.0 per cent for Malaysia (2008: 10.1 per cent).

No goodwill impairment charges were recognised in 2009 or 2008. If discounted cash flows per cash-generating unit should fall by 10 per cent, or the discount rate was increased at an after tax rate of 1 per cent, there would be no impairment.

10 Property, plant and equipment

	Freehold property £m	Leasehold property £m	Plant and equipment £m	Assets in the course of construction £m	Total £m
1 January 2009					
Cost	**1,014**	**257**	**4,565**	**316**	**6,152**
Accumulated depreciation and impairment	**(351)**	**(95)**	**(2,630)**		**(3,076)**
Net book value at 1 January 2009	**663**	**162**	**1,935**	**316**	**3,076**
Differences on exchange	**(17)**	**(12)**	**(107)**	**(11)**	**(147)**
Additions					
– separately acquired	**23**	**4**	**139**	**305**	**471**
– acquisitions of subsidiaries	**20**		**47**	**11**	**78**
Reallocations	**33**		**247**	**(280)**	
Depreciation	**(26)**	**(11)**	**(351)**		**(388)**
Impairment	**(16)**		**(36)**		**(52)**
Disposals			**(21)**	**(5)**	**(26)**
Net reclassifications as held-for-sale		**(1)**	**(1)**		**(2)**
31 December 2009					
Cost	**1,101**	**237**	**4,466**	**336**	**6,140**
Accumulated depreciation and impairment	**(421)**	**(95)**	**(2,614)**		**(3,130)**
Net book value at 31 December 2009	**680**	**142**	**1,852**	**336**	**3,010**
1 January 2008					
Cost	810	212	3,573	239	4,834
Accumulated depreciation and impairment	(298)	(71)	(2,087)		(2,456)
Net book value at 1 January 2008	512	141	1,486	239	2,378
Differences on exchange	76	27	291	27	421
Additions					
– separately acquired	13	3	231	267	514
– acquisitions of subsidiaries	102		125	8	235
Reallocations	31	3	191	(225)	
Depreciation	(28)	(11)	(352)		(391)
Impairment	(4)		(6)		(10)
Disposals	(20)	(1)	(29)		(50)
Reclassifications as held-for-sale	(19)		(2)		(21)
31 December 2008					
Cost	1,014	257	4,565	316	6,152
Accumulated depreciation and impairment	(351)	(95)	(2,630)		(3,076)
Net book value at 31 December 2008	663	162	1,935	316	3,076
Assets held under finance leases					
31 December 2009					
Cost		**3**	**117**		**120**
Accumulated depreciation and impairment		**(2)**	**(87)**		**(89)**
Net book value at 31 December 2009		**1**	**30**		**31**
31 December 2008					
Cost		4	170		174
Accumulated depreciation and impairment		(2)	(100)		(102)
Net book value at 31 December 2008		2	70		72

10 Property, plant and equipment continued

The Group's finance lease arrangements relate principally to the lease of vending machines by the Group's Japanese subsidiary. Assets held under finance leases are secured under finance lease obligations included in note 21.

	2009 £m	2008 £m
Cost of freehold land within freehold property on which no depreciation is provided	**92**	91
Leasehold property comprises		
– net book value of long leasehold	**102**	120
– net book value of short leasehold	**40**	42
	142	162
Contracts placed for future expenditure	**11**	36

Bank borrowings are secured by property, plant and equipment to the value of £14 million (2008: £14 million).

11 Investments in associates and joint ventures

	2009 £m	2008 £m
1 January	**2,552**	2,316
Differences on exchange	**(258)**	724
Share of profit after taxation *(note 5)*	**483**	503
Dividends *(note 5)*	**(331)**	(326)
Share buy-backs		(62)
Actuarial gains/(losses) relating to pensions and other post-retirement benefits	**61**	(396)
Disposals		(214)
Other equity movements	**14**	7
31 December	**2,521**	2,552
Non-current assets	**3,984**	4,534
Current assets	**1,884**	2,066
Non-current liabilities	**(1,980)**	(2,667)
Current liabilities	**(1,367)**	(1,381)
	2,521	2,552
Reynolds American Inc. (Group's share of market value £4,019 million (2008: £3,435 million))	**1,805**	1,884
Other listed associates (Group's share of market value £4,071 million (2008: £2,968 million))	**682**	638
Unlisted	**34**	30
	2,521	2,552

The Group's share of non-current assets above includes £1,463 million (2008: £1,643 million) of goodwill and £485 million (2008: £641 million) of trademarks arising from the Reynolds American transaction in 2004. In addition, the non-current assets above includes £653 million (2008: £733 million) of goodwill and £302 million (2008: £361 million) of trademarks arising from the acquisition of Conwood by Reynolds American in 2006.

Details of the Group's contingent liabilities are set out in note 30. In addition to US litigation involving Group companies, which is covered by the R.J. Reynolds Tobacco Company (RJRT) indemnity referred to in note 30, Reynolds American Inc. (RAI) group companies are named in litigation which does not involve Group companies. While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, it is not impossible that the results of operations or cash flows of RAI, in particular quarterly or annual periods, could be materially affected by this and by the final outcome of any particular litigation. However, having regard to the contingent liability disclosures on litigation made by RAI in its public financial reports, the Directors are satisfied with the carrying value included above for RAI.

11 Investments in associates and joint ventures continued

The Group's share of the RAI results for the year to 31 December 2009 includes £33 million (2008: £22 million) in respect of external legal fees and other external product liability defence costs.

As explained in note 26(c), the Group acquired 100 per cent of ST's cigarette and snus businesses on 2 July 2008. The transaction was accounted for as an acquisition of 67.65 per cent of the cigarette and snus businesses net assets of ST and a disposal of the Group's existing 32.35 per cent interest in the non-cigarette and snus businesses of ST reflected in the above table.

Additional information on associates as well as principal subsidiary undertakings is provided in the Principal subsidiary undertakings and Principal associate undertakings sections to the Annual Report.

12 Retirement benefit schemes

The Group's subsidiary undertakings operate around 160 retirement benefit arrangements worldwide. These arrangements have been developed in accordance with local practices in the countries concerned. The majority of scheme members belong to defined benefit schemes, most of which are funded externally, although the Group also operates a number of defined contribution schemes.

The liabilities arising in the defined benefit schemes are determined in accordance with the advice of independent, professionally qualified actuaries, using the projected unit credit method. All schemes are formally valued at least every three years.

The principal pension schemes are in the UK, Germany, Canada, the Netherlands and Switzerland. Together these schemes account for over 85 per cent of the total obligations of the Group's defined benefit schemes.

In addition, the Group operates significant schemes in Canada which provide employees with certain other retirement benefits such as healthcare. The liabilities in respect of these benefits are also assessed by qualified independent actuaries, applying the projected unit credit method.

The amounts recognised in the balance sheet are determined as follows:

	Pension schemes		Healthcare schemes		Total	
	2009 £m	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Present value of funded scheme liabilities	**(5,222)**	(4,623)	**(28)**	(24)	**(5,250)**	(4,647)
Fair value of funded scheme assets	**4,618**	4,169	**16**	13	**4,634**	4,182
	(604)	(454)	**(12)**	(11)	**(616)**	(465)
Minimum funding requirement obligations	**(75)**				**(75)**	
Unrecognised funded scheme surpluses	**(52)**	(61)			**(52)**	(61)
	(731)	(515)	**(12)**	(11)	**(743)**	(526)
Present value of unfunded scheme liabilities	**(148)**	(129)	**(134)**	(119)	**(282)**	(248)
Unrecognised past service cost	**1**	1			**1**	1
	(878)	(643)	**(146)**	(130)	**(1,024)**	(773)
The above net liability is recognised in the balance sheet as follows						
– retirement benefit scheme liabilities	**(983)**	(718)	**(146)**	(130)	**(1,129)**	(848)
– retirement benefit scheme assets	**105**	75			**105**	75
	(878)	(643)	**(146)**	(130)	**(1,024)**	(773)

The total accumulated net actuarial losses taken through other comprehensive income at 31 December 2009 were £886 million (2008: £591 million) for subsidiaries, and £296 million (2008: £357 million) net of tax for associates and joint ventures.

In Jamaica, the pension scheme holds shares in Carreras Group Ltd (a Group subsidiary) with a fair value of £3 million (2008: £4 million). In 2008, a pension scheme in Switzerland owned a property with a fair value of £19 million part of which is occupied by British American Tobacco Switzerland SA.

12 Retirement benefit schemes continued

The amounts recognised in the income statement are as follows:

	Pension schemes		Healthcare schemes		Total	
	2009 £m	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Defined benefit schemes						
– current service cost	**65**	67	**3**	1	**68**	68
– interest cost	**271**	251	**9**	8	**280**	259
– expected return on scheme assets	**(259)**	(292)	**(1)**	(1)	**(260)**	(293)
– past service cost	**17**	12			**17**	12
– settlements and curtailments	**4**		**1**		**5**	
	98	38	**12**	8	**110**	46
Defined contribution schemes	**27**	25			**27**	25
Total amount recognised in the income statement *(note 3(a))*	**125**	63	**12**	8	**137**	71

The above charges are recognised within employee benefit costs in 2009 and 2008 in note 3(a) and include £11 million in 2009 (2008: £2 million) in respect of pension costs reported as part of the restructuring costs charged in arriving at profit from operations (see note 3(e)).

The movements in scheme liabilities are as follows:

	Pension schemes		Healthcare schemes		Total	
	2009 £m	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Present value at 1 January	**4,752**	4,359	**143**	138	**4,895**	4,497
Exchange differences	**(86)**	607	**6**	17	**(80)**	624
Current service cost	**68**	75	**3**	1	**71**	76
Interest cost	**277**	273	**10**	8	**287**	281
Past service costs – vested	**16**	14			**16**	14
Contributions by scheme members	**3**	4			**3**	4
Benefits paid	**(313)**	(302)	**(8)**	(10)	**(321)**	(312)
Settlements and curtailments	**(1)**	(1)	**1**			(1)
Acquisition of subsidiaries	**12**	25			**12**	25
Scheme changes	**(4)**	(3)			**(4)**	(3)
Actuarial losses/(gains)	**646**	(299)	**7**	(11)	**653**	(310)
Present value at 31 December	**5,370**	4,752	**162**	143	**5,532**	4,895
Funded schemes	**5,222**	4,623	**28**	24	**5,250**	4,647
Unfunded schemes	**148**	129	**134**	119	**282**	248
	5,370	4,752	**162**	143	**5,532**	4,895

The actuarial losses and gains in both years principally relate to changes in assumptions regarding discount rates and inflation rates.

12 Retirement benefit schemes continued

The movements in funded scheme assets are as follows:

	Pension schemes		Healthcare schemes		Total	
	2009 £m	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Fair value of scheme assets at 1 January	**4,169**	4,209	**13**	14	**4,182**	4,223
Exchange differences	**(94)**	615	**2**	(1)	**(92)**	614
Expected return on scheme assets	**264**	321	**1**	1	**265**	322
Company contributions	**214**	145	**6**	6	**220**	151
Contributions by scheme members	**6**	5			**6**	5
Benefits paid	**(298)**	(290)	**(7)**	(7)	**(305)**	(297)
Acquisition of subsidiaries		23				23
Scheme changes		(2)				(2)
Actuarial gains/(losses)	**357**	(857)	**1**		**358**	(857)
Fair value of scheme assets at 31 December	**4,618**	4,169	**16**	13	**4,634**	4,182

The actuarial gains and losses in both years principally relate to movements in the market value of scheme assets.

Contributions to defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes, taking into account regulatory requirements. Contributions in 2010 are expected to be £198 million for pension schemes and £9 million for healthcare schemes, compared to £214 million and £6 million respectively in 2009.

	Pension schemes		Healthcare schemes		Total	
	2009 £m	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Actual return on scheme assets	**621**	(536)	**2**	1	**623**	(535)

The movements in the unrecognised funded scheme surpluses are as follows:

	Pension schemes		Healthcare schemes		Total	
	2009 £m	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Unrecognised funded scheme surpluses at 1 January	**(61)**	(50)			**(61)**	(50)
Exchange differences	**10**	(11)			**10**	(11)
Movement in year	**(1)**				**(1)**	
Unrecognised funded scheme surpluses at 31 December	**(52)**	(61)			**(52)**	(61)

During the year, £75 million (2008: £nil) was recognised in respect of minimum funding obligations in relation to pension schemes in Canada.

Movements in unrecognised scheme surpluses and minimum funding obligations are recognised in other comprehensive income.

12 Retirement benefit schemes continued

The principal actuarial assumptions (weighted to reflect individual scheme differences) used in the following principal countries are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2009					
Rate of increase in salaries	**5.0**	**2.5**	**4.0**	**3.1**	**1.6**
Rate of increase in pensions in payment	**3.5**	**1.5**	**Nil**	**1.9**	**Nil**
Rate of increase in deferred pensions	**3.5**	**Nil**	**Nil**	**1.9**	
Discount rate	**5.7**	**5.3**	**5.4**	**5.2**	**3.5**
General inflation	**3.5**	**1.5**	**3.0**	**1.9**	**1.0**

For healthcare inflation in Canada, the assumption is 10 per cent reducing to 5 per cent by 2018.

For the remaining pension schemes, typical assumptions are that real salary increases will be from 0 per cent to 5 per cent per annum and discount rates will be from 1 per cent to 7 per cent above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2008					
Rate of increase in salaries	4.4	3.0	4.0	3.0	1.6
Rate of increase in pensions in payment	2.9	2.0	Nil	1.9	Nil
Rate of increase in deferred pensions	2.9	Nil	Nil	1.9	
Discount rate	6.0	6.0	5.8	5.9	3.3
General inflation	2.9	2.0	3.0	1.9	1.0

For healthcare inflation in Canada, the assumption is 10 per cent reducing to 5 per cent by 2018.

For the remaining pension schemes, typical assumptions are that real salary increases will be from 0 per cent to 4 per cent per annum and discount rates will be from 1 per cent to 5 per cent above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

Discount rates are determined by reference to normal yields on high quality corporate bonds at the balance sheet date. For countries where there is not a deep market in such corporate bonds, the yield on government bonds is used.

Mortality assumptions are subject to regular review. In the UK, Canada, Germany, Switzerland and the Netherlands the same tables were used for both years. In the UK, for post-retirement mortality assumptions PXA92 (year of birth) table rated up two years for active and deferred members, with a 1.2 per cent underpin on future improvements and PXA92 (year of birth) table rated up three years for current pensioners with no underpin on future improvements, all with the medium cohort effect, have been used. In Canada UP94 tables, in Germany Heubeck tables 2005G, in Switzerland EVK 2000 mortality tables and in the Netherlands GBM/V 2005-2050 tables have been used.

Based on the above, the weighted average life expectancy, in years, for mortality tables used to determine benefit obligations is as follows:

	UK		Germany		Canada		Netherlands		Switzerland	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
31 December 2009										
Member age 65 (current life expectancy)	**19.6**	**22.4**	**18.2**	**22.3**	**19.5**	**22.0**	**18.1**	**21.1**	**17.8**	**20.6**
Member age 45 (life expectancy at age 65)	**23.2**	**26.6**	**20.9**	**24.9**	**21.1**	**22.8**	**19.8**	**21.9**	**20.6**	**23.3**
31 December 2008										
Member age 65 (current life expectancy)	19.4	22.2	18.0	22.2	19.4	22.0	18.0	21.0	17.8	20.6
Member age 45 (life expectancy at age 65)	23.1	26.5	20.8	24.8	21.0	22.8	19.7	21.8	20.6	23.3

12 Retirement benefit schemes continued

The expected rates of return on scheme assets in the following principal countries are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2009					
Equities	**7.5**	**8.0**	**9.0**	**7.7**	**7.2**
Bonds	**5.1**	**5.0**	**4.5**	**4.1**	**3.0**
Property	**7.5**	**5.5**		**6.6**	**4.5**
Other assets	**7.5**		**Nil**	**3.8**	**5.5**

For the remaining pension schemes, typical expected long-term real rates of return ranged from 1 per cent to 10 per cent.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2008					
Equities	6.9	8.0	8.5	7.4	7.5
Bonds	5.3	5.5	5.5	4.3	3.0
Property	6.9	5.0		6.1	4.9
Other assets	6.9		Nil	4.4	4.0

For the remaining pension schemes, typical expected long-term real rates of return ranged from 1 per cent to 8 per cent.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2007					
Equities	7.5	8.0	8.8	8.4	7.3
Bonds	5.2	5.5	5.5	4.6	3.5
Property	7.5	4.5		7.3	4.4
Other assets	8.0		Nil	3.6	5.2

For the remaining pension schemes, typical expected long-term real rates of return ranged from 2 per cent to 8 per cent.

Expected rates of return are determined taking into account the current level of expected returns on risk free investments, the historical level of risk premium associated with other invested assets, and the expectations for future returns on such assets.

The major categories of assets as a percentage of the total fair value of scheme assets are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %	Others %	Total %
31 December 2009							
Equities	**56.8**	**30.0**	**39.2**	**26.2**	**31.4**	**18.5**	**39.5**
Bonds	**37.3**	**30.1**	**46.5**	**61.7**	**44.3**	**55.7**	**43.3**
Property	**2.1**	**39.9**		**6.2**	**16.9**	**1.6**	**9.0**
Other assets	**3.8**		**14.3**	**5.9**	**7.4**	**24.2**	**8.2**
31 December 2008							
Equities	50.0	24.5	42.7	19.9	25.8	17.7	34.6
Bonds	39.6	37.1	50.6	64.6	47.9	49.0	45.8
Property	4.2	38.4		8.5	16.1	1.4	10.5
Other assets	6.2		6.7	7.0	10.2	31.9	9.1

Other assets principally comprise hedge funds, cash and reinsurance contracts.

12 Retirement benefit schemes continued

Valuation of post-retirement schemes involves judgments about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 December 2009 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions such as salary increases. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation and the impacts may offset to some extent.

	1 year increase £m	1 year decrease £m	0.25 percentage point increase £m	0.25 percentage point decrease £m
Rate of mortality				
– (decrease)/increase in profit before taxation	(7)	7		
– increase/(decrease) of scheme liabilities	123	(122)		
Rate of inflation				
– (decrease)/increase in profit before taxation			(10)	9
– increase/(decrease) of scheme liabilities			127	(122)
Discount rate				
– increase/(decrease) in profit before taxation			2	(2)
– (decrease)/increase of scheme liabilities			(145)	147
Expected return on scheme assets				
– increase/(decrease) in profit before taxation			9	(9)

	2.5 percentage point increase £m	2.5 percentage point decrease £m
Market value of scheme assets		
– increase/(decrease) in profit before taxation	6	(6)
– increase/(decrease) of scheme assets	93	(93)

The effect on the profit before taxation reflects the impact on current service cost, interest cost and expected return on scheme assets where relevant, for 2010. The effect on scheme assets and liabilities is as at 31 December 2009.

A 1 percentage point change in healthcare inflation would have the following effects:

	1 percentage point increase £m	1 percentage point decrease £m
31 December 2009		
Effect on total of current service cost and interest cost	2	(1)
Effect on healthcare scheme liabilities	22	(18)

The history of the present value of the scheme liabilities, fair value of the scheme assets, the scheme net deficits and experience gains and losses are as follows:

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Historical information					
Scheme liabilities	5,532	4,895	4,497	4,421	4,630
Scheme assets	4,634	4,182	4,223	3,950	3,836
Scheme net deficits	(898)	(713)	(274)	(471)	(794)
Experience losses/(gains) on scheme liabilities	75	156	6	35	(6)
Experience (gains)/losses on scheme assets	(358)	857	94	(141)	(253)

Experience losses and gains on scheme liabilities are presented as part of actuarial gains and losses.

13 Deferred tax

Deferred tax assets comprise:

	Stock relief £m	Excess of depreciation over capital allowances £m	Tax losses £m	Retirement benefits £m	Fair value (gains)/losses £m	Other temporary differences £m	Total £m
At 1 January 2009	**29**	**56**	**64**	**144**	**17**	**245**	**555**
Exchange differences	**(1)**	**(4)**	**(5)**	**(5)**	**(2)**		**(17)**
Credited/(charged) to the income statement	**5**	**11**	**(9)**	**(8)**		**14**	**13**
Credited/(charged) to other comprehensive income			**4**	**(16)**	**(6)**	**(17)**	**(35)**
Other		**(1)**	**(3)**	**(6)**	**(3)**	**26**	**13**
At 31 December 2009	**33**	**62**	**51**	**109**	**6**	**268**	**529**
At 1 January 2008	35	8	22	102		204	371
Exchange differences	4	1	3	16		35	59
Credited/(charged) to the income statement	(10)	44	36	(18)		(31)	21
Credited to other comprehensive income				45	16	43	104
Subsidiaries acquired						4	4
Other		3	3	(1)	1	(10)	(4)
At 31 December 2008	29	56	64	144	17	245	555

Deferred tax liabilities comprise:

	Stock relief £m	Excess of capital allowances over depreciation £m	Undistributed earnings of associates and subsidiaries £m	Retirement benefits £m	Fair value gains/(losses) £m	Other temporary differences £m	Total £m
At 1 January 2009	**13**	**207**	**160**	**162**	**1**	**219**	**762**
Exchange differences		**(12)**	**(6)**	**(14)**		**(21)**	**(53)**
(Credited)/charged to the income statement	**(5)**	**19**	**8**	**(21)**		**(26)**	**(25)**
(Credited)/charged to other comprehensive income				**(8)**	**(2)**	**3**	**(7)**
Subsidiaries acquired						**31**	**31**
Other		**1**	**(1)**	**(2)**	**2**	**(2)**	**(2)**
At 31 December 2009	**8**	**215**	**161**	**117**	**1**	**204**	**706**
At 1 January 2008	14	139	109	141		40	443
Exchange differences	4	26	16	33		10	89
(Credited)/charged to the income statement	(7)	34	39	46	1	(2)	111
(Credited)/charged to other comprehensive income			(2)	(57)		7	(52)
Subsidiaries acquired		23				150	173
Other	2	(15)	(2)	(1)		14	(2)
At 31 December 2008	13	207	160	162	1	219	762

	2009 £m	2008 £m
Net deferred tax liabilities	**177**	207

13 Deferred tax continued

The net deferred tax liabilities are reflected in the Group balance sheet as follows, after offsetting assets and liabilities where there is a legally enforceable right to offset current tax assets and liabilities and where the deferred income taxes relate to the same fiscal authority.

	2009 £m	2008 £m
Deferred tax assets	**(350)**	(392)
Deferred tax liabilities	**527**	599
	177	207

Deferred tax expected to be recovered within 12 months:

	2009 £m	2008 £m
Deferred tax assets	**(99)**	(117)
Deferred tax liabilities	**95**	197
	(4)	80

At the balance sheet date, the Group has unused tax losses of £597 million (2008: £982 million) which have no expiry date, and unused tax losses of £331 million (2008: £155 million) which will expire within the next 10 years. No amount of deferred tax has been recognised in respect of these unused losses.

At the balance sheet date, the Group has not recognised a deferred tax asset in respect of deductible temporary differences of £1,092 million (2008: £839 million). These unrecognised deductible temporary differences have no expiry date.

At the balance sheet date, the Group has unused tax credits of £80 million (2008: £199 million) which have no expiry date. No amount of deferred tax has been recognised in respect of these unused tax credits.

At the balance sheet date, the aggregate amount of taxable temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was £2 billion (2008: £7 billion). This amount reflects current legislation on the taxation of cross border remittances of dividends. No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future.

14 Trade and other receivables

	2009 £m	2008 £m
Trade receivables	**1,732**	1,789
Loans and other receivables	**609**	560
Prepayments and accrued income	**174**	239
	2,515	2,588
Current	**2,344**	2,395
Non-current	**171**	193
	2,515	2,588

Prepayments and accrued income include £68 million (2008: £72 million) in respect of dividends from associates and £1 million (2008: £9 million) in respect of interest.

Trade and other receivables have been reported in the balance sheet net of allowances as follows:

	2009 £m	2008 £m
Gross trade and other receivables	**2,586**	2,662
Allowance account	**(71)**	(74)
Net trade and other receivables per balance sheet	**2,515**	2,588

14 Trade and other receivables continued

The movements in the allowance account are as follows:

	2009 £m	2008 £m
1 January	**74**	51
Differences on exchange	**1**	12
Provided in the year	**21**	33
Amounts reversed during the year	**(5)**	(3)
Amounts in respect of receivables written-off	**(20)**	(19)
31 December	**71**	74

Impairment of trade receivables charged during the year is included as part of other operating expenses. For 2009, the net impairment charged was £24 million (2008: £31 million) of which £16 million (2008: £30 million), is reflected in the above table.

As at 31 December 2009, trade and other receivables of £57 million (2008: £67 million) were past due their contractual payment date but not impaired. These relate to a number of external parties where there is no expectation of default. The age analysis of these trade receivables is as follows:

	2009 £m	2008 £m
Less than three months	**39**	57
Between three and six months	**8**	4
Between six months and one year	**6**	3
Greater than one year	**4**	3

The Group holds bank guarantees, other guarantees and credit insurance in respect of some of the past due debtor balances.

Trade and other receivables are predominantly denominated in the functional currencies of subsidiary undertakings apart from the following:

	2009 £m	2008 £m
US dollar	**118**	155
UK sterling	**92**	71
Euro	**30**	41
Other currencies	**52**	55

Trade and other receivables also include certain interest bearing amounts and their effective interest rates are as follows:

	2009 £m	2008 £m	2009 %	2008 %
US dollar		8		1.5
Euro	**4**	1	**4.0**	4.0
Other currencies	**12**	24	**7.8**	17.8

There is no material difference between the above amounts for trade and other receivables and their fair value, due to the short-term duration of the majority of trade and other receivables. There is no concentration of credit risk with respect to trade receivables as the Group has a large number of customers, internationally dispersed.

15 Available-for-sale investments

	2009 £m	2008 £m
1 January	**106**	97
Differences on exchange	**(2)**	9
Additions and advances	**251**	237
Revaluations	**3**	1
Disposals and repayments	**(275)**	(238)
31 December	**83**	106
Current	**57**	79
Non-current	**26**	27
	83	106

The classification of these investments under the IFRS 7 fair value hierarchy is given in note 24.

Investments have the following maturities:

	As per balance sheet		Contractual gross maturities	
	2009 £m	2008 £m	2009 £m	2008 £m
Equity investments	**28**	29	**28**	29
Non-equity investments				
– within one year	**44**	73	**44**	73
– beyond one year and within two years	**6**	4	**6**	4
– beyond two years and within three years	**5**		**5**	
	83	106	**83**	106

The contractual gross maturities in each year include the investments maturing in that year together with forecast interest receipts on all investments which are due for all or part of that year.

Investments are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	2009 £m	2008 £m
Functional currencies	**79**	101
US dollar	**2**	2
Other currencies	**2**	3
	83	106

Non-equity investments of £55 million (2008: £77 million) are principally denominated in UK sterling and have an effective interest rate of 4 per cent (2008: 6.2 per cent).

From the Chairman
Performance and strategy
Regional review
Financial review
Governance
Group financial statements
Parent Company financial statements
Shareholder information

16 Derivative financial instruments

The fair values of derivatives are determined based on market data (primarily yield curves, implied volatilities and exchange rates) to calculate the present value of all estimated flows associated with each derivative at the balance sheet date. In the absence of sufficient market data, fair values would be based on the quoted market price of similar derivatives. The classification of these assets and liabilities under the IFRS 7 fair value hierarchy is given in note 24.

	2009		2008	
	Assets £m	**Liabilities £m**	Assets restated £m	Liabilities restated £m
Fair value hedges				
– interest rate swaps	**108**	**1**	92	
– cross-currency swaps	**5**	**79**	53	111
Cash flow hedges				
– cross-currency swaps			230	
– forward foreign currency contracts	**28**	**38**	75	77
Net investment hedges				
– cross-currency swaps				135
– forward foreign currency contracts	**59**	**39**	27	354
Cash flow hedges and net investment hedges				
– bifurcated cross-currency swaps	**10**			
Trading				
– interest rate swaps			13	
– forward foreign currency contracts	**31**	**50**	65	340
– others	**8**	**14**	41	46
Total	**249**	**221**	596	1,063
Current	**156**	**127**	417	841
Non-current	**93**	**94**	179	222
	249	**221**	596	1,063
Derivatives				
– in respect of net debt	**149**	**127**	436	554
– other	**100**	**94**	160	509
	249	**221**	596	1,063

The Group has a number of derivative contracts taken out by central Treasury operations to hedge transactions in subsidiaries where, for Group reporting, cash flow hedging can be obtained. It is considered more appropriate to disclose the relevant derivatives as cash flow hedges rather than trading derivatives and therefore the comparative information in this note has been restated to reflect this treatment. Consequently, the trading forward foreign currency contract assets and liabilities for 2008 have been reduced by £41 million and £46 million respectively, with corresponding increases in forward foreign currency contracts classified as cash flow hedges. The disclosure of the relevant derivatives as cash flow hedges has no impact on the overall valuation of derivatives.

Certain derivatives held for trading with a settlement date greater than one year have been reclassified from current to non-current, as explained in note 1 under basis of accounting, and in accordance with IAS 1 Revised, the restated comparatives as at 1 January 2008 are:

	2008	
	Assets restated £m	Liabilities restated £m
1 January 2008		
Current	81	215
Non-current	154	59
	235	274

16 Derivative financial instruments continued

The maturity dates of all derivative financial instruments as recognised in the balance sheet are as follows:

	2009		2008	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	**156**	**127**	417	841
Between one and two years	**7**	**2**	4	24
Between two and three years	**23**		83	83
Between three and four years	**31**	**6**	5	
Between four and five years	**4**	**2**	40	7
Beyond five years	**28**	**84**	47	108
	249	**221**	596	1,063

For cash flow hedges, including bifurcated hedges, the timing of expected cash flows is as follows:

	2009		2008	
	Assets £m	Liabilities £m	Assets restated £m	Liabilities restated £m
Within one year	**33**	**36**	227	68
Between one and two years	**50**	**2**	2	9
Between two and three years	**2**		76	
	85	**38**	305	77
Less: bifurcated cross-currency swap designated as a net investment hedge *(note i)*	**(47)**			
	38	**38**	305	77

(i) The Group has a receive €465 million fixed rate pay DKK3,468 million fixed rate cross-currency swap which has been bifurcated into a receive €465 million fixed rate pay £368 million fixed rate cross-currency swap designated as a cash flow hedge and a receive £368 million fixed rate pay DKK3,468 million fixed rate cross-currency swap designated as a net investment hedge. The above table includes the timing of expected cash flows on the bifurcated cross-currency swap designated as a cash flow hedge.

The Group's cash flow hedges are principally in respect of sales or purchases of inventory and certain debt instruments. The timing of expected cash flows in respect of derivatives designated as cash flow hedges is broadly expected to be comparable to the timing of when the hedged item will affect profit or loss.

The tables below set out the maturities of the Group's derivative financial instruments on an undiscounted contractual basis, based on spot rates.

16 Derivative financial instruments continued

The maturity dates of all gross settled derivative financial instruments are as follows:

	2009				2008			
	Assets		Liabilities		Assets		Liabilities	
	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m
Within one year								
– forward contracts	**4,437**	**(4,327)**	**4,769**	**(4,904)**	1,953	(1,746)	6,573	(7,388)
– cross-currency swaps	**25**	**(26)**	**18**	**(8)**	678	(492)	404	(454)
– other	**1,282**	**(1,276)**	**1,273**	**(1,284)**	1,650	(1,598)	1,553	(1,604)
Between one and two years								
– forward contracts	**270**	**(261)**	**167**	**(168)**	89	(85)	373	(394)
– cross-currency swaps	**446**	**(435)**	**18**	**(13)**	27	(25)	43	(44)
Between two and three years								
– forward contracts	**44**	**(41)**	**14**	**(13)**				
– cross-currency swaps	**1**	**(1)**	**18**	**(17)**	485	(389)	407	(494)
Between three and four years								
– cross-currency swaps	**1**	**(1)**	**18**	**(18)**	1	(1)	18	(21)
Between four and five years								
– cross-currency swaps	**1**	**(1)**	**18**	**(19)**	1	(1)	18	(21)
Beyond five years								
– cross-currency swaps	**22**	**(17)**	**361**	**(458)**	25	(16)	395	(538)
	6,529	**(6,386)**	**6,674**	**(6,902)**	4,909	(4,353)	9,784	(10,958)

The maturity dates of net settled derivative financial instruments are as follows:

	2009		2008	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	**43**	**(10)**	36	2
Between one and two years	**35**	**(2)**	26	2
Between two and three years	**18**	**6**	13	2
Between three and four years	**3**	**7**	22	2
Between four and five years	**3**	**7**	14	2
Beyond five years	**15**		21	
	117	**8**	132	10

The above analysis of derivatives settled on a net basis primarily relates to the Group's interest rate swaps.

In summary by type, the fair value of derivative financial instruments is as follows:

	2009		2008	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Interest rate swaps	**108**	**1**	105	
Cross-currency swaps	**15**	**79**	283	246
Forward foreign currency contracts	**118**	**127**	167	771
Others	**8**	**14**	41	46
	249	**221**	596	1,063

16 Derivative financial instruments continued

(a) Interest rate swaps

	Maturity date	Principal currency	m	£m	Interest rate % Original	Interest rate % Swapped	2009 Assets £m	2009 Liabilities £m
Fixed to floating	**2012**	**EUR**	**750**	**666**	**3.6**	**note (a)**	**33**	
	2013	**EUR**	**400**	**355**	**5.1**	**note (a)**	**31**	
	2013	**GBP**	**150**	**150**	**5.8**	**note (a)**	**8**	
	2014	**GBP**	**500**	**500**	**6.0**	**note (a)**		**1**
	2014	**GBP**	**250**	**250**	**6.0**	**note (a)**	**11**	
	2015	**EUR**	**650**	**578**	**4.9**	**note (a)**	**1**	
	2019	**GBP**	**250**	**250**	**6.4**	**note (a)**	**24**	
							108	**1**

	Maturity date	Principal currency	m	£m	Interest rate % Original	Interest rate % Swapped	2008 Assets £m	2008 Liabilities £m
Fixed to floating	2009	EUR	550	532	4.9	note (a)	10	
	2009	EUR	250	242	4.1	note (a)	3	
	2012	EUR	750	725	3.6	note (a)	8	
	2013	EUR	400	387	5.1	note (a)	24	
	2013	GBP	350	350	5.8	note (a)	20	
	2019	GBP	250	250	6.4	note (a)	40	
							105	

Note (a): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 32 and 268 basis points (2008: nil and 137 basis points).

The fixed to floating swaps have been used to manage the interest rate profile of external borrowings and are reflected in the repricing table in note 21. The floating to fixed swaps have been used to manage the interest rate profile of both internal and external financing arrangements, and those relating to external borrowings are also reflected in the repricing table in note 21.

(b) Cross-currency swaps

	Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	2009 Assets £m	2009 Liabilities £m
Fixed to fixed	**2011**	**EUR**	**5.9**	**465**	**413**	**DKK**	**6.2**	**3,468**	**414**	**10**	
Fixed to floating	**2016**	**GBP**	**5.5**	**325**	**325**	**EUR**	**note (b)**	**473**	**420**		**79**
	2019	**EUR**	**4.6**	**20**	**18**	**USD**	**note (b)**	**22**	**14**	**5**	
										15	**79**

	Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	2008 Assets £m	2008 Liabilities £m
Fixed to fixed	2009	EUR	4.9	500	483	USD	6.5	564	392	151	51
	2011	EUR	5.9	465	450	DKK	6.2	3,468	450	79	85
Fixed to floating	2009	EUR	4.9	150	145	GBP	note (b)	104	104	45	
	2016	GBP	5.5	325	325	EUR	note (b)	473	457		108
	2019	EUR	4.6	20	19	USD	note (b)	22	15	8	2
										283	246

Note (b): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 82 and 83 basis points (2008: 78 and 83 basis points).

16 Derivative financial instruments continued

(c) Forward foreign currency contracts

Forward foreign currency contracts are denominated in the following currencies:

Fair values of assets

	2009 Currencies purchased forward					2008 Currencies purchased forward				
	GBP £m	USD £m	EUR £m	Others £m	Total £m	GBP £m	USD £m	EUR £m	Others £m	Total £m
Currencies sold forward										
AUD	3				3		10			10
EUR	29	5		1	35	1	22			23
GBP		2	1	5	8		5	24	21	50
JPY		11			11					
NOK								22		22
RUR		1			1	1	11	19		31
USD	46		1	3	50			2		2
Other currencies	9		1		10	1	10	18		29
	87	19	3	9	118	3	58	85	21	167

Fair values of liabilities

	2009 Currencies purchased forward					2008 Currencies purchased forward				
	GBP £m	USD £m	EUR £m	Others £m	Total £m	GBP £m	USD £m	EUR £m	Others £m	Total £m
Currencies sold forward										
AUD	11	5	1		17	81				81
CAD	17	2			19	27				27
CHF	3		1		4	97		5		102
EUR	7	7			14	184	6		2	192
GBP		2	7	2	11					
HKD						13				13
JPY		6			6		51			51
NOK			4	1	5	1				1
SAR						16				16
SGD	2				2	12				12
USD	13		1	1	15	222		3	2	227
ZAR	18	1	1		20	26				26
Other currencies	3	5	6		14	17	2	1	3	23
	74	28	21	4	127	696	59	9	7	771

16 Derivative financial instruments continued

Forward foreign currency contracts have been used to hedge both internal and external forecast transactions as well as the hedging of internal and external assets and liabilities. Certain contracts were used to manage the currency profile of external borrowings and are reflected in the currency table in note 21, and their nominal values are as follows:

	2009		2008	
	£m	**£m**	£m	£m
Forward contracts to purchase GBP, sell CHF	**(167)**	**165**	(142)	182
Forward contracts to purchase GBP, sell CAD	**(401)**	**413**	(377)	394
Forward contracts to purchase GBP, sell AUD	**(942)**	**947**	(761)	824
Forward contracts to purchase EUR, sell DKK	**(177)**	**177**	(451)	452
Forward contracts to purchase EUR, sell SEK	**(175)**	**177**	(189)	181
Forward contracts to purchase EUR, sell NOK	**(156)**	**160**	(360)	339
Forward contracts to purchase EUR, sell GBP	**(218)**	**221**		

(d) Others

	2009		2008	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Others: Bund forwards *(note i)*	**4**	**7**	36	38
Interest derivative *(note ii)*		**7**		8
Sinking fund policy *(note iii)*	**4**		5	
	8	**14**	41	46

Notes:
(i) Forward contracts to purchase and sell German government securities with a nominal value of €1.4 billion (2008: €1.6 billion) taken out to manage internal financing arrangements and maturing within one year.
(ii) Remaining impact of an interest derivative with a nominal value of €1 billion maturing in 2013.
(iii) Investment in sinking fund policy with a nominal value of ZAR46 million (2008: ZAR68 million).

17 Inventories

	2009 £m	2008 £m
Raw materials and consumables	**1,587**	1,495
Finished goods and work in progress	**1,443**	1,475
Goods purchased for resale	**231**	207
	3,261	3,177

Inventories pledged as security for liabilities amount to £10 million (2008: £5 million). Write-offs taken to other operating expenses in the Group income statement comprise £63 million (2008: £25 million), including amounts relating to restructuring costs.

18 Income tax receivable and payable

Income tax balances shown on the Group balance sheet as current assets and current liabilities, while subject to some uncertainty as to the extent and timing of cash flows, are largely expected to be received or paid within 12 months at the balance sheet date for both 2009 and 2008.

19 Cash and cash equivalents

	2009 £m	2008 £m
Cash and bank balances	**965**	1,050
Cash equivalents	**1,196**	1,259
	2,161	2,309

Cash equivalents mainly comprise short-term deposits and investments in money market funds with an original maturity of three months or less. The carrying value of cash and cash equivalents approximates their fair value.

Cash and cash equivalents are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	2009 £m	2008 £m
Functional currency	**1,604**	1,824
US dollar	**211**	173
UK sterling	**6**	4
Euro	**262**	253
Other currencies	**78**	55
	2,161	2,309

The currency in which cash and cash equivalents are held, together with the effective interest rates applicable to cash and cash equivalents are as follows:

	Values		Rates	
	2009 £m	2008 £m	2009 %	2008 %
US dollar	**221**	195	**0.9**	1.8
UK sterling	**437**	219	**0.4**	2.4
Euro	**340**	313	**0.4**	2.7
Canadian dollar	**43**	106	**0.4**	1.4
Australian dollar	**53**	49	**3.3**	4.2
Other currencies	**1,067**	1,427	**5.3**	9.2
	2,161	2,309		

At 31 December 2009, cash and cash equivalents of £nil (2008: £19 million) were pledged as collateral principally in respect of excise creditors.

In the Group cash flow statement, net cash and cash equivalents are shown after deducting bank overdrafts and accrued interest, as follows:

	2009 £m	2008 £m
Cash and cash equivalents as above	**2,161**	2,309
Less		
– accrued interest	**(1)**	(3)
– overdrafts	**(181)**	(86)
Net cash and cash equivalents	**1,979**	2,220

Cash and cash equivalents include restricted amounts of £80 million (2008: £173 million), principally due to exchange control regulations in certain countries.

NOTES ON THE ACCOUNTS CONTINUED

20 Capital and reserves – reconciliation of movement in total equity

	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Shareholders' funds £m	Minority interests £m	Total equity £m
1 January 2009	**506**	**3,905**	**955**	**1,578**	**6,944**	**271**	**7,215**
Comprehensive income and expense							
Profit for the year				2,713	2,713	243	2,956
Differences on exchange							
– subsidiaries			142		142	24	166
– associates			(258)		(258)		(258)
Cash flow hedges							
– net fair value losses			(72)		(72)		(72)
– reclassified and reported in profit for the year			67		67		67
– reclassified and reported in net assets			(1)		(1)		(1)
Available-for-sale investments							
– net fair value gains			3		3		3
– reclassified and reported in profit for the year			(3)		(3)		(3)
Net investment hedges							
– net fair value gains			238		238		238
– differences on exchange on borrowings			12		12		12
Retirement benefit schemes							
– actuarial losses in respect of subsidiaries *(note 12)*				(292)	(292)	(3)	(295)
– surplus recognition and minimum funding obligations in respect of subsidiaries *(note 12)*				(75)	(75)	(1)	(76)
– actuarial gains in respect of associates net of tax *(note 11)*				61	61		61
Tax on other items recognised directly in other comprehensive income *(note 6(d))*			(51)	(8)	(59)	(12)	(71)
Other changes in equity							
Employee share options							
– value of employee services				61	61		61
– proceeds from shares issued		2		5	7		7
Dividends and other appropriations							
– ordinary shares				(1,798)	(1,798)		(1,798)
– to minority interests						(240)	(240)
Purchase of own shares							
– held in employee share ownership trusts				(94)	(94)		(94)
Minority interests in Bentoel						1	1
Minority interests – capital injection *(note 29)*						16	16
Other movements				17	17		17
31 December 2009	**506**	**3,907**	**1,032**	**2,168**	**7,613**	**299**	**7,912**

20 Capital and reserves – reconciliation of movement in total equity continued

	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Shareholders' funds £m	Minority interests £m	Total equity £m
1 January 2008	506	3,902	658	1,805	6,871	218	7,089
Comprehensive income and expense							
Profit for the year				2,457	2,457	202	2,659
Differences on exchange							
– subsidiaries			190		190	23	213
– associates			724		724		724
Differences on exchange reclassified and reported in profit for the year			(22)		(22)		(22)
Cash flow hedges							
– net fair value gains			180		180		180
– reclassified and reported in profit for the year			(173)		(173)		(173)
– reclassified and reported in net assets			1		1		1
Available-for-sale investments							
– net fair value gains			1		1		1
– reclassified and reported in profit for the year			(6)		(6)		(6)
Net investment hedges							
– net fair value losses			(672)		(672)		(672)
– differences on exchange on borrowings			(178)		(178)		(178)
Revaluation of existing business *(note 26)*			179		179		179
Retirement benefit schemes							
– actuarial losses in respect of subsidiaries *(note 12)*				(547)	(547)		(547)
– actuarial gains in respect of associates net of tax *(note 11)*				(396)	(396)		(396)
Tax on items recognised directly in other comprehensive income *(note 6(d))*			73	102	175	9	184
Other changes in equity							
Employee share options							
– value of employee services				51	51		51
– proceeds from shares issued		3		7	10		10
Dividends and other appropriations							
– ordinary shares				(1,393)	(1,393)		(1,393)
– to minority interests						(176)	(176)
Purchase of own shares							
– held in employee share ownership trusts				(116)	(116)		(116)
– share buy-back programme				(400)	(400)		(400)
Acquisition of minority interests						(5)	(5)
Other movements				8	8		8
31 December 2008	506	3,905	955	1,578	6,944	271	7,215

Details relating to the authorised and allotted share capital, and movements therein, are included in note 4 of the Parent Company financial statements.

20 Capital and reserves – reconciliation of movement in total equity continued

Share premium account, capital redemption reserves and merger reserves comprise:

	Share premium account £m	Capital redemption reserves £m	Merger reserves £m	Total £m
1 January 2008	53	101	3,748	3,902
31 December 2008	56	101	3,748	3,905
31 December 2009	58	101	3,748	3,907

The share premium account includes the difference between the value of shares issued and their nominal value. The increase of £2 million (2008: £3 million) relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration report.

On the purchase of own shares as part of the share buy-back programme for shares which are cancelled, a transfer is made from retained earnings to the capital redemption reserve equivalent to the nominal value of shares purchased. Purchased shares which are not cancelled are classified as treasury shares and presented as a deduction from total equity.

Shareholders' funds are stated after deducting the cost of treasury shares which include £523 million (2008: £523 million) for shares repurchased and not cancelled and £249 million (2008: £222 million) in respect of the cost of own shares held in employee share ownership trusts.

Transaction costs deducted from equity for the year ended 31 December 2009 were £nil (2008: £3 million).

In 1999, shares were issued for the acquisition of the Rothmans International B.V. Group, and the difference between the fair value of shares issued and their nominal value was credited to merger reserves.

20 Capital and reserves – reconciliation of movement in total equity continued

Movements in other reserves and retained earnings (which is after deducting treasury shares) shown above comprise:

							Retained earnings	
	Translation reserve £m	Hedging reserve £m	Available-for-sale reserve £m	Revaluation reserve £m	Other £m	Total other reserves £m	Treasury shares £m	Other £m
1 January 2009	**188**	**4**	**11**	**179**	**573**	**955**	**(745)**	**2,323**
Comprehensive income and expense								
Profit for the year								**2,713**
Differences on exchange								
– subsidiaries	**142**					**142**		
– associates	**(258)**					**(258)**		
Cash flow hedges								
– net fair value losses		**(72)**				**(72)**		
– reclassified and reported in profit for the year		**67**				**67**		
– reclassified and reported in net assets		**(1)**				**(1)**		
Available-for-sale investments								
– net fair value gains			**3**			**3**		
– reclassified and reported in profit for the year			**(3)**			**(3)**		
Net investment hedges								
– net fair value gains	**238**					**238**		
– differences on exchange on borrowings	**12**					**12**		
Retirement benefit schemes								
– actuarial losses in respect of subsidiaries *(note 12)*								**(292)**
– surplus recognition and minimum funding obligations in respect of subsidiaries *(note 12)*								**(75)**
– actuarial gains in respect of associates net of tax *(note 11)*								**61**
Tax on items recognised directly in other comprehensive income *(note 6(d))*	**(47)**	**(4)**				**(51)**		**(8)**
Other changes in equity								
Employee share options								
– value of employee services								**61**
– proceeds from shares issued							**5**	
Dividends and other appropriations								
– ordinary shares								**(1,798)**
Purchase of own shares								
– held in employee share ownership trusts							**(94)**	
Other movements							**62**	**(45)**
31 December 2009	**275**	**(6)**	**11**	**179**	**573**	**1,032**	**(772)**	**2,940**

The revaluation reserve relates to the acquisition of the cigarette and snus businesses of ST as explained in note 26(c).

20 Capital and reserves – reconciliation of movement in total equity continued

	Translation reserve £m	Hedging reserve £m	Available-for-sale reserve £m	Revaluation reserve £m	Other £m	Total other reserves £m	Retained earnings: Treasury shares £m	Retained earnings: Other £m
1 January 2008	80	(11)	16		573	658	(296)	2,101
Comprehensive income and expense								
Profit for the year								2,457
Differences on exchange								
– subsidiaries	190					190		
– associates	724					724		
Differences on exchange reclassified and reported in profit for the year	(22)					(22)		
Cash flow hedges								
– net fair value gains		180				180		
– reclassified and reported in profit for the year		(173)				(173)		
– reclassified and reported in net assets		1				1		
Available-for-sale investments								
– net fair value gains			1			1		
– reclassified and reported in profit for the year			(6)			(6)		
Net investment hedges								
– net fair value losses	(672)					(672)		
– differences on exchange on borrowings	(178)					(178)		
Revaluation of existing business *(note 26)*				179		179		
Retirement benefit schemes								
– actuarial losses in respect of subsidiaries *(note 12)*								(547)
– actuarial gains in respect of associates net of tax *(note 11)*								(396)
Tax on items recognised directly in other comprehensive income *(note 6(d))*	66	7				73		102
Other changes in equity								
Employee share options								
– value of employee services								51
– proceeds from shares issued							7	
Dividends and other appropriations								
– ordinary shares								(1,393)
Purchase of own shares								
– held in employee share ownership trusts							(116)	
– share buy-back programme							(400)	
Other movements							60	(52)
31 December 2008	188	4	11	179	573	955	(745)	2,323

The translation reserve is as explained in the accounting policy on foreign currencies in note 1.

The hedging reserve and the available-for-sale reserve are as explained in the accounting policy on financial instruments in note 1.

Of the amounts released from the hedging reserve during the year, losses of £4 million (2008: £3 million loss) and gains of £9 million (2008: £25 million loss) were reported within revenue and raw materials and consumables respectively, together with a gain of £14 million (2008: £nil) reported in other operating expenses and a loss of £86 million (2008: £201 million gain) reported within net finance costs.

20 Capital and reserves – reconciliation of movement in total equity continued

Other reserves comprise:

(a) £483 million which arose in 1998 from merger accounting in a Scheme of Arrangement and Reconstruction whereby British American Tobacco p.l.c. acquired the entire share capital of B.A.T Industries p.l.c. and the share capital of that company's principal financial services subsidiaries were distributed, so effectively demerging them; and

(b) in the Rothmans transaction, convertible redeemable preference shares were issued as part of the consideration. The discount on these shares was amortised by crediting other reserves and charging retained earnings. The £90 million balance in other reserves comprises the accumulated balance in respect of the preference shares converted during 2004.

The tax attributable to components of other comprehensive income is as follows:

	2009 £m	2008 £m
Translation reserve		
Differences on exchange	**(42)**	39
Net investment hedges		
– net fair value losses		(3)
– difference on exchange on borrowings	**(5)**	30
	(47)	66
Hedging reserve		
Cash flow hedges		
– net fair value gains	**(4)**	15
– reclassified and reported in profit for the year		(8)
	(4)	7
Retained earnings		
– actuarial losses in respect of subsidiaries	**(31)**	102
– surplus recognition and minimum funding obligations in respect of subsidiaries	**23**	
	(8)	102
Shareholders' funds	**(59)**	175
Minority interests	**(12)**	9
Total tax recognised in other comprehensive income for the period *(note 6(d))*	**(71)**	184

NOTES ON THE ACCOUNTS CONTINUED

21 Borrowings

	Currency	Maturity dates	Interest rates	2009 £m	2008 £m
Eurobonds	Euro	2009 to 2021	3.6% to 5.9%	**5,500**	6,778
	UK sterling	2009 to 2034	5.5% to 7.3%	**2,297**	1,754
Bonds issued pursuant to Rule 144A and RegS under the US Securities Act (as amended)	US dollar	2013 to 2018	8.1% to 9.5%	**620**	694
Floating rate notes	Euro	2010	floating rate	**467**	510
Other notes	Malaysian ringgit	2009 to 2014	3.7% to 5.0%	**119**	132
	Indonesian rupiah	2012	10.5%	**90**	
	Other currencies			**25**	27
Syndicated bank loans	US dollar	2012	floating rate	**427**	469
	Euro	2009 to 2012	floating rate	**613**	1,116
Euro commercial paper				**187**	
Bank loans				**519**	514
Other loans				**2**	3
Finance leases				**35**	78
Overdrafts				**181**	86
				11,082	12,161

The floating rate interest rates are based on EURIBOR or US LIBOR plus a margin ranging between 36 and 500 basis points.

	2009 £m	2008 £m
Current	**1,370**	2,724
Non-current	**9,712**	9,437
	11,082	12,161

Current borrowings include interest payable of £232 million at 31 December 2009 (2008: £270 million). Included within non-current borrowings are £3,019 million (2008: £2,957 million) of borrowings subject to fair value hedges where their amortised cost has been increased by £96 million (2008: increased by £116 million) in the table above.

The fair value of borrowings is estimated to be £11,646 million (2008: £11,792 million) and has been determined using quoted market prices or discounted cash flow analysis.

	2009 £m	2008 £m
Amounts secured on Group assets	**59**	97

Amounts secured include finance leases of £35 million (2008: £78 million) and the remaining amounts are secured on certain property and inventory of the Group (notes 10 and 17).

Borrowings are repayable as follows:

	Per balance sheet		Contractual gross maturities	
	2009 £m	2008 £m	2009 £m	2008 £m
Within one year	**1,370**	2,724	**1,404**	2,852
Between one and two years	**1,083**	575	**1,440**	1,026
Between two and three years	**1,895**	1,151	**2,463**	1,607
Between three and four years	**844**	1,288	**1,199**	1,690
Between four and five years	**624**	1,584	**996**	1,908
Beyond five years	**5,266**	4,839	**7,264**	6,198
	11,082	12,161	**14,766**	15,281

The contractual gross maturities in each year include the borrowings maturing in that year together with forecast interest payments on all borrowings which are outstanding for all or part of that year.

21 Borrowings continued

Borrowings are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	Functional currency £m	US dollar £m	UK sterling £m	Euro £m	Canadian dollar £m	Australian dollar £m	Other currencies £m	Total £m
31 December 2009								
Total borrowings	**4,718**	**1,155**	**328**	**4,863**			**18**	**11,082**
Effect of derivative financial instruments								
– cross-currency swaps		**14**	**(325)**	**(10)**			**413**	**92**
– forward foreign currency contracts	**(1,289)**			**(726)**	**413**	**947**	**679**	**24**
	3,429	**1,169**	**3**	**4,127**	**413**	**947**	**1,110**	**11,198**
31 December 2008								
Total borrowings	4,317	1,181	328	6,335				12,161
Effect of derivative financial instruments								
– cross-currency swaps		407	(221)	(640)			450	(4)
– forward foreign currency contracts	(1,280)			(1,000)	394	824	1,154	92
	3,037	1,588	107	4,695	394	824	1,604	12,249

Details of the derivative financial instruments included in these tables are given in note 16.

The exposure to interest rate changes when borrowings are repriced is as follows:

	Within 1 year £m	Between 1-2 years £m	Between 2-3 years £m	Between 3-4 years £m	Between 4-5 years £m	Beyond 5 years £m	Total £m
31 December 2009							
Total borrowings	**1,439**	**1,442**	**1,467**	**844**	**624**	**5,266**	**11,082**
Effect of derivative financial instruments							
– interest rate swaps	**2,749**		**(666)**	**(505)**	**(750)**	**(828)**	
– cross-currency swaps	**434**					**(343)**	**91**
	4,622	**1,442**	**801**	**339**	**(126)**	**4,095**	**11,173**
31 December 2008							
Total borrowings	3,699	141	1,080	819	1,584	4,838	12,161
Effect of derivative financial instruments							
– interest rate swaps	1,712			(725)	(737)	(250)	
– cross-currency swaps	472					(344)	128
	5,883	141	1,080	94	847	4,244	12,289

Details of the derivative financial instruments included in these tables are given in note 16.

21 Borrowings continued

Effective interest rates are as follows:

	2009 £m	2008 £m	2009 %	2008 %
US dollar	**1,223**	1,249	**5.7**	6.5
UK sterling	**2,284**	1,761	**6.3**	6.6
Euro	**6,780**	8,421	**4.6**	4.8
Canadian dollar	**13**	12	**5.6**	5.8
Other currencies	**782**	718	**6.0**	5.8
	11,082	12,161		

The values and rates shown above do not reflect the effect of the interest rate and cross-currency swaps detailed in note 16.

Finance lease liabilities per the balance sheet and on a contractual gross maturity basis are payable as follows:

	2009			2008		
	Principal £m	Interest £m	Total £m	Principal £m	Interest £m	Total £m
Within one year	**17**	**1**	**18**	38	3	41
Between one and two years	**10**	**1**	**11**	22	2	24
Between two and three years	**4**		**4**	10	1	11
Between three and four years	**2**		**2**	5		5
Between four and five years	**1**		**1**	2		2
Beyond five years	**1**		**1**	1		1
	35	**2**	**37**	78	6	84

Borrowings facilities

	2009 £m	2008 £m
Undrawn committed facilities expiring		
– within one year	**436**	144
– between one and two years	**130**	
– between two and three years	**1,651**	99
– between three and four years		1,651
	2,217	1,894

The facilities include undrawn amounts in respect of the Group's central banking facility of £1.75 billion (2008: £1.75 billion) and Turkish facilities of £319 million (2008: £nil).

On 13 February 2008, the Group entered into an acquisition credit facility whereby lenders agreed to make available an amount of US$2 billion. On 1 May 2008, this facility was syndicated in the market and was redenominated into two euro facilities of €420 million and €860 million; €395 million and €759 million were outstanding as at 31 December 2008 respectively. The €395 million was repaid in September 2009 and €759 million was repaid in October 2009. The €759 million was refinanced by a new €700 million term loan facility with a maturity date of 31 October 2012 with an option to extend it to October 2013, at the discretion of the banking participants in the syndicated facility.

The Group defines net debt as follows:

	2009 £m	2008 £m
Borrowings *(note 21)*	**11,082**	12,161
Derivatives in respect of net debt:		
– assets *(note 16)*	**(149)**	(436)
– liabilities *(note 16)*	**127**	554
Cash and cash equivalents *(note 19)*	**(2,161)**	(2,309)
Current available-for-sale investments *(note 15)*	**(57)**	(79)
	8,842	9,891

22 Other provisions for liabilities and charges

	Restructuring of existing businesses £m	Acquired businesses £m	Employee related benefits £m	Other provisions £m	Total £m
1 January 2009	**180**	**23**	**35**	**243**	**481**
Differences on exchange	**(12)**	**(2)**	**1**	**11**	**(2)**
Provided in respect of the year	**99**	**1**	**10**	**2**	**112**
Utilised during the year	**(75)**	**(13)**	**(8)**	**(38)**	**(134)**
Other movements	**(5)**	**(1)**		**5**	**(1)**
31 December 2009	**187**	**8**	**38**	**223**	**456**
Analysed on the balance sheet as					
– current	**144**	**2**	**10**	**156**	**312**
– non-current	**43**	**6**	**28**	**67**	**144**
	187	**8**	**38**	**223**	**456**
1 January 2008	182	23	20	203	428
Differences on exchange	44	5	2	28	79
Provided in respect of the year	65	9	15	62	151
Utilised during the year	(108)	(15)	(4)	(50)	(177)
Other movements	(3)	1	2		
31 December 2008	180	23	35	243	481
Analysed on the balance sheet as					
– current	104	15	9	167	295
– non-current	76	8	26	76	186
	180	23	35	243	481

The restructuring provisions relate to the restructuring and integration costs incurred and reported as adjusting items in the income statement. The principal restructuring activities in 2009 and 2008 are as described in note 3(e). While some elements of the non-current provisions of £43 million will unwind over several years, as termination payments are made over extended periods in some countries, it is estimated that over 55 per cent will unwind in 2011 and approximately 80 per cent within five years.

Provisions in respect of acquired businesses mostly relate to those which were part of the integration of the Rothmans businesses in 1999 and the reorganisation of the Italian business acquired in 2003. While some elements of the non-current provisions of £6 million will unwind over several years, it is estimated that around 60 per cent will unwind within five years.

Employee related benefits mainly relate to long-term employee benefits other than post-retirement benefits. As the principal components of these provisions are long service awards and 'jubilee' payments due after a certain service period, they will unwind over several years. It is estimated that approximately 40 per cent of the non-current provisions of £28 million will unwind within five years.

Other provisions comprise balances set up in the ordinary course of general business that cannot be classified within the other categories, such as sales returns, onerous contracts, together with amounts in respect of supplier, excise and other disputes. The nature of the amounts provided in respect of disputes is such that the extent and timing of cash flows is difficult to estimate and the ultimate liability may vary from the amounts provided.

Amounts provided above are shown net of reversals of unused provisions which include £9 million (2008: £20 million) for restructuring of existing businesses, £nil (2008: £6 million) for acquired businesses, £2 million (2008: £nil) for employee benefits and £90 million (2008: £15 million) for other provisions.

23 Trade and other payables

	2009 £m	2008 £m
Trade payables	**650**	808
Duty, excise and other taxes	**2,909**	2,859
Accrued charges and deferred income	**943**	800
Social security and other taxation	**19**	27
Sundry payables	**386**	390
	4,907	4,884
Current	**4,727**	4,718
Non-current	**180**	166
	4,907	4,884

Accrued charges and deferred income include £19 million (2008: £2 million) in respect of interest payable.

There is no material difference between the above amounts for trade and other payables and their fair value, due to the short-term duration of the majority of trade and other payables.

Trade and other payables are predominantly denominated in the functional currencies of subsidiary undertakings with less than 5 per cent (2008: 5 per cent) in other currencies.

24 Financial instruments

Management of financial risks

One of the principal responsibilities of Treasury is to manage the financial risks arising from the Group's underlying operations. Specifically, Treasury manages, within an overall policy framework, the Group's exposure to funding and liquidity, interest rate, foreign exchange and counterparty risks. The approach is one of risk reduction within an overall framework of delivering Total Shareholder Return.

The Group defines capital as net debt (see note 21) and equity (see note 20). The only externally imposed capital requirement for the Group is interest cover as described under interest rate risk below. The Group assesses its financial capacity by reference to cash flow and interest cover. Group policies include a set of financing principles including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital base is managed and, in particular, the policies on dividends (as a percentage of long-term sustainable earnings) and share buy-back are decided.

The Group manages its financial risks in line with the classification of its financial assets and liabilities in the Group's balance sheet and related notes.

The Group's management of specific risks is dealt with as follows:

Liquidity risk

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group has a target average centrally managed debt maturity of five years with no more than 20 per cent of centrally managed debt maturing in a single year. As at 31 December 2009, the average centrally managed debt maturity was 6.6 years (2008: 5.1 years) and the highest proportion of centrally managed debt maturing in a single year was 18.4 per cent (2008: 18.3 per cent). It is Group policy that short-term sources of funds (including drawings under the £1 billion euro commercial paper (ECP) programme) are backed by undrawn committed lines of credit and cash. £187 million of ECP was outstanding at 31 December 2009.

The Group repaid a €900 million bond in February 2009 which was financed by bond issues during 2008 and cash generated from operations. In May 2009, the Group repaid Malaysian ringgit (MYR) 100 million which was refinanced by a new MYR250 million bond in August 2009. The additional proceeds were used to repay MYR150 million in November 2009. During 2009, the Group also issued a new £250 million bond maturing in June 2022.

24 Financial instruments continued

In November 2009, the terms of €481 million of the €1.0 billion bond maturing in 2013 were modified by extending the maturity to 2021. At the same time, the Group issued an additional €169 million bond with a maturity of 2021. In addition, £199 million of the £350 million bond maturing in 2013 was purchased and cancelled; at the same time the Group issued a new £500 million bond with a maturity of 2034.

On 13 February 2008, the Group entered into an acquisition credit facility whereby lenders agreed to make available an amount of US$2 billion. On 1 May 2008, this facility was syndicated in the market and was redenominated into two euro facilities of €420 million and €860 million; €395 million and €759 million were outstanding as at 31 December 2008 respectively. The €395 million was repaid in September 2009 and €759 million was repaid in October 2009. The €759 million was refinanced by a new €700 million term loan facility with a maturity date of 31 October 2012 with an option to extend it to October 2013, at the discretion of the banking participants in the syndicated facility.

In the year ended 31 December 2008, the €1.8 billion revolving acquisition credit facility arranged in December 2007 was cancelled and replaced with the issue of €1.25 billion and £500 million bonds maturing in 2015 and 2024 respectively. In addition to this, the Group increased its €1 billion (5.375 per cent, maturity 2017) bond by an additional €250 million in 2008, bringing the total size of the bond to €1.25 billion.

In 2008, the Group also issued US$300 million and US$700 million bonds, maturing in 2013 and 2018 respectively, pursuant to Rule 144A and RegS under the US Securities Act. The Group also repaid US$330 million and £217 million bonds upon maturity in May and November 2008 respectively.

In addition, in 2008, the Group repurchased its Mexican 2011 MXN1,055 million UDI bond and refinanced it with a floating rate borrowing of MXN1,444 million.

The Group continues to have a central banking facility of £1.75 billion, with a final maturity date of March 2012, which was undrawn as at 31 December 2009.

The Group utilises cash pooling and zero balancing bank account structures in addition to inter-company loans and borrowings to ensure that there is the maximum mobilisation of cash within the Group. The amount of debt issued by the Group is determined by forecasting the net debt requirement after the mobilisation of cash.

The Group continues to target investment-grade credit ratings; as at 31 December 2009 the ratings from Moody's and S&P were Baa1/BBB+ (2008: Baa1/BBB+) and these ratings were maintained throughout the year. The strength of the ratings has underpinned the debt issuance during 2009 and 2008 and, despite the impact of the turbulence in financial markets, the Group is confident of its ability to successfully access the debt capital markets, as demonstrated with the issue of US$1 billion bonds in the US bond market towards the end of 2008, as well as issues in the euro and sterling markets in 2009.

As part of its short-term cash management, the Group invests in a range of cash and cash equivalents, including money market funds, which are regarded as highly liquid and are not exposed to significant changes in fair value. These are kept under continuous review as described in the credit risk section below. At 31 December 2009, cash and cash equivalents include £669 million invested in money market funds (2008: £458 million).

Subsidiary companies are funded by share capital and retained earnings, loans from the central finance companies on commercial terms, or through local borrowings by the subsidiaries in appropriate currencies. All contractual borrowing covenants have been met and none of them is expected to inhibit the Group's operations or funding plans.

Currency risk

The Group is subject to exposure on the translation of the net assets of foreign currency subsidiaries and associates into its reporting currency, sterling. The Group's primary balance sheet translation exposures are to the US dollar, Canadian dollar, euro, Danish krone, Turkish lira, South African rand, Russian rouble, Brazilian real and Australian dollar. These exposures are kept under continuous review. The Group's policy on borrowings is to broadly match the currency of these borrowings with the currency of cash flows arising from the Group's underlying operations. Within this overall policy, the Group aims to minimise all balance sheet translation exposure where it is practicable and cost-effective to do so through matching currency assets with currency borrowings. At 31 December 2009, the currency profile of the Group's gross debt, after taking into account derivative contracts, was 11 per cent (2008: 14 per cent) US dollar, 54 per cent (2008: 55 per cent) euro, 4 per cent (2008: 3 per cent) Canadian dollar, 6 per cent (2008: 2 per cent) sterling, 8 per cent (2008: 7 per cent) Australian dollar and 17 per cent (2008: 19 per cent) other currencies.

24 Financial instruments continued

The Group faces currency exposures arising from the translation of profits earned in foreign currency subsidiaries and associates; these exposures are not normally hedged. Exposures also arise from:

(i) foreign currency denominated trading transactions undertaken by subsidiaries. These exposures comprise committed and highly probable forecast sales and purchases, which are offset wherever possible. The remaining exposures are hedged within the Treasury policies and procedures with forward foreign exchange contracts and options, which are designated as hedges of the foreign exchange risk of the identified future transactions; and

(ii) forecast dividend flows from subsidiaries to the centre. To ensure cash flow certainty, the Group hedges such flows using forward foreign exchange contracts designated as net investment hedges of the foreign exchange risk arising from the investments in these subsidiaries.

IFRS 7 requires a sensitivity analysis that shows the impact on the income statement and on items recognised directly in other comprehensive income of hypothetical changes of exchange rates in respect of non-functional currency financial assets and liabilities held across the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. All financial assets and liabilities held in the functional currency of the Group's subsidiaries, as well as non-financial assets and liabilities and translation risk, are not included in the analysis. The Group considers a 10 per cent strengthening or weakening of the functional currency against the non-functional currency of its subsidiaries as a reasonably possible change. The impact is calculated with reference to the financial asset or liability held as at the year end, unless this is unrepresentative of the position during the year.

A 10 per cent strengthening of functional currencies against non-functional currencies would result in pre-tax profit being £122 million higher (2008: £187 million higher) and items recognised directly in other comprehensive income being £268 million higher (2008: £427 million higher). A 10 per cent weakening of functional currencies against non-functional currencies would result in pre-tax profit being £152 million lower (2008: £216 million lower) and items recognised directly in other comprehensive income being £328 million lower (2008: £519 million lower).

The exchange sensitivities on items recognised directly in other comprehensive income relates to hedging of certain net asset currency positions in the Group, but does not include sensitivities in respect of exchange on non-financial assets, as well as on cash flow hedges in respect of future transactions debt.

Interest rate risk

The objectives of the Group's interest rate risk management policy are to lessen the impact of adverse interest rate movements on the earnings, cash flow and economic value of the Group and to safeguard against any possible breach of its financial covenants. Additional objectives are to minimise the cost of hedging and the associated counterparty risk.

The Group targets gross interest cover to be between 5 and 9 and for 2009 it is 8.6 times (2008: 8.5 times). The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of 4.5.

In order to manage its interest rate risk, the Group maintains both floating rate and fixed rate debt. The Group sets targets (within overall guidelines) for the desired ratio of floating to fixed rate debt on both a gross (50:50 +/- 10) and net (at least 50 per cent fixed in the short to the medium term) basis as a result of regular reviews of market conditions and strategy by the Corporate Finance Committee and the board of the main central finance company. At 31 December 2009, the relevant ratios of floating to fixed rate borrowings were 48:52 (2008: 45:55) on a gross basis and 30:70 (2008: 25:75) on a net basis. Underlying borrowings are arranged on both a fixed rate and a floating rate basis and, where appropriate, the Group uses derivatives, primarily interest rate swaps, to vary the fixed and floating mix. The interest rate profile of liquid assets is taken into account in determining the net interest rate exposure.

IFRS 7 requires a sensitivity analysis that shows the impact on the income statement and on items recognised directly in other comprehensive income of hypothetical changes of interest rates in respect of financial assets and liabilities of the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. For the purposes of this sensitivity analysis, financial assets and liabilities with fixed interest rates are not included. The Group considers a 100 basis point change in interest rates a reasonably possible change except where rates are less than 100 basis points. In these instances it is assumed that the interest rates increase by 100 basis points and decrease to zero for the purpose of performing the sensitivity analysis. The impact is calculated with reference to the financial asset or liability held as at the year end, unless this is unrepresentative of the position during the year.

A 100 basis point increase in interest rates would result in pre-tax profit being £35 million lower (2008: £52 million lower). A 100 basis point decrease in interest rates, or less where applicable, would result in pre-tax profit being £34 million higher (2008: £52 million higher). The effect of these interest rate changes on items recognised directly in other comprehensive income is not material in either year.

24 Financial instruments continued

Credit risk

The Group has no significant concentrations of customer credit risk. Subsidiaries have policies in place requiring appropriate credit checks on potential customers before sales commence. The process for monitoring and managing credit risk once sales to customers have been made varies depending on local practice in the countries concerned.

Certain territories have bank guarantees, other guarantees and credit insurance provided in the Group's favour in respect of Group trade receivables, the issuance and terms of which are dependent on local practices in the countries concerned.

Cash deposits and other financial instruments give rise to credit risk on the amounts due from the related counterparties. Generally the Group targets a long-term counterparty credit rating of at least A/A2 however, the Group recognises that due to the need to operate over a large geographic footprint, sovereign risk can be the determining factor on the suitability of a counterparty. From time to time the Group may invest in short dated corporate commercial paper, for this the Group has identified specific counterparties with a minimum short-term rating of A1/P1.

Counterparty credit risk is managed on a global basis by limiting the aggregate amount and duration of exposure to any one counterparty, taking into account its credit rating. The credit ratings of all counterparties are reviewed regularly.

The Group ensures that it has sufficient counterparty credit capacity of requisite quality to undertake all anticipated transactions throughout its geographic footprint, while at the same time ensuring that there is no geographic concentration in the location of counterparties.

The maximum exposure to the credit risk of financial assets at the balance sheet date is reflected by the carrying values included in the Group's balance sheet. In addition, the Group has issued guarantees to third parties, part of which has been recognised on the balance sheet in accordance with IAS 39. The unrecognised portion of these guarantees amounts to £84 million (2008: £66 million).

Price risk

The Group is exposed to equity price risk on equity investments held by the Group, which are included in available-for-sale investments on the consolidated balance sheet, but the quantum of such is not material.

Hedge accounting

In order to qualify for hedge accounting, the Group is required to document prospectively the relationship between the item being hedged and the hedging instrument. The Group is also required to demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is reperformed periodically to ensure that the hedge has remained, and is expected to remain highly effective.

Fair value estimation

The fair values of financial assets and liabilities with maturities of less than one year, other than derivatives, are assumed to approximate their book values. For other financial instruments which are measured at fair value in the balance sheet, the basis for fair values is described below.

24 Financial instruments continued

Fair value hierarchy

The following table presents the Group's financial assets and liabilities that are measured at fair value in accordance with the IFRS 7 classification hierarchy:

	2009			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets at fair value				
Available-for-sale investments *(note 15)*	5	54	24	83
Derivatives relating to				
– interest rate swaps *(note 16)*		108		108
– cross-currency swaps *(note 16)*		15		15
– forward foreign currency contracts *(note 16)*		118		118
– others *(note 16)*	4	4		8
Assets at fair value	9	299	24	332
Liabilities at fair value				
Derivatives relating to				
– interest rate swaps *(note 16)*		1		1
– cross-currency swaps *(note 16)*		79		79
– forward foreign currency contracts *(note 16)*		127		127
– others *(note 16)*		14		14
Liabilities at fair value		221		221

Level 1 financial instruments are traded in an active market and fair value is based on quoted prices at 31 December 2009. This category includes listed equity shares of £8 million.

Level 2 financial instruments are not traded in an active market but the fair values are based on quoted market prices, broker dealer quotations, or alternative pricing sources with reasonable levels of price transparency. Level 2 financial instruments include certain money market securities and most OTC derivatives.

The fair values of level 3 financial instruments have been determined using a valuation technique where at least one input (which could have a significant effect on the instrument's valuation) is not based on observable market data. Level 3 financial instruments primarily consist of an equity investment in an unquoted entity which is valued using the discounted cash flows of estimated future dividends. The valuation assumes the following:

– future dividends grow by 2 per cent and a 100 basis points decrease in the growth rate would result in the valuation being £2 million lower; and

– discount rate of 8 per cent and a 100 basis points decrease in the discount rate would result in the valuation being £4 million higher.

The following table presents the changes in level 3 financial instruments for the year ended 31 December 2009:

	2009 Available-for-sale investments £m
Beginning of year	24
Gains included in other comprehensive income	2
Differences on exchange	(2)
End of year	24

25 Cash flow

Cash generated from operations

	2009 £m	2008 £m
Profit from operations	**4,101**	3,572
Adjustments for		
– amortisation of trademarks	**58**	24
– gains on disposal of businesses and trademarks	**(2)**	(141)
– depreciation and impairment of property, plant and equipment	**433**	350
– amortisation and write-off of intangible assets	**120**	56
– increase in inventories	**(125)**	(367)
– decrease in trade and other receivables	**30**	19
– increase in trade and other payables	**174**	746
– decrease in net retirement benefit liabilities	**(127)**	(99)
– decrease in provisions for liabilities and charges	**(38)**	(31)
– other non-cash items	**21**	27
Cash generated from operations	**4,645**	4,156

Profit from operations includes charges in respect of Group restructuring and integration costs referred to in note 3(e). These are also reflected in the movements in depreciation, amortisation, inventories, receivables, payables and provisions above and in the proceeds on disposal of subsidiaries as well as on disposal of property, plant and equipment shown in the Group cash flow statement. The net cash outflow in respect of the Group's restructuring costs was £173 million (2008: £151 million), of which £187 million (2008: £210 million) is included in cash generated from operations above.

In 2008, cash generated from operations included an outflow of £102 million relating to the Canadian settlement explained in note 3(f).

Cash flows from investing activities

(a) Proceeds on disposals of intangibles

In 2008, the £17 million cash inflow on disposal of intangibles comprised the cash received on the termination of a licence agreement in South Africa in 2007.

(b) Purchases and proceeds on disposals of investments

The purchases and disposals of investments (which comprise available-for-sale investments and loans and receivables) included a net cash inflow of £37 million (2008: £8 million) in respect of current investments and a £nil (2008: £1 million) inflow from non-current investments.

(c) Proceeds from associates' share buy-backs

In 2008, the proceeds from associates' share buy-backs principally reflected proceeds of £41 million in respect of the Group's participation in the share buy-back programme conducted by Reynolds American Inc (see note 29).

(d) Purchase of Bentoel

In 2009, the net cash outflow of £370 million on the purchase of Bentoel reflects the settlement of the purchase consideration for an initial 85 per cent stake followed by the acquisition of a further 14 per cent from minority shareholders, together with related acquisition costs and the acquired cash and cash equivalents and overdrafts as shown in note 26(a).

(e) Purchase of Tekel cigarette assets

As explained in note 26(b), the cash outflow of £12 million in 2009 reflected additional cash paid in respect of purchase price adjustments from the conclusion of the Tekel transaction. In 2008, the cash outflow of £873 million reflected the initial purchase price and related acquisition costs as shown in note 26(b).

(f) Proceeds from ST trademark disposals and purchase of ST businesses

The cash inflow in 2009 reflects proceeds of £188 million from the disposal of a small number of ST trademarks in Norway (see note 3(h)), the payment of the related disposal costs of £3 million and a £2 million refund of the original purchase price. In 2008, the net cash outflow of £1,243 million comprised the settlement of the purchase consideration, together with related acquisition costs and the acquired cash and cash equivalents and overdrafts.

25 Cash flow continued

(g) Purchases of other subsidiaries, associates and minority interests

The purchase of other subsidiaries, associates and minority interests in 2009 principally arises from equity investments in associate companies, while in 2008, the cash outflow arose from the acquisition of minority interests in the Group's subsidiaries in the Africa and Middle East and Western Europe regions.

(h) Proceeds on disposal of subsidiaries

In 2008, the cash inflow principally reflected the net proceeds on disposal of a non-core business in the Asia-Pacific region.

Cash flows from financing activities

(a) In November 2009, the terms of €481 million of the €1.0 billion bond maturing in 2013 were modified by extending the maturity to 2021. At the same time, the Group issued an additional €169 million bond with a maturity of 2021. In addition, £199 million of the £350 million bond maturing in 2013 was purchased and cancelled; at the same time the Group issued a new £500 million bond with a maturity of 2034.

In June and August 2009, the Group issued a £250 million bond maturing in 2022, and a MYR250 million bond maturing in 2014. The Group also repaid €900 million, MYR100 and MYR150 million bonds upon maturity in February, May and November respectively. During 2009, the Group also re-established its euro commercial paper programme (ECP). £187 million of ECP was outstanding at 31 December 2009.

In 2008, the increase in borrowings principally reflected the issue of €1.25 billion and £500 million bonds maturing in 2015 and 2024 respectively. The bonds replaced the €1.8 billion revolving credit facility arranged in December 2007 and cancelled in 2008. In addition, the Group increased its €1 billion 5.375 per cent bond by an additional €250 million, bringing the total size of the bond to €1.25 billion.

On 13 February 2008, the Group entered into an acquisition credit facility whereby lenders agreed to make available an amount of US$2 billion. On 1 May 2008, this facility was syndicated in the market and was redenominated into two euro facilities of €420 million and €860 million; €395 million and €759 million were outstanding as at 31 December 2008 respectively. The €395 million was repaid in September 2009 and €759 million was repaid in October 2009. The €759 million was refinanced by a new €700 million term loan facility with a maturity date of 31 October 2012 with an option to extend it to October 2013, at the discretion of the banking participants in the syndicated facility.

In November 2008, the Group also issued US$300 million and US$700 million bonds, maturing in 2013 and 2018 respectively, pursuant to Rule 144A and RegS under the US Securities Act. On 22 September 2008, the Group repurchased its maturing Mexican MXN1,055 million UDI bond and refinanced it with a floating rate borrowing of MXN1,444 million, as well as repaying its US$330 million and £217 million fixed rate bonds upon maturity in May 2008 and November 2008 respectively.

(b) The movement relating to derivative financial instruments is in respect of derivatives taken out to hedge cash and cash equivalents and external borrowings, derivatives taken out to hedge inter-company loans and borrowings and derivatives treated as net investment hedges. Derivatives taken out as cash flow hedges in respect of financing activities are also included in the movement relating to derivative financial instruments, while other such derivatives in respect of operating and investing activities are reflected along with the underlying transactions.

26 Business combinations and disposals

(a) PT Bentoel Internasional Investama Tbk (Bentoel)

On 17 June 2009, the Group acquired from PT Rajawali Corpora and other shareholders an 85 per cent stake in Indonesia's fourth largest cigarette maker Bentoel for US$494 million (£303 million). The price is equivalent to IDR873 per share, a premium of 20 per cent over Bentoel's closing price of IDR730 per share on 17 June 2009. A public tender offer for the remaining shares was announced after the acquisition and was completed on 26 August 2009, resulting in the acquisition of a further 14 per cent share in the company, for IDR855,783 million (£52 million), bringing the total shareholding in the Bentoel Group to 99.7 per cent.

On 20 October 2009, it was announced that Bentoel and BAT Indonesia would enter into a merger plan whereby BAT Indonesia would merge into Bentoel. This was completed with an effective date of 1 January 2010, and the total shareholding in the merged group is 99.14%. The Bentoel name has been retained and the company remains listed on the Indonesian Stock Exchange.

The goodwill of £188 million on the acquisition of the cigarette business of Bentoel, stated at the exchange rates ruling at the date of the transaction, arises as follows:

	Book value £m	Fair value adjustments £m	Fair value £m
Intangible assets	4	92	96
Property, plant and equipment	57	21	78
Deferred tax asset	5	(5)	
Inventories	152	(13)	139
Trade and other receivables	41		41
Cash and cash equivalents	3		3
Overdrafts	(13)		(13)
Borrowings	(84)		(84)
Retirement benefit liabilities	(9)	(1)	(10)
Deferred tax liabilities		(29)	(29)
Trade and other payables	(48)		(48)
Net assets acquired	108	65	173
Less: minority share of net assets acquired			(1)
			172
Goodwill			188
Total consideration including acquisition costs of £5 million *(note 25(d))*			360

The book values of the acquired assets have been revalued to fair value as at acquisition date. The main adjustments relate to the recognition of trademarks, the revaluation of property, plant and equipment and inventory and the related impact of deferred taxation.

The goodwill of £188 million on the acquisition of the business represents a strategic premium to enter the large Indonesian kretek market and the anticipated synergies that will arise from combining the businesses in Indonesia.

In the period from 17 June 2009 to 31 December 2009, the acquired business contributed revenue of £105 million and profit from operations of £6 million after charging £4 million for amortisation of acquired intangibles and £2 million in respect of restructuring and integration costs.

If the acquisition had occurred on 1 January 2009, before accounting for anticipated synergies, restructuring and pricing benefits, it is currently estimated that Group revenue would have been £14,291 million and Group profit from operations would have been £4,108 million for the 12 months to 31 December 2009. These amounts have been estimated based on Bentoel's results for the six months prior to acquisition, adjusted to reflect changes arising from differences in accounting policies and the anticipated effect of fair value adjustments. The amounts reported for profit from operations are after charging £4 million for the amortisation of acquired intangibles for the period to 17 June 2009.

From the Chairman
Performance and strategy
Regional review
Financial review
Governance
Group financial statements
Parent Company financial statements
Shareholder information

26 Business combinations and disposals continued

(b) Tekel

On 22 February 2008, the Group announced that it had won the public tender to acquire the cigarette assets of Tekel, the Turkish state-owned tobacco company, with a bid of US$1,720 million. The acquisition only related to the cigarette assets of Tekel, which principally comprised trademarks, factories and tobacco leaf stocks. The acquisition did not include employees and the Group had directly employed the required workforce by the effective date of the transaction. Completion of this transaction was subject to regulatory approval which was subsequently received and on 24 June 2008 the Group completed the transaction subject to finalisation of the purchase price based on agreed completion accounts.

As noted in the 2008 Annual Report, part of the transaction had still to be finalised. This occurred in 2009 with an adjustment of £12 million to the provisional purchase price of £873 million and therefore to goodwill. The goodwill of £578 million (previously £566 million) on the cigarette assets of Tekel, stated at the exchange rates ruling on the date of the transaction, arose as follows:

	Fair value £m
Net assets acquired	**307**
Goodwill	**578**
Total consideration	**885**
Consideration comprises	
– cash	**878**
– acquisition costs	**7**
Total consideration	**885**

(c) Skandinavisk Tobakskompagni (ST)

On 27 February 2008, the Group agreed to acquire 100 per cent of ST's cigarette and snus businesses in exchange for its existing 32.35 per cent holding in ST and payment of DKK11,582 million (£1,237 million) in cash. Completion of this transaction was subject to regulatory approval which was subsequently received on the condition that the Group agreed to divest a small number of local trademarks, primarily in Norway. The transaction was completed on 2 July 2008. The transaction resulted in a revaluation gain of £179 million, included in other comprehensive income for the year ended 31 December 2008, and goodwill of £923 million. The gain on disposal from this transaction and subsequent trademark disposals are explained in note 3(h).

Until the date of the transaction, the results of ST were equity accounted as an associated undertaking and following the transaction, the results of the acquired businesses have been consolidated.

(d) Items classified as held-for-sale

At 31 December 2009, £12 million of inventories and £2 million of current trade and other receivables have been presented as held-for-sale assets and £16 million of current trade and other payables have been presented as held-for-sale liabilities and relate to a non-core business being actively marketed for sale in Western Europe.

At 31 December 2008, held-for-sale assets reflect principally ST trademarks of £182 million which were disposed of in 2009 (note 3(h)) as a condition for regulatory approval of the acquisition of the cigarette and snus businesses of ST, and £18 million of property, plant and equipment in Bologna, Italy which was sold in 2009. Of the £16 million of property, plant and equipment acquired from Tekel classified as held-for-sale at 31 December 2008, £3 million of plant and equipment has been sold in 2009 and £1 million reclassified to property, plant and equipment as the sale of these assets is no longer highly probable. £13 million of property continues to be classified as held-for-sale at 31 December 2009.

The remainder of 2009 and 2008 held-for-sale assets comprises non-core assets in various locations being actively marketed for sale comprising plant, property and equipment of £3 million (2008: £9 million).

27 Share-based payments

During the period ended 31 December 2009, the following material share-based payment arrangements existed, which are described below:

Type of arrangement	Long-Term Incentive Plan	Deferred Share Bonus Scheme	Sharesave Scheme	Share Option Scheme	Share Reward Scheme
Timing of grant	Annually in March and May	Annually in March	Annually in November	See note (a)	Annually in April
Number of options/ shares granted in 2009	March – 3,809,739	3,567,941	3 year – 104,361 5 year – 115,004	n/a	253,678
Number of options/ shares granted in 2008	March – 1,973,421 May – 755,187	1,739,960	3 year – 143,280 5 year – 165,859	n/a	155,643
Fair value per share for 2009 grant	March – £11.00	£ 13.47	3 year – £3.89 5 year – £4.15	n/a	£ 16.07
Fair value per share for 2008 grant	March – £12.80 May – £13.47	£ 17.03	3 year – £3.73 5 year – £3.95	n/a	£ 19.22
Method of settlement	Both equity and cash-settled grants	Both equity and cash-settled grants	Equity	Both equity and cash-settled grants	Equity
Contractual life	10 years	3 years	3.5 or 5.5 years	10 years	3 years
Vesting conditions	See note (b)	See note (c)	See note (d)	See note (e)	See note (f)

Notes:

(a) The granting of options under this scheme ceased with the last grant made in March 2004. Eligible individuals are entitled to participate in the Long-Term Incentive Plan and Deferred Share Bonus Scheme.

(b) Nil-cost options exercisable three years from date of grant, with payout subject to performance conditions based on earnings per share relative to inflation (50 per cent of grant) and total shareholder return, combining the share price and dividend performance of the Company by reference to two comparator groups (50 per cent of grant). Participants are not entitled to dividends prior to the exercise of the options. For grants made in 2005 and thereafter, a cash equivalent dividend will accrue through the vesting period and will be paid on vesting.

(c) Free shares released three years from date of grant and may be subject to forfeit if participant leaves employment before the end of the three year holding period. Participants receive a separate payment equivalent to a proportion of the dividend during the holding period.

(d) Options granted by invitation at a 20 per cent discount to the market price. Options are exercisable at the end of a three year or five year savings contract. Participants are not entitled to dividends prior to the exercise of the options. The maximum amount that can be saved by a participant in this way is £3,000 in any tax year.

(e) Options exercisable three years from date of grant and subject to earnings per share performance condition relative to inflation. Participants are not entitled to receive dividends in the period prior to the exercise of the options.

(f) Free shares granted (maximum £3,000 in any year) subject to a three year holding period and may be subject to forfeit if the employee leaves within this period. Participants are entitled to receive dividends during the holding period which are reinvested to buy further shares.

During the period, the Company operated a Partnership Share Scheme, which was open to all eligible employees, where employees can allocate part of their pre-tax salary to purchase shares in British American Tobacco p.l.c. The maximum amount that can be allocated in this way to any individual is £1,500 in any tax year. The shares purchased are held in a UK-based trust and are normally capable of transfer to participants tax free after a five year holding period.

Further details on the operation of share-based payment arrangements can be found in the Remuneration report.

27 Share-based payments continued

Share option schemes

Details of the movements for equity-settled share option schemes during the years ended 31 December 2009 and 31 December 2008 covering the Share Option and Sharesave Schemes were as follows:

	2009		2008	
	Number of options	Weighted average exercise price per share £	Number of options	Weighted average exercise price per share £
Outstanding at start of year	**3,289,947**	**8.34**	4,596,010	7.32
Granted during the period	**219,365**	**15.55**	309,139	13.60
Exercised during the period	**(1,016,568)**	**7.60**	(1,507,887)	6.17
Forfeited during the period	**(57,160)**	**12.72**	(107,315)	10.25
Outstanding at end of year	**2,435,584**	**9.55**	3,289,947	8.34
Exercisable at end of year	**1,203,109**	**6.79**	2,209,370	6.78

In addition to the above options, the movement in nil-cost equity-settled options from the Long-Term Incentive Plan was as follows:

	2009 Number of options	2008 Number of options
Outstanding at start of year	**6,712,197**	7,322,045
Granted during the period	**3,451,451**	2,363,555
Exercised during the period	**(2,271,963)**	(2,544,530)
Forfeited during the period	**(330,835)**	(423,591)
Changed to cash-settled share-based payment arrangement*	**(1,230)**	(5,282)
Outstanding at end of year	**7,559,620**	6,712,197
Exercisable at end of year	**619,141**	1,036,291

*During 2009, equity-settled awards in respect of 1,230 (2008: 5,282) options were modified to a cash-settled basis.

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the period was £17.58 (2008: £18.77). A detailed breakdown of the range of exercise prices for options outstanding for the years ended 31 December 2009 and 31 December 2008 is shown in the table below:

	2009			2008		
Range of exercise prices	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £
Nil-cost	**7,559,620**	**8.2**	**n/a**	6,712,197	7.8	n/a
£2.53 to £4.99	**60,672**	**0.2**	**2.54**	107,256	1.2	2.54
£5.00 to £6.99	**609,528**	**2.7**	**6.08**	1,185,185	3.1	5.98
£7.00 to £8.99	**738,914**	**3.1**	**7.68**	1,016,553	4.4	7.77
£9.00 to £12.49	**306,281**	**1.6**	**10.93**	445,619	2.0	10.60
£12.50 to £15.99	**720,189**	**3.6**	**14.41**	535,334	4.2	13.92
	9,995,204	**6.9**	**2.33**	10,002,144	6.1	2.74

The weighted average fair value of equity-settled share option schemes shares granted during 2009 was £10.58 (2008: £11.96).

27 Share-based payments continued

Assumptions used in the Black-Scholes models to determine the fair value of share options at grant date were as follows:

	2009		2008	
	Long-Term Incentive Plan	**Sharesave Schemes****	Long-Term Incentive Plan*	Sharesave Schemes**
Share price at date of grant (£)	**15.79**	**19.43**	19.03/20.01	17.00
Exercise price (£)	**nil-cost**	**15.55**	nil-cost	13.60
Volatility (%)	**24**	**25**	18	23
Average expected term to exercise (years)	**3.5**	**3.2/5.2**	3.5	3.2/5.2
Risk-free rate (%)	**2.1**	**1.6/2.6**	3.9/4.5	2.7/3.2
Expected dividend yield (%)	**5.3**	**4.6**	3.7/3.5	4.1

*Where two figures have been quoted for the Long-Term Incentive Plan, the first number represents the March award and the second number the May award.

**Where two figures have been quoted for the Sharesave Schemes, the first number represents the assumptions for the three-year savings contract and the second number for the five-year savings contract.

Market condition features were incorporated into the Monte Carlo models for the total shareholder return elements of the Long-Term Incentive Plan, in determining fair value at grant date. Assumptions used in these models were as follows:

	2009	2008
Average share price volatility FTSE 100 comparator group	**35**	26
Average share price volatility FMCG comparator group	**24**	19
Average correlation FTSE 100 comparator group	**38**	31
Average correlation FMCG comparator group*	**32**	18/17

*Where two figures have been quoted for the Long-Term Incentive Plan, the first number represents the March award and the second number the May award.

The expected British American Tobacco p.l.c. share price volatility was determined taking account of the daily share price movements over a five year period. The respective FMCG and FTSE 100 share price volatility and correlations were also determined over the same periods. The average expected term to exercise used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural conditions, forfeiture and historical experience.

The risk-free rate has been determined from market yield curves for government gilts with outstanding terms equal to the average expected term to exercise for each relevant grant. The expected dividend yield was determined by calculating the yield from the last two declared dividends divided by the grant share price, adjusted for the Group's announced change in dividend policy.

For grants containing earnings per share performance conditions, the payout calculation is based on the expectations published in analysts' forecasts.

Other equity share-based payment arrangements (other than share options)

Details of the movements of other equity share-based payment arrangements during the years ended 31 December 2009 and 31 December 2008, covering the Deferred Share Bonus and Share Reward Schemes, were as follows:

	2009 Number of shares	2008 Number of shares
Outstanding at start of year	**5,069,083**	5,613,160
Granted during the period	**3,326,759**	1,616,662
Exercised during the period	**(1,847,581)**	(2,102,905)
Forfeited during the period	**(57,921)**	(56,929)
Changed to cash-settled share-based payment arrangement*	**(8,376)**	(905)
Outstanding at end of year	**6,481,964**	5,069,083
Exercisable at end of year	**240,408**	307,244

*Equity-settled awards in respect of 8,376 (2008: 905) shares were modified to a cash-settled basis.

The shares outstanding for the year ended 31 December 2009 had a weighted average contractual life of 1.4 years (2008: 1.1 years).

27 Share-based payments continued

The fair value for other equity share-based payment arrangements granted during the period was determined using the Black-Scholes model with the following input assumptions at their grant date:

	2009		2008	
	Deferred Share Bonus Scheme	Share Reward Scheme	Deferred Share Bonus Scheme	Share Reward Scheme
Grant price (£)	**15.79**	**16.07**	19.03	19.22
Expected volatility (%)	**24**	**24**	18	18
Average expected term to exercise (years)	**3.0**	**5.0**	3.0	5.0
Risk-free rate (%)	**2.0**	**2.3**	3.9	4.0
Expected dividend yield (%)	**5.3**	**5.2**	3.7	3.7

The weighted average fair value of other equity share-based payment arrangements granted during 2009 was £13.67 (2008: £17.24).

Cash-settled share-based payment arrangements

The Group issues to certain employees cash-settled share-based payments that require the Group to pay the intrinsic value of these share-based payments to the employee at the date of exercise. The Group has recorded liabilities at the end of 2009 of £25.7 million (2008: £23.1 million) of which £5.7 million (2008: £5.0 million) was in respect of vested grants. Fair value was determined from the Black-Scholes and Monte Carlo models, using assumptions revised at the balance sheet date for cash-settled share-based payment arrangements. The Group recorded total expenses of £14.0 million in 2009 (2008: £12.4 million).

Details of movements for cash-settled arrangements in respect of the Share Option Scheme during the years ended 31 December 2009 and 31 December 2008, were as follows:

	2009		2008	
	Number of options	Weighted average exercise price per share £	Number of options	Weighted average exercise price per share £
Outstanding at start of year	**213,189**	**6.51**	295,331	6.63
Granted during the period	**n/a**	**n/a**	n/a	n/a
Exercised during the period	**(103,113)**	**6.15**	(82,142)	6.92
Forfeited during the period				
Outstanding at end of year	**110,076**	**6.85**	213,189	6.51
Exercisable at end of year	**110,076**	**6.85**	213,189	6.51

In addition to the above, the movement in other nil-cost cash-settled arrangements during the years ended 31 December 2009 and 31 December 2008, covering the Long-Term Incentive Plan and Deferred Share Bonus Scheme, were as follows:

	2009 Number of shares	2008 Number of shares
Outstanding at start of year	**2,015,771**	2,278,828
Granted during the period	**853,148**	643,994
Exercised during the period	**(644,496)**	(849,468)
Forfeited during the period	**(41,006)**	(63,770)
Changed from equity-settled share-based arrangement*	**9,606**	6,187
Outstanding at end of year	**2,193,023**	2,015,771
Exercisable at end of year	**209,736**	143,742

*As explained in the sections for Share Option Schemes and Other equity share-based payment arrangements, 9,606 (2008: 6,187) awards in respect of shares were changed from an equity-settled to a cash-settled basis.

Assumptions used to determine the fair value of cash-settled share-based payment arrangements at date of grant, can be found in the sections relating to share option schemes and other equity share-based payment arrangements.

27 Share-based payments continued

The weighted average British American Tobacco p.l.c. share price at the date of exercise for cash-settled share-based arrangements exercised during the period was £17.17 (2008: £18.86). A detailed breakdown of the range of exercise prices for cash-settled share-based payment arrangements outstanding for the years ended 31 December 2009 and 31 December 2008 are shown in the table below:

	2009			2008		
Range of exercise prices	**Number outstanding at end of year**	**Weighted average remaining contractual life in years**	**Weighted average exercise price per share £**	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £
Nil-cost	**2,193,023**	**5.9**	**n/a**	2,015,771	5.5	n/a
£5.60 to £5.98	**51,281**	**3.2**	**5.98**	96,859	4.0	5.96
£6.39 to £8.09	**58,795**	**3.1**	**6.93**	116,330	3.9	6.98
	2,303,099	**5.6**	**0.54**	2,228,960	5.4	0.62

Share-based payment expense

The amounts recognised in the income statement in respect of share-based payments were as follows:

	2009 £m	2008 £m
Equity-settled share-based payments	**61**	51
Cash-settled share-based payments	**14**	12
Total amount recognised in the income statement *(note 3(a))*	**75**	63

28 Group employees

The average number of persons employed by the Group and its associates during the year, including Directors, was 95,710 (2008: 96,381).

	2009 Number	2008 Number restated
Asia-Pacific	**16,414**	10,866
Americas	**16,626**	16,223
Western Europe	**12,906**	13,386
Eastern Europe	**8,079**	7,969
Africa and Middle East	**7,028**	7,726
Subsidiary undertakings	**61,053**	56,170
Associates	**34,657**	40,211
	95,710	96,381

The table above has been re-presented for the new regional structure effective 1 January 2009.

Details of Directors' remuneration, share options and retirement benefits are given in the Remuneration report.

The acquisition of Bentoel in June 2009 included a labour force of over 19,000 of which 12,400 are temporary workers and therefore not included in the average number of persons employed by the Group. Included within the employee numbers for Europe are certain employees in the UK in respect of central functions. Some of the costs of these employees are allocated or charged to the various regions and markets in the Group.

29 Related party disclosures

The Group has a number of transactions and relationships with related parties, as defined in IAS 24 (Related Party Disclosures), all of which are undertaken in the normal course of business.

Transactions and balances with associates relate mainly to the sale and purchase of cigarettes and tobacco leaf. Amounts receivable from associates in respect of dividends included in the table below were £68 million (2008: £72 million). The Group's share of dividends from associates included in other net income in the table below, was £331 million (2008: £326 million). Legal fees recovered from Reynolds American Inc. included in other net income amounted to £nil (2008: £1 million).

In 2008, proceeds of £41 million were received from the Group's participation in the Reynolds American Inc. share buy-back programme (note 25), and a further £1 million from the repurchase of shares by Procesadora Unitab.

	2009 £m	2008 £m
Transactions		
– revenue	**47**	29
– purchases	**(365)**	(298)
– other net income	**329**	325
Amounts receivable at 31 December	**78**	79
Amounts payable at 31 December	**(34)**	(59)

As discussed in notes 3(h) and 26, in 2008 the Group realised a gain of £139 million on the disposal of its 32.35 per cent holding in the non-cigarette and snus businesses of ST. The gain on disposal is not included in the above table.

As shown in note 20, a capital injection was made into British American Tobacco (Algérie) S.P.A. where the minority shareholder SOCALTA (Societe Algerienne de Trading Alimentaire) contributed £16 million. This minority contribution was assisted by a loan from another Group subsidiary of £4 million.

The key management personnel of British American Tobacco consist of the members of the Board of Directors of British American Tobacco p.l.c. and the members of the Management Board. No such person had any material interest during the year in a contract of significance (other than a service contract) with the Company or any subsidiary company. The term key management personnel in this context includes the respective members of their households.

	2009 £m	2008 £m
The total compensation for key management personnel, including Directors, was:		
– salaries and other short-term employee benefits	**18**	18
– post-employment benefits	**3**	3
– share-based payments	**9**	7
	30	28

There were no other long-term benefits applicable in respect of key personnel other than those disclosed in the Remuneration report in the Annual Report.

In November 2008, the controlling companies of R&R Holdings S.A., Richemont and Remgro, distributed the 30 per cent of the shares of British American Tobacco that they indirectly held to their shareholders. A new subsidiary of Richemont and Remgro, Reinet Investments S.C.A, now owns 4 per cent (2008: 4 per cent) of the shares of British American Tobacco, while the rest are owned by non-related individuals and institutions.

30 Contingent liabilities and financial commitments

The Group is subject to contingencies pursuant to requirements that it complies with relevant laws, regulations and standards. Failure to comply could result in restrictions in operations, damages, fines, increased tax, increased cost of compliance, interest charges, reputational damage, or other sanctions. These matters are inherently difficult to quantify.

In cases where the Group has an obligation as a result of a past event existing at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and the amount of the obligation can be reliably estimated, a provision would be recognised based on best estimates and management judgment.

There are, however, contingent liabilities in respect of litigation, taxes in some countries and guarantees for which no provisions were made.

The Group has exposures in respect of the payment or recovery of a number of taxes. The Group is and has been subject to a number of tax audits covering amongst others, excise tax, value added taxes, sales taxes, corporate taxes, withholding taxes and payroll taxes.

The estimated costs of known tax obligations have been provided in these accounts in accordance with the Group's accounting policies. In some countries, tax law requires that full or part payment of disputed tax assessments be made pending resolution of the dispute. To the extent that such payments exceed the estimated obligation, they would not be recognised as an expense. In some cases disputes are proceeding to litigation.

While the amounts that may be payable or receivable could be material to the results or cash flows of the Group in the period in which they are recognised, the Board does not expect these amounts to have a material effect on the Group's financial condition.

Product liability litigation

Group companies, notably Brown & Williamson Holdings, Inc. (formerly Brown & Williamson Tobacco Corporation) (B&W) as well as other leading cigarette manufacturers, are defendants, principally in the United States, in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

Indemnity

In 2004, B&W completed the combination of the assets, liabilities and operations of its US tobacco business with R.J. Reynolds Tobacco Company (RJRT), a wholly-owned subsidiary of R.J. Reynolds Tobacco Holdings, Inc., pursuant to which Reynolds American Inc. was formed (the Business Combination). As part of the Business Combination, B&W contributed to RJRT all of the assets and liabilities of its US cigarette and tobacco business, subject to specified exceptions, in exchange for a 42 per cent equity ownership interest in Reynolds American. As a result of the Business Combination:

- B&W discontinued the active conduct of any tobacco business in the United States;
- B&W contributed to RJRT all of its assets other than the capital stock of certain subsidiaries engaged in non-US businesses and other limited categories of assets;
- RJRT assumed all liabilities of B&W (except liabilities to the extent relating to businesses and assets not contributed by B&W to RJRT and other limited categories of liabilities) and contributed subsidiaries or otherwise to the extent related to B&W's tobacco business as conducted in the US on or prior to 30 July 2004; and
- RJRT agreed to indemnify B&W and each of its associates (other than Reynolds American and its subsidiaries) against, among other matters, all losses, liabilities, damages, expenses, judgments, attorneys' fees, etc., to the extent relating to or arising from such assumed liabilities or the assets contributed by B&W to RJRT (the RJRT Indemnification).

The scope of the RJRT Indemnification includes all expenses and contingent liabilities in connection with litigation to the extent relating to or arising from B&W's US tobacco business as conducted on or prior to 30 July 2004, including smoking and health tobacco litigation, whether the litigation is commenced before or after 30 July 2004 (the Tobacco Litigation).

Pursuant to the terms of the RJRT Indemnification, RJRT is liable for any possible judgments, the posting of appeal bonds or security, and all other expenses of and responsibility for managing the defence of the Tobacco Litigation. RJRT has assumed control of the defence of the Tobacco Litigation involving B&W, to which RJRT is also a party in most (but not all) of the same cases. Accordingly, RJRT uses or plans to use the same law firm or firms to represent both B&W and RJRT in any single or similar case (except in certain limited circumstances) as RJRT's interests are typically aligned with B&W's interests, as RJRT has substantial experience in managing recognised external legal counsel in defending the Tobacco Litigation, and external counsel have independent professional responsibilities to represent the interests of B&W. In addition, in accordance with the terms of the RJRT Indemnification, associates of B&W have retained control of the defence in certain Tobacco Litigation cases with respect to which such associates are entitled to indemnification.

30 Contingent liabilities and financial commitments continued

US litigation

The total number of US product liability cases pending at 31 December 2009 involving B&W and/or other Group companies was approximately 3,203 (2008: 3,251). These case numbers do not include any cases where RJRT is sued as successor to B&W. At 31 December 2009, UK-based Group companies have been served as co-defendants in six of those cases (2008: six). In 2009, only one case (Lincoln Smith, see below) was tried against B&W. No product liability case in which a UK-based Group company is a defendant was tried in 2009, and no case in which a UK-based Group company is a defendant is currently scheduled for trial in 2010. Four cases naming B&W are currently scheduled for trial in 2010. These four cases include the consolidated proceedings in West Virginia (see below), and three individual smoking and health cases, which are pending in Maryland state court, Missouri state court, and the US District Court for the Central District of California.

Since many of these pending cases seek unspecified damages, it is not possible to quantify the total amounts being claimed, but the aggregate amounts involved in such litigation are significant, possibly totalling billions of US dollars. The cases fall into four broad categories:

(a) Medical reimbursement cases

These civil actions seek to recover amounts spent by government entities and other third party providers on health care and welfare costs claimed to result from illnesses associated with smoking. Although B&W continues to be a defendant in health care cost recovery cases involving plaintiffs such as hospitals and Native American tribes (see below), the vast majority of such cases have been dismissed on legal grounds.

At 31 December 2009, two US medical reimbursement suits were pending against B&W. One of these suits was brought by an Indian tribe in an Indian tribal court in South Dakota. The other reimbursement case (City of St. Louis) is pending against B&W, British American Tobacco (Investments) Limited (Investments) and several other defendants in state court in Missouri. In City of St. Louis, plaintiffs consist of more than 50 public and non-profit hospitals in Missouri and seek reimbursement of past and future alleged smoking-related health care costs. Plaintiffs have previously filed a motion requesting the court to give collateral estoppel effect to the factual findings of the US Department of Justice case to which certain defendants (including B&W and Investments) filed a memorandum in opposition. This motion remains pending. On 30 June 2009, the court denied defendants' motion for summary judgment based on the plaintiffs' failure to link alleged wrongful conduct to alleged damages. Defendants' motion for reconsideration of the court's 30 June 2009 order remains pending. A provisional trial date is set for 10 January 2011.

(b) Class actions

At 31 December 2009, B&W has been named as a defendant in eight (2008: 10) separate actions attempting to assert claims on behalf of classes of persons allegedly injured or financially impacted through smoking or where classes of tobacco claimants have been certified. If the classes are or remain certified and the possibility of class-based liability is eventually established, it is likely that individual trials will be necessary to resolve any claims by individual plaintiffs. Class-action suits have been filed in a number of US state and federal courts against individual cigarette manufacturers and their parent corporations, alleging that the use of terms 'lights' and 'ultralights' constitutes unfair and deceptive trade practices.

A class-action complaint (Schwab) was filed in the US District Court for the Eastern District of New York on 11 May 2004 against several defendants, including B&W and certain UK-based Group companies. The complaint challenges the defendants' practices with respect to the marketing, advertising, promotion and sale of 'light' cigarettes, and seeks billions of dollars in economic damages. The district court granted plaintiffs' motion for class certification on 25 September 2006. On 3 April 2008, in a unanimous ruling, the Schwab class was decertified by the US Court of Appeals for the Second Circuit. The Court of Appeals issued the mandate officially returning the case to the district court on 29 May 2008. Defendants have until 5 March 2010 to answer the plaintiffs' Second Amended Complaint.

A class-action complaint (Cleary) was filed in state court in Chicago, Illinois on 3 June 1998 against several defendants, including B&W, B.A.T Industries p.l.c. (Industries) and Investments. Industries was dismissed on jurisdictional grounds by an intermediate appellate court on 17 March 2000. The Third Amended Complaint, filed on 3 March 2009, alleges that all defendants fraudulently concealed facts regarding the addictive nature of nicotine, that certain US defendants (but not Investments) marketed tobacco products to underage consumers, and that defendant Philip Morris fraudulently marketed Marlboro Lights cigarettes. Plaintiffs seek disgorgement of profits. The case was removed to federal court on 13 March 2009, and plaintiffs' motion to remand the case back to state court was denied on 1 July 2009. On 15 July 2009, plaintiffs filed a motion for class certification. On 30 October 2009, Investments, along with other defendants, filed motions for summary judgment. On 1 February 2010, the court issued an order that granted summary judgment dismissing plaintiffs' fraudulent concealment of addiction claim, and permitted plaintiffs 45 days (or until 18 March 2010) to seek to reinstate that claim if plaintiffs can identify a new plaintiff to represent the putative class asserting that claim. The court further granted summary judgment dismissing plaintiffs' youth marketing claims and permitted the Marlboro Lights claim to proceed against defendant Philip Morris at this time. To date, the court has not issued any decision on the class certification motion.

Other types of class-action suits assert claims on behalf of classes of individuals who claim to be addicted, injured, or at greater risk of injury by the use of tobacco or exposure to environmental tobacco smoke, or the legal survivors of such persons.

In Engle (Florida), filed on 5 May 1994, a jury rendered a punitive damages verdict in favour of the Florida class against all defendants, with US$17.6 billion (approximately £10.9 billion) in punitive damages assessed against B&W. After various post-trial and appellate proceedings, the Florida Supreme Court, among other things, affirmed an intermediate appellate court's decision to decertify the class, vacated the jury's punitive damages award and permitted putative Engle class members to file individual lawsuits against the Engle defendants within one year of the court's decision (subsequently extended to 11 January 2008). The court's order precludes defendants from litigating certain issues of liability against the putative Engle class members in these individual actions. On 1 October 2007, the United States Supreme Court denied defendants' request for certiorari review of the Florida Supreme Court's decision. As of 31 December 2009, B&W has been named in approximately 53 Engle progeny cases in both state and federal courts in Florida. These cases include approximately 109 plaintiffs.

In the first trial of an individual Engle class member (Lukacs), the jury, on 11 June 2002, awarded plaintiff US$37.5 million (approximately £23.2 million) in compensatory damages (B&W's share: US$8.4 million (approximately £5.2 million)). After post-trial proceedings, on 12 November 2008, the trial court entered judgment for plaintiff in the amount of US$24,835,000 (approximately £15.4 million) (plus interest), for which defendants were jointly and severally liable. Defendants filed an appeal from the judgment on 1 December 2008 and B&W served their moving brief on 5 June 2009. On 19 March 2009, pursuant to its indemnification of B&W, RJRT posted a bond (approximately US$15.2 million (approximately £9.4 million)). Oral argument has been scheduled for 1 March 2010.

In a case filed on 24 May 1996 by a class of Louisiana smokers (Scott) in Louisiana state court against several US cigarette manufacturers (including B&W), the jury, on 28 July 2003, returned a verdict in defendants' favour on a medical monitoring claim, but made findings against defendants with respect to claims relating to fraud, conspiracy, marketing to minors and smoking cessation. On 21 May 2004, the jury returned a verdict in the amount of US$591 million (approximately £366 million) on the class's claim for a smoking cessation programme. On 7 February 2007, an intermediate appellate court, among other things, affirmed class certification and upheld the smoking cessation programme for certain smokers who began smoking before 1 September 1988, but reduced the US$591 million jury award by US$312 million (approximately £193.2 million) and rejected any award of prejudgment interest. On 21 July 2008, the trial court entered judgment in the case, finding that defendants were jointly and severally liable for funding the cost of a court-supervised smoking cessation programme, and ordering defendants to deposit approximately US$263 million (approximately £162.9 million) together with interest from 30 June 2004 into a trust for the funding of the programme. On 15 December 2008, the trial court entered an order permitting defendants to take a suspensive appeal, thereby staying enforcement of the judgment pending the resolution of defendants' appeal. Oral arguments occurred on 1 September 2009 and a decision remains pending.

(c) Individual cases

Approximately 3,191 cases were pending against B&W at 31 December 2009 (2008: 3,238) filed by or on behalf of individuals in which it is contended that diseases or deaths have been caused by cigarette smoking or by exposure to environmental tobacco smoke (ETS). Of these cases, approximately: (a) 2,595 are ETS cases brought by flight attendants who were members of a class action (Broin) that was settled on terms that allow compensatory but not punitive damages claims by class members; (b) 476 of the individual cases against B&W are cases brought in consolidated proceedings in West Virginia; (c) 53 are Engle progeny cases; and (d) 67 are cases filed by other individuals.

There are three verdicts against B&W that remained subject to appeal in 2009:

In December 2003 and January 2004, a New York state court jury (Frankson) awarded an individual plaintiff compensatory and punitive damages against B&W and two industry organisations. After post-trial and appellate proceedings, a final judgment was entered by the clerk of court on 26 June 2007 in the amounts of US$175,000 (approximately £100,000) in compensatory damages and US$5 million (approximately £3.1 million) in punitive damages. RJRT posted a bond in the approximate amount of US$8.018 million (approximately £5 million) on 3 July 2007. Defendants subsequently appealed from the judgment to an intermediate appellate court and appellate oral argument was heard on 26 January 2009. On 29 September 2009, the appellate court issued a decision modifying the final judgment by deleting the punitive damages award and remanding the case to the trial court on the issue of punitive damages. On 22 December 2009, plaintiff filed a motion for an extension of time to seek leave to reargue the appeal, or in the alternative, to take a further appeal to the New York Court of Appeals. On 15 January 2010, the intermediate appellate court denied plaintiff's motion seeking an extension to file a motion for leave to appeal to the New York Court of Appeals, and granted plaintiff's motion seeking an extension to file a motion for leave to reargue the appeal. Plaintiff filed a motion to reargue on 27 January 2010, which remains pending.

NOTES ON THE ACCOUNTS CONTINUED

30 Contingent liabilities and financial commitments continued

In February 2005, a Missouri state court jury (Smith) awarded the family of a deceased smoker US$500,000 (approximately £300,000) in compensatory damages and US$20 million (approximately £12.4 million) in punitive damages against B&W. On 16 December 2008, an intermediate Missouri appellate court affirmed the compensatory damages award, but remanded the case for a new trial on issues relating to punitive damages. Following a new trial, on 20 August 2009, a Missouri jury returned a verdict awarding US$1.5 million (approximately £900,000) in punitive damages against B&W. On 24 September 2009, B&W filed a motion for a new trial and a motion for judgment notwithstanding the verdict and the plaintiffs filed a motion to increase the punitive damages to US$20 million (approximately £12.4 million) and to vacate, modify or set aside judgment or alternatively for a new trial. These motions were denied on 21 December 2009. On 30 December 2009, B&W filed a notice of appeal to the intermediate Missouri appellate court. Plaintiffs filed a notice of appeal to the same court on 31 December 2009. Those appeals have been consolidated and remain pending.

On 18 March 2005, a New York jury (Rose) awarded an individual plaintiff US$1.7 million (approximately £1.1 million) in compensatory damages against B&W. On 10 April 2008, an intermediate state appellate court reversed the judgment and ordered that the case be dismissed. On 16 December 2008, the New York Court of Appeals affirmed the intermediate appellate court's ruling. Plaintiff filed a motion to reargue to the Court of Appeals on 14 January 2009, which was denied on 26 March 2009. In June 2009, plaintiff filed a petition for a writ of certiorari in the US Supreme Court, which was denied on 5 October 2009.

(d) Other claims

The Flintkote Company (Flintkote), a US asbestos production and sales company, was included in the acquisition of Genstar Corporation (Genstar) by Imasco Limited in 1986 and became a Group subsidiary following the restructuring of Imasco Limited (now Imperial Tobacco Canada Limited (ITCAN), the Group's operating company in Canada) in 2000. Soon after this acquisition, and as part of the acquisition plan, Genstar began to sell most of its assets, including the non-asbestos related operations and subsidiaries of Flintkote. The liquidation of Flintkote assets produced cash proceeds and, having obtained advice from the law firm of Sullivan & Cromwell LLP and other advice that sufficient assets would remain to satisfy liabilities, Flintkote and Imasco authorised the payment of a dividend of US$170.2 million (approximately £105.4 million) in 1986 and a further dividend of US$355 million (approximately £219.8 million) in 1987. In 2003, ITCAN divested Flintkote and then, in 2004, Flintkote filed for bankruptcy in the United States Bankruptcy Court for the District of Delaware. In 2006, Flintkote, representatives of both the present and future asbestos claimants, and individual asbestos claimants were permitted by the bankruptcy court to file a complaint against ITCAN and numerous other defendants including Sullivan & Cromwell LLP, for the recovery of the dividends and other compensation under various legal and equitable theories. Sullivan & Cromwell LLP and ITCAN have since filed cross complaints against each other. The parties are presently engaged in case management discussions to establish the scope and manner of discovery in this case. Although the litigation is at a preliminary stage, the judge has stated an intention to consider two discrete issues for potential early resolution either through evidentiary hearings or trial in an effort to simplify or clarify determinative issues. The first issue the judge is considering in separate proceedings is whether Flinkote's claim for malpractice against Sullivan & Cromwell LLP is time barred. This will include consideration as to whether Sullivan & Cromwell LLP's representation of Flintkote was continuous and the scope of this enquiry may require findings of fact impacting upon ITCAN's involvement in this first issue. The second issue involves an enquiry into the two dividends and whether they were fraudulently transferred. Until these preliminary issues have been resolved, it is difficult to estimate when the remaining issues will be heard.

In Wisconsin, the authorities have identified potentially responsible parties (PRPs) to fund the clean up of the Fox River, Wisconsin. The pollution was caused by the alleged discharges of toxic material from paper mills operating close to the river. The Government's most recent published estimate of the cost of the clean up work is US$700 million (approximately £433.5 million), although other reports have suggested that the costs are increasing. Among the PRPs are NCR Corporation (NCR) and Appleton Papers Inc. (Appleton) who may be liable for a proportion of the clean up costs. In 1978, Industries purchased what was then NCR's Appleton Papers Division from NCR. In 1978, Industries also incorporated a US entity by the name of BATUS, Inc. (BATUS), which in 1980 became the holding company for all of Industries' US subsidiaries, including Appleton. As the holding company, BATUS obtained insurance policies for itself and its subsidiaries that included coverage for certain environmental liabilities. Industries/BATUS spun off the Appleton business in 1990 to Wiggins Teape Appleton p.l.c. and Wiggins Teape Appleton (Holdings) p.l.c., now known as Arjo Wiggins Appleton Ltd. and Arjo Wiggins US Holdings Ltd. (collectively, the AWA Entities), obtaining full indemnities from AWA Entities for past and future environmental claims. Disputes between NCR, Appleton, the AWA Entities, and Industries as to the indemnities given and received under the purchase agreement in 1978 have been the subject of arbitrations in 1998 and 2005. Under the terms of the arbitration awards, Industries and Appleton/the AWA Entities have an obligation to share the costs of environmental claims with NCR, but Industries has never been required to pay any sums in this regard because Appleton and the AWA Entities have paid any sums demanded to date, and the authorities have not identified Industries or BATUS as PRPs. In 2005,

Appleton sued those insurance carriers that remained solvent that had issued the insurance policies to BATUS in the late 1970s and 1980s for a declaratory judgment that the policies provided coverage for Appleton's liability for the Fox River clean up. In 2008, Appleton prevailed in its suit and the court issued a ruling that the insurance policies provided coverage for the Fox River clean up. Further, the court held that Appleton was entitled to select from among the insurance policies an individual policy year and work its way through the policies in that year collecting coverage. Once that year is exhausted, Appleton may select additional policy years, one at a time, and proceed through those years in the same manner. In total, the insurance policies provide general coverage of US$1,052,300,000. This amount is subject to reduction to reflect insolvent insurance carriers within the BATUS insurance programme. The insurance carriers have appealed the trial court's ruling. The ultimate amount of insurance available will depend on whether the trial court's rulings concerning which policies are triggered and how losses may be allocated are disturbed or modified on appeal. If the ruling stands on appeal, it is believed that all future environmental liabilities will continue to be met directly by Appleton and the AWA Entities by self-funding or insurance cover and no demand will be made upon Industries. NCR has recently advised Industries that it believes that it is entitled to call upon Industries for contribution if necessary, while also reaffirming its intent to look to Appleton and the AWA entities in the first instance. If, however, Appleton and the AWA entities are unable to meet their obligations, NCR may look to Industries for contribution. There is a risk that Appleton and the AWA Entities will exhaust insurance policies beyond that which Industries believes Appleton and the AWA Entities are entitled to under the demerger agreement, potentially leaving Industries with no insurance. There is a tolling agreement in place between Appleton, the AWA Entities, Industries and BATUS relating to the demerger agreement, which runs to 31 December 2011 and preserves the parties' rights to litigate the issue.

In a separate federal action in Wisconsin, Appleton and NCR sought a contribution towards the contamination clean up costs from various other companies that also operated along the Fox River. On 17 December 2009, the judge dismissed the lawsuit on the basis that Appleton and NCR were responsible for at least 98 per cent of the contamination and that attributing the remaining 2 per cent amongst other companies was not worthwhile. Appleton and NCR are therefore liable for the clean up costs in full. This could potentially increase the amount of insurance sought by Appleton and therefore increases the risk of Appleton exhausting the insurance policies beyond its entitlement. It is open for Appleton and NCR to appeal the 17 December 2009 decision.

UK-based Group companies

At 31 December 2009, Industries was a defendant in the US in one class-action, the Schwab case mentioned previously. In that case, Industries was substituted for the Company as a defendant. Investments had been served in one reimbursement case (City of St. Louis), the Department of Justice case (see below), one anti-trust case (Daric Smith, see below), two class actions (Cleary and Schwab) and two individual actions (Eiser and Perry).

Conduct-based claims

On 22 September 1999, the US Department of Justice brought an action in the US District Court for the District of Columbia against various industry members, including B&W, Industries and Investments. Industries was dismissed for lack of personal jurisdiction on 28 September 2000. The Government sought, among other relief, the disgorgement of US$280 billion (approximately £173.4 billion) in past profits pursuant to the federal Racketeer Influenced and Corrupt Organisations Act (RICO) statute. On 4 February 2005, the DC Circuit Court of Appeals ruled that the Government could not claim disgorgement of profits under RICO. On 17 August 2006, the district court issued its final judgment in favour of the Government, and against certain defendants, including B&W and Investments. The court also ordered a wide array of injunctive relief, including a ban on the use of 'lights' and other similar descriptors. Investments' compliance with the court-ordered remedies may result in potentially significant financial exposure. Defendants, including B&W and Investments, filed notices of appeal to the DC Circuit Court of Appeals on 11 September 2006. On 31 October 2006, the Court of Appeals granted defendants' motion to stay enforcement of the judgment pending the outcome of the appeal. On 22 May 2009, a three-judge appellate panel unanimously affirmed the district court's RICO liability judgment against several defendants, including Investments, and among other things remanded for further factual findings and clarification as to whether liability should be imposed against B&W. The Government's cross-appeal seeking disgorgement of past profits and the funding of smoking education and cessation programmes was denied. Investments' petition for panel rehearing and a rehearing to consider the panel's decision was filed on 31 July 2009 and was denied on 22 September 2009 by the Court of Appeals. Following this, the parties are in a position to file petitions for certiorari with the US Supreme Court. On 11 December 2009, the Court of Appeals entered an order continuing the effective stay of the district court's injunctive remedies pending the US Supreme Court's final disposition of the case.

In the Daric Smith case, filed on 7 February 2000, purchasers of cigarettes in the State of Kansas brought a class-action in the Kansas State Court against B&W, Investments and certain other tobacco companies seeking injunctive relief, treble damages, interest and costs. The allegations are that defendants participated in a conspiracy to fix or maintain the price of cigarettes sold in the US, including the State of Kansas, in violation of the Kansas Restraint of Trade Act. Discovery of documents continues with Investments challenging the scope of discovery to which the plaintiff is entitled.

30 Contingent liabilities and financial commitments continued

Product liability outside the United States

At 31 December 2009, active claims against the Group's companies existed in 22 (2008: 18) markets outside the US but the only markets with more than five active claims were Argentina, Brazil, Canada, Chile, Italy, Nigeria, and the Republic of Ireland. There has been new litigation in Brazil (individual claims), Italy (individual claims) and Canada (Ontario recoupment claim and class-action claims). In 2009, judgments in favour of the defence were rendered in Russia. Significant developments outside the United States fall into four broad categories:

(a) Medical reimbursement cases

Argentina

ATLA (Argentine Tort Law Association) in June 2007 instigated a lawsuit seeking damages and medical recoupment claims against Nobleza-Piccardo S.A.I.C.y F. (Nobleza Piccardo). ATLA sought to have certain public entities joined as plaintiffs. On 23 December 2008, the court allowed intervention by the national Government and declined to accept in full certain defences asserting legal invalidity of the claims. On 2 October 2009, Nobleza Piccardo filed a substantive defence, supplementing its earlier preliminary defences on lack of jurisdiction, lack of standing to sue and the statute of limitations. On 23 December 2009, the civil court issued an order declining to exercise jurisdiction over the case as a result of the national Government's intervention. The case will now be referred to the contentious administrative court.

Brazil

The São Paulo State Public Prosecutor instigated a lawsuit in July 2007 comprising product liability, ETS and medical recoupment claims. On 7 October 2008, Souza Cruz S.A. (Souza Cruz) filed an objection to a motion to intervene as an additional plaintiff by ACTbr, a private anti-tobacco group. On 17 October 2008, the court issued an order to plaintiffs to respond to certain of defendants' procedural requests, as well as certain defences and objections. The court has determined that issues of third party standing will be determined at the main hearing. A similar claim was lodged against Philip Morris and Souza Cruz's motion to consolidate the two claims was rejected, with the case removed to a lower court. Souza Cruz filed a motion to reconsider the refusal for consolidation and an interlocutory appeal against assignment to the lower court. The Public Prosecutor filed a counter motion and the court has ordered the assignment issue to proceed to a final review.

Canada

The Government of the Province of British Columbia brought a claim pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2000 (the Recovery Act) against domestic and foreign manufacturers seeking to recover plaintiff's costs of health care benefits. Investments, Industries, Ryesekks Plc, ITCAN and certain former Rothmans Group companies are named as defendants.

The constitutionality of the Recovery Act was challenged by certain defendants. Ultimately, in September 2005, the Supreme Court of Canada declared the Recovery Act to be constitutionally valid. Defendants joined the federal Government of Canada pursuant to a Third Party Notice and the federal Government, in turn, filed a motion to strike the claim. The Supreme Court of British Columbia found in favour of the federal Government, dismissing it from the action. Defendants' subsequent appeal of that order was consolidated with a similar appeal in the Knight case (see below). On 8 December 2009, the British Columbia Court of Appeal handed down its decision in the Medicaid and Knight cases. In the Medicaid case, the appeal was granted in part, with the court holding that it was not plain and obvious that the Federal Government did not owe a duty of care to tobacco manufacturers when it implemented its tobacco control strategy. On 8 February 2010, the Federal Government sought leave to appeal this decision. Non-Canadian defendants, including Investments and Industries, sought to dismiss the underlying Medicaid action on the ground that the British Columbia court lacked personal jurisdiction over them. These motions were subsequently denied, and defendants' appeal of these decisions was ultimately unsuccessful. The case is currently scheduled for trial in September 2011 as a target date.

In another Canadian recoupment case, the Government of the Province of New Brunswick has brought a health care recoupment claim against domestic and foreign tobacco manufacturers, pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2000 passed in that Province in June 2006. The Company, Investments, Industries, ITCAN and certain former Rothmans Group companies have been named as defendants. The Government filed a statement of claim on 13 March 2008. The UK-based Group defendants were served with the Notice of Action and Statement of Claim on 2 June 2008. ITCAN was served on 10 April 2008. In November 2009, the UK-based Group defendants filed notices of motion challenging jurisdiction. Plaintiff filed its material in response. These motions are scheduled for hearing in June 2010.

On 29 September 2009, the Government of the Province of Ontario filed a health care recoupment claim against the Company, Investments, Industries, ITCAN and certain former Rothmans Group companies, pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2009. The UK-based Group defendants served their notices of motion and supporting evidence challenging jurisdiction on 29 January 2010.

Colombia

British American Tobacco (South America) Limited (BAT South America) was served on 18 July 2008 in Garrido, a public interest action that has a recoupment component. The case was brought by two Colombian citizens alleging that the defendant violated numerous 'collective' interests and rights of the Colombian population. In addition to equitable and injunctive relief, plaintiffs are seeking 25 per cent of

smoking-related health care costs since the time that the Group has been operating in Colombia. BAT South America initially filed preliminary objections to the action with a view to joining the claim to another public interest action brought by Sandra Florez (see below). However, the preliminary objections in Garrido are now moot because the Florez case was decided in BAT South America's favour in September 2009. BAT South America will submit a full defence in Garrido in due course.

Israel
Clalit, one of the main health care providers in Israel, filed a recoupment claim on 28 September 1998 in the Tel Aviv District Court against several local and international tobacco companies. Clalit seeks NIS7.6 billion (approximately £1.2 billion) in damages and injunctive relief. Following a series of procedural negotiations between the parties, the Group companies currently named as defendants in the action are Industries (who is disputing service), B&W, B.A.T (U.K. and Export) Limited (BATUKE) and Investments. On 29 March 2005, B&W, Investments and BATUKE sought leave to appeal the denial of their application to strike out the action on the grounds of remoteness and a decision from the Supreme Court on this issue is still awaited. Plaintiff's motion filed on 30 August 2009 to separate consideration of Clalit from another case (in which no Group company is named) was denied by the Supreme Court.

Nigeria
In 2007, four Nigerian states (Lagos, Kano, Gombe and Oyo) and the Nigerian federal Government filed separate health care recoupment actions, each seeking the equivalent of billions of US dollars for costs allegedly incurred by the state and federal Governments in treating smoking-related illnesses. British American Tobacco (Nigeria) Limited, the Company and Investments were all named as defendants and filed preliminary objections in each of the cases.

On 21 February 2008, the initial Lagos action was voluntarily discontinued by plaintiffs. On 13 March 2008, the Attorney General of Lagos State filed a substantially similar action. British American Tobacco (Nigeria) Limited, the Company and Investments were all served in the new action. On 18 September 2009, the High Court of Lagos State issued a ruling denying the preliminary objections filed by the Company and Investments. On 2 October 2009, the Company and Investments filed notices of appeal from the court's ruling and filed motions to stay all proceedings pending the resolution of their appeals. The stay motions remain pending before the High Court of Lagos State and are to be argued at the next hearing.

On 8 July 2008, the High Court of Gombe State set aside service on all defendants (including the Company, Investments and British American Tobacco (Nigeria) Limited) and struck out the claim. The Attorney General of Gombe State filed and served a renewed action, to which all Group defendants have filed preliminary objections, which remain pending.

In 2008, a health care recoupment claim was filed in the State of Akwa Ibom. The Company and Investments were served with process and filed preliminary objections. British American Tobacco (Nigeria) Limited was not served and, on 21 July 2009, was dismissed from the action. On 19 October 2009, following repeated requests for adjournment by counsel for the Attorney General of the State of Akwa Ibom, the court struck out the claim for want of diligent prosecution.

An action was filed by the Attorney General of Ogun State in 2009. In the Ogun State claim, there has been purported service of the proceedings on the Company, Investments and British American Tobacco (Nigeria) Limited. The companies have each filed preliminary objections. The preliminary objections were heard on 14 December 2009 and a decision is awaited.

In 2009, process was also purportedly served on British American Tobacco (Nigeria) Limited in two health care recoupment claims brought by the Attorneys General of the States of Ondo and Ekiti. British American Tobacco (Nigeria) Limited is the only Group company named as a defendant in these actions. In Ondo, British American Tobacco (Nigeria) Limited filed an application to strike out the claim based on defects in the issuance of the writ. While this application was pending, on 17 June 2009, the Attorney General of Ondo State filed a notice of discontinuance, and on 18 June 2009, the court accordingly struck out the action without prejudice and awarded British American Tobacco (Nigeria) Limited costs. In Ekiti, British American Tobacco (Nigeria) Limited filed preliminary objections. On 5 October 2009, following the service of a 2 October 2009 notice of discontinuance filed by the Attorney General of Ekiti State, the court struck out the claim without prejudice.

Saudi Arabia
The Saudi Ministry of Health is pursuing a health care recoupment action in the Riyadh General Court against a number of tobacco distributors and agents, but no Group company has been served with process. The Ministry of Health is reportedly seeking damages of at least 127 billion Saudi Riyals (approximately £21 billion).

Spain
The Junta de Andalucía, together with the Health Service of Andalucía (hereinafter 'Junta') filed, on 20 September 2007, a contentious-administrative claim against the Spanish State and six tobacco companies, including British American Tobacco España, S.A. (BAT España). The Junta seeks the reimbursement of €1,769,964 (approximately £1.6 million) allegedly spent in health care costs for treating patients with smoking-related diseases. The Court upheld the State's preliminary objections to the claim and dismissed the claim on 14 November 2007. On 4 March 2008, the Junta filed a notice of its intention to appeal that decision, and its appeal was dismissed by a Supreme Court Judgment of 30 September 2009. In the interim however, on 6 May 2009, the Junta filed a new contentious-administrative claim based on the same facts, which proceedings are still progressing.

30 Contingent liabilities and financial commitments continued

(b) Class-actions

Brazil

In 1995, a class-action was filed by the Association for the Defence of the Health of Smokers (ADESF) against Souza Cruz and other tobacco manufacturers in the São Paulo Lower Civil Court alleging that defendants are liable to a class of smokers and former smokers for failing to warn of cigarette addiction. Plaintiffs seek monetary damages and injunctive relief. The case was stayed in 2004 pending defendants' appeal from a decision issued by the lower civil court on 7 April 2004. On 12 November 2008, the São Paulo Court of Appeals overturned the lower court's unfavourable decision of 2004, finding that the lower court had failed to provide defendants with an opportunity to produce evidence. The case was returned to the lower court for production of evidence and a new judgment. The matter continues on the issue of sufficiency of court-appointed expert evidence.

The Brazilian Association for the Defence of Consumers' Health (Saudecon) filed a class-action against Souza Cruz in the City of Porto Alegre, Brazil on 3 November 2008. Plaintiff purports to represent all Brazilian smokers whom, it alleges, are unable to quit smoking and lack access to cessation treatments. Plaintiff is seeking an order requiring the named defendants to fund, according to their market share, the purchase of cessation treatments for these smokers over a minimum period of two years. On 18 May 2009, the case was dismissed with judgment on the merits. Plaintiffs appealed in August 2009 and Souza Cruz responded. Parties are now awaiting judgment.

A consumer association known as ACODE (Association of Exploited Consumers of the Federal District) instigated an action in essence seeking a court order to stop Souza Cruz from marketing cigarettes in Brazil. In December 2006, the 4th Chamber of the Federal District Court of Appeals confirmed a lower court decision that ruled the claim groundless and unlawful. Plaintiff filed an appeal before the Superior Court of Justice which has been pending final review since May 2007. On 12 March 2009, the Superior Court affirmed the ruling and rejected plaintiff's appeal. Plaintiff issued another appeal which, on 23 March 2009, was unanimously rejected by the Superior Court. An appeal is now pending before the Federal Supreme Court.

The State of Sergipe instigated in 2004 a class-action seeking compensation for smokers in Sergipe State who purportedly sought to quit smoking. The lower court denied plaintiffs' request for early relief and determined ANVISA be ordered to join the case as co-defendants. ANVISA is a Federal Agency so the case was removed to the Federal Court where ANVISA successfully argued that it lacked standing to be sued. The claim against ANVISA was dismissed and the Federal Court sent the case back to the lower state court for proceedings to continue, but the action was stayed on 18 December 2009 pending a decision by the Superior Court on which court has jurisdiction.

Bulgaria

In March 2008, a collective claim was filed in the Sofia City Court of Bulgaria against 21 defendants, including British-American Tobacco Polska S.A., British-American Tobacco (Romania) Trading SRL and House of Prince A/S. Plaintiff seeks recovery of roughly 17,000 Leva (approximately £7,700) in damages per class member and injunctive relief. The claim was dismissed twice on procedural deficiencies, but re-instated both times on appeal. On 2 December 2008, the Sofia City Court dismissed the youth advertising claim and required plaintiff to meet various evidentiary and procedural conditions in order to proceed with the claim. Plaintiff's application to appeal was hindered by an expired time period and, on 11 December 2009, the Supreme Court of Cassation held a closed hearing on that issue, and thereafter denied plaintiff's request for a restoration of the expired time period. This latest decision remains subject to appeal.

Canada

In the Knight class-action brought against ITCAN in Canada, the Supreme Court of British Columbia certified a class of all consumers of cigarettes bearing 'light' or 'mild' descriptors since 1974 manufactured in British Columbia by ITCAN. The British Columbia Court of Appeal affirmed the certification of the class but has limited any potential financial liability to the period from 1997. This is a 'lights' class action in which plaintiff alleges that the marketing of light and mild cigarettes is deceptive because it conveys a false and misleading message that those cigarettes are less harmful than regular cigarettes. Plaintiff seeks compensation for amounts spent on 'light and mild' products and a disgorgement of profits from ITCAN. ITCAN joined the federal Government of Canada pursuant to a Third Party Claim and the federal Government, in turn, filed a motion to strike the claim. The court subsequently dismissed the federal Government from the action. ITCAN appealed that order, and its appeal was consolidated with a similar appeal in the British Columbia recoupment litigation (see above). On 8 December 2009, the British Columbia Court of Appeal handed down its decision in the Medicaid and Knight cases. In the Knight case, the court held that it was not plain and obvious that firstly, the Federal Government did not owe a duty of care to tobacco manufacturers when it implemented its tobacco control strategy and secondly, that it was not plain and obvious that the Federal Government did not owe a duty of care to the members of the class. On 8 February 2010, the Federal Government sought leave to appeal this decision.

A similar 'lights' and 'mild' class-action claim has been filed in Newfoundland against ITCAN, who has filed a third party notice against the Federal Government. The certification hearing took place in September 2007. Certification was denied on 29 December 2008 and ITCAN subsequently received plaintiffs' notice for leave to appeal. Plaintiff's application for leave to appeal was heard in November 2009 and a decision is now awaited.

There are currently two class-actions in Quebec against ITCAN. On 21 February 2005, the Quebec Superior Court granted certification. The court certified two classes, which include residents of Quebec who suffered from lung, throat and laryngeal cancer or emphysema, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. ITCAN is currently in discovery and case management.

In August 2009, the Ragoonanan proposed class action against ITCAN in Ontario was dismissed. It sought to certify as a class "all persons who suffered bodily damage or property damage as a result of fires commenced by cigarettes that did not automatically extinguish upon being dropped or left unattended". Certification was denied in first instance and leave to appeal was denied in the 12 May 2008 decision. In summary, the court decided that there was no rational relationship between the class definition and the proposed common issues and that a class-action was not a preferable procedure. A further appeal was dismissed on 26 August 2009, thus ending the litigation.

In June 2009, four class-actions were filed in Nova Scotia, Manitoba, Saskatchewan and Alberta naming Investments, Industries, Ryesekks Plc, ITCAN and certain former Rothmans Group companies. There are service issues in relation to the UK-based Group companies for Alberta and Manitoba. In Saskatchewan, the UK-based Group companies have served notices of motion challenging jurisdiction and these motions are due to be heard on 11 and 12 March 2010. Proceedings in these four class-actions have also been served on ITCAN.

Colombia

On 2 September 2009, a 'consumer popular' ('acción popular') action was brought by Sandra Florez against BAT South America. The ruling held that an "acción popular" is not an action for damages and that BAT neither threatened nor violated any "collective right", but instead acted in accordance with the law without misrepresenting the risks of "light" cigarettes. Plaintiff did not appeal this ruling and the decision is now final.

Israel

In May 2008, nine smokers of low-yield cigarettes filed a class-action in Israel, known as Numberg, before the Tel Aviv District Court against various defendants including the Group's Israeli distributor, Globrands Agencies 2007 Limited (Globrands Agencies). Plaintiffs allege that, since December 2004, defendants have fraudulently marketed and sold low-yield cigarettes in Israel, in contravention of what they interpret to be an express ban on the sale of such products following the prohibition on the use of 'lights' descriptors, by using methods such as marking cigarette packages in a special colour, using descriptors such as 'slim' or 'super slim', and displaying text that describes the amount of tar and nicotine yields. In addition to injunctive and declaratory relief, plaintiffs seek NIS78.5 billion (approximately £12.8 billion) in monetary damages. In January 2009, the Tel Aviv District Court denied plaintiffs' motion for a temporary restraining order prohibiting defendants from marketing and selling low-yield products in Israel. On 3 December 2009, Globrands Agencies sought an order from the court requiring the three plaintiffs who smoked British American Tobacco brand cigarettes to deposit NIS200,000 (approximately £33,000) each as a guarantee against trial costs. On 28 December 2009, the judge granted this motion, requiring the three plaintiffs to deposit jointly the amount of NIS100,000 (approximately £16,000) by 19 January 2010. As a result of this decision, the remaining defendants filed similar applications. A pre-trial hearing was scheduled for 20 January 2010, to resolve all outstanding preliminary issues and discuss the schedule for a hearing on class certification. Since the three plaintiffs did not deposit the guarantee, the court ordered, during the pre-trial hearing on 20 January 2010, that the action against Globrands Agencies be dismissed without prejudice. The three plaintiffs that smoked British American Tobacco brand cigarettes are seeking leave to appeal the deposit decision to the Israeli Supreme Court, a motion that remains pending.

Venezuela

FEVACU (Venezuelan Federation of Associations of Users and Consumers) instigated a purported class-action that was admitted by the court on 22 October 2008 seeking, among other relief, that defendant be required to fund a trust for the treatment of alleged smoking-related diseases. On 19 January 2009, C.A. Cigarrera Bigott Sucs. notified the court of its intention to appear as a third party whose rights may be affected by the proceedings, as provided under the procedural law. A public hearing to determine its status as a third party has yet to be scheduled.

(c) Individual cases

Australia

In 2006, proceedings were instituted by Donald Laurie in the Dust Diseases Tribunal (DDT) against British American Tobacco Australia Services Limited (BATAS), the Commonwealth of Australia and an asbestos manufacturer, alleging tobacco and asbestos-related illness. In November 2009, BATAS sought an order in the New South Wales Court of Appeal for the recusal of the judge appointed to hear the matter, having been unsuccessful at obtaining such relief from the DDT. On 17 December 2009, the Court of Appeal delivered its judgement against BATAS, denying its bid to recuse the trial judge. BATAS has now made an application for special leave to appeal the recusal decision to the High Court of Australia. While BATAS's appeals have been pending, plaintiff has chosen not to prosecute the underlying claims in the DDT.

In January 2009, proceedings were commenced by Terry Gottlieb in the Supreme Court of Victoria against various BAT Group companies and other tobacco companies alleging smoking and passive smoking-related illness. These proceedings were discontinued on 27 October 2009.

30 Contingent liabilities and financial commitments continued

In 2001, proceedings were instituted by Rolah Ann McCabe in the Supreme Court of Victoria against BATAS. Findings were made against BATAS in March, April and May 2002 by the trial court. These findings were overturned by the Victorian Court of Appeal in December 2002 and March 2003. An application for special leave to appeal to the High Court of Australia by the McCabe estate was refused in October 2003. Since that time, the case has largely been dormant. As of 19 November 2009, BATAS has been awarded AUS$1,102,378.45 (approximately £600,000) in costs (out of AUS$2,098,693 claimed (approximately £1.2 million)) arising out of the trial and the appeals before the Victorian Court of Appeal.

In November 2006, BATAS commenced proceedings against Slater & Gordon (an Australian plaintiff law firm who represented the plaintiff in the McCabe case (see above)) in a matter relating to the leaking of legal documents to the press and public. British American Tobacco Australia Limited commenced parallel proceedings against Slater & Gordon and Peter Gordon (a partner of the firm) regarding the same matter. In early 2007, Roxanne Cowell (executrix of the McCabe estate) was joined as a defendant in each proceeding. The proceedings are before the Victorian Supreme Court. On 15 December 2009, the respective proceedings against Slater & Gordon and Peter Gordon were resolved in favour of BATAS and British American Tobacco Australia Limited, with costs to be determined after the proceedings against Roxanne Cowell are resolved.

Brazil
As of 31 December 2009, there were approximately 312 (2008: 310) individual cases that remain pending in Brazil against Souza Cruz in which it is contended that the smokers' diseases or deaths were caused by cigarette smoking. Since 1995, approximately 598 individual cases have been filed in Brazil against Souza Cruz. Approximately 16 of these cases have resulted in court decisions favourable to plaintiffs in either the civil court or court of appeal, all of which remain on appeal.

Canada
Four individual smoking and health cases have been filed in Canada. Of these, two (Battaglia and Landry) have been in abeyance since 2004 and 2003 respectively. A third (Spasic) is active and currently at a preliminary stage. One smoking and health case (Stright) has been filed in Nova Scotia but had previously been in abeyance since 2005. The parties have been summoned to appear before the court where it is anticipated that the plaintiff will advance its case to avoid the claim being quashed.

Chile
On 16 December 2008, the Civil Court of Santiago dismissed an individual smoking and health action filed by Mr Andres Javier Rada Meza against Compania Chilena de Tabacos S.A. (Chiletabacos) and other tobacco manufacturers in 2006. In March 2009, plaintiff's appeal period lapsed, making the Civil Court of Santiago's decision final. There are eight smoking and health claims pending against Chiletabacos that have not been decided yet. The most recent smoking and health claim against Chiletabacos was purportedly served on 15 January 2010 and was brought by the estate of a smoker who allegedly died as a result of lung cancer.

Costa Rica
In February 2006, Mr Jorge Enrique Guerra Ruiz filed a claim against, among others, British American Tobacco Central America S.A. (Costa Rica branch) (BAT Costa Rica), alleging improper use of terms in language other than the official country language (Spanish) on cigarette packs. BAT Costa Rica was cleared of Mr Ruiz's allegations in October 2009, except for the Consumer Defence Commission's finding that it was liable to a fine for the use of 'light'. This decision has been challenged by BAT Costa Rica.

Denmark
In 2003, a claim was filed against House of Prince A/S and Skandinavisk Tobakskompagni A/S claiming €65,000 (approximately £58,000) (plus damages and costs) for damages to health including addiction, arising from allegations of failure to warn, defective design, and product manipulation. The trial has been postponed until at least late 2010.

Finland
On 10 October 2008, following a consolidated trial, the Helsinki District Court dismissed three individual smoking and health actions that were brought against British American Tobacco Nordic Oy (BAT Nordic), amongst others, and ordered each plaintiff to pay BAT Nordic costs of €125,000 (approximately £100,000). In December 2008, plaintiffs appealed the District Court's decisions in their entirety but one plaintiff (Lindroos) has subsequently withdrawn her appeal. Trial of the action before the Court of Appeal began on 31 August 2009 and concluded on 7 December 2009. A decision of the court is expected from the Court of Appeal in May 2010.

Ireland
Fifteen individual smoking and health cases are ongoing in the Republic of Ireland, in which plaintiffs seek compensation for various alleged tobacco-related injuries. The Group defendants involved in these claims are PJ Carroll & Co. Ltd and Rothmans of Pall Mall (Ireland) Ltd, although both Group companies are not named in every action. One

case (McCormack) was dismissed by judgment perfected on 17 July 2007, but plaintiff has filed a notice of appeal and no date for the appeal has yet been set. Dismissal motions in 13 other cases are pending the decision of the Supreme Court in McCormack. The fifteenth case is currently dormant.

Italy
As of 31 December 2009, there were approximately 226 individual 'lights' cases in Italy pending against British American Tobacco Italia S.p.A. (2008: 1,672). Almost 75 per cent of the individual 'lights' cases filed in Italy are pending before lower level (Justices of the Peace) courts, with the remainder on appeal. Because of the type of court involved, the maximum possible recovery in damages is €1,033 (approximately £900) (plus legal fees and costs). In 2007, 2,230 'lights' cases were filed by a single plaintiffs' counsel in the jurisdiction of Pescopagano. In 2008, all of these claims were withdrawn. As of 31 December 2009, approximately 1,128 cases (not including the Pescopagano cases) have been suspended or dismissed. There are 38 individual smoking and health cases pending before Italian Civil Courts (including eight cases on appeal, which includes both the seven cases pending before the Court of Appeal and the one case pending before the Supreme Court), in which it is contended that the smokers' diseases or deaths were caused by cigarette smoking.

Kenya
In October 2002, a plaintiff commenced a smoking and health case against British American Tobacco Kenya Limited. Since November 2007, the parties have been engaged in a dispute over plaintiff's failure to produce requested discovery.

Netherlands
On 17 December 2008, the District Court of Amsterdam dismissed an individual smoking and health action filed in June 2005 by Peter Josef Romer against British American Tobacco Western Europe Area II B. V. and British American Tobacco Manufacturing B.V. Plaintiff had until 18 March 2009 to appeal the dismissal but failed to do so. Therefore the decision is now final.

Poland
A claim for PLN50,000 (approximately £11,000) was brought by an incarcerated plaintiff and served on British American Tobacco Polska S.A. in March 2009, alleging addiction and unspecified health losses. The plaintiff moved to voluntarily withdraw the claim in November 2009 and a decision from the court regarding costs and discontinuation of proceedings is currently pending.

Sri Lanka
In 2003, a plaintiff filed a smoking and health claim against Ceylon Tobacco Company Limited (CTC). CTC filed preliminary objections which were rejected by the District Court and Court of Appeal. Leave to appeal to the Supreme Court was granted and the appeal will be heard on 11 May 2010.

(d) Consumer protection litigation

Russia
On 8 September 2008, a consumer fraud action was filed in the Savelovsky District Court of Moscow by the Ministry of Health and Social Development in Russia against OJSC British American Tobacco – Yava (Yava) and its retail distributor, CJSC International Tobacco Marketing Services. The claim seeks a declaration from the court that the use of the words 'light, superlight, and 1mg light' on cigarette packets of Yava's low tar cigarettes are misleading and unlawful, and further seeks the removal of these descriptors. In November 2008, the action was dismissed for lack of jurisdiction, but on 13 January 2009 the dismissal was reversed on appeal. Leave to appeal this decision was refused but the case was remitted to the district court for a hearing on the merits and on 25 March 2009 was dismissed in full. Plaintiff's appeal, heard on 16 June 2009, upheld the first instance decision and plaintiff had until 16 December 2009 to lodge a further appeal. No appeal was filed.

Other litigation outside the US

Regulatory and Constitutional Challenges

In 2009, there were regulatory and constitutional challenges in Brazil, Canada (Quebec), South Africa, Paraguay, Turkey and Uruguay. In Brazil, a regulatory challenge was brought by Souza Cruz against the National Surveillance Health Agency (ANVISA). This action mainly challenged the legality of the images of new health warnings and sought an injunction to suspend the effects of the resolution that established these images until a final decision is issued on the merit of the case. Although initially granted, the injunction was later disregarded by the Court of Appeal. A first instance decision is pending. In Quebec, ITCAN and other Canadian manufacturers filed a constitutional challenge of the Quebec Medicaid Legislation. The Attorney-General of Quebec has filed a motion to dismiss the challenge and this motion will be heard on 8 to 9 April 2010. In South Africa, in September 2009, a constitutional challenge was commenced by British American Tobacco South Africa (Pty) Ltd against the Ministry of Health. This challenge relates to one to one communications between tobacco manufacturers (together with importers, wholesalers and retailers) and consenting adult tobacco consumers. Further regulatory challenges in Turkey, Paraguay and Uruguay have also been instituted to challenge certain health warning, and tobacco product packaging and labelling requirements.

30 Contingent liabilities and financial commitments continued

Canada
On 9 December 2009, ITCAN was served with a class action filed by Ontario tobacco farmers and the Provincial Marketing Board, which alleges that between 1989 and 1994 ITCAN improperly paid lower prices for tobacco leaf destined for duty-free products, as opposed to the higher domestic leaf price.

Russia
In September 2008, a new action was commenced by a minority shareholder of Yava in relation to approval of interested-party transactions. The claim was filed by Branston Holdings Ltd. and its value was 4,362,537,236 roubles (approximately £89.1 million). The claim was filed against British American Tobacco Holdings (Russia) BV, whereas Yava was a third party to the case. We have been informed that Branston has filed an application with the court to withdraw its claims in full. The next hearing is currently planned for 22 April 2010, at which the issue of withdrawal of the claim and consequent termination of the proceedings will be examined by the court.

Conclusion
While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, the Group believes that the defences of the Group's companies to all these various claims are meritorious on both the law and the facts, and a vigorous defence is being made everywhere. If an adverse judgment is entered against any of the Group's companies, an appeal will be made. Such appeals could require the appellants to post appeal bonds or substitute security in amounts which could in some cases equal or exceed the amount of the judgment. In any event, with regard to US litigation, the Group has the benefit of the RJRT Indemnification. At least in the aggregate, and despite the quality of defences available to the Group, it is not impossible that the Group's results of operations or cash flows in particular quarterly or annual periods could be materially affected by the final outcome of any particular litigation.

Having regard to all these matters, the Group (i) does not consider it appropriate to make any provision in respect of any pending litigation and (ii) does not believe that the ultimate outcome of this litigation will significantly impair the Group's financial condition.

Guarantees
Performance guarantees given to third parties in respect of Group companies were £nil (2008: £1 million).

Operating leases
Total future minimum lease payments under non-cancellable operating leases comprise leases where payments fall due:

	2009 £m	2008 £m
Property		
Within one year	**71**	77
Between one and five years	**168**	150
Beyond five years	**139**	160
	378	387
Plant and equipment		
Within one year	**29**	32
Between one and five years	**33**	38
	62	70

31 Post balance sheet events

On 22 January 2010, the Group announced the closure of the Tire factory in Turkey and the consolidation of all manufacturing in Turkey in the Samsun factory. The estimated costs of closure are £37 million and closure of the Tire factory is expected to be completed by 31 December 2010.

In respect of the Franked Investment Income Group Litigation Order, the Court of Appeal handed down its judgment on 23 February 2010 and further details have been provided in note 6(b).

FIVE YEAR SUMMARY

For the years ended 31 December	**2009 £m**	2008 £m	2007 £m	2006 £m	2005 £m
Income statement					
Gross turnover (including duty, excise and other taxes)	**40,713**	33,921	27,104	25,503	24,082
Revenue (after deducting duty, excise and other taxes)	**14,208**	12,122	10,018	9,762	9,325
Profit from operations*	**4,101**	3,572	2,904	2,632	2,426
Profit before taxation	**4,080**	3,684	3,077	2,774	2,590
Profit for the year (before minority interest)	**2,956**	2,659	2,287	2,057	1,898
*after (charging)/crediting					
– restructuring and integration costs	**(304)**	(160)	(173)	(216)	(271)
– Canadian settlement		(102)			
– amortisation of trademarks	**(58)**	(24)			
– gains on disposal of businesses and trademarks	**2**	141	75	41	72

	2009 pence	2008 pence	2007 pence	2006 pence	2005 pence
Earnings per share					
– basic unadjusted	**137.0**	123.3	105.2	92.6	84.5
– diluted unadjusted	**136.3**	122.5	104.5	91.8	83.8
– diluted adjusted	**153.0**	128.8	108.5	98.6	89.5
Dividends declared per share	**99.5**	83.7	66.2	55.9	47.0

At 31 December	**2009 £m**	2008 restated £m	2007 restated £m	2006 restated £m	2005 restated £m
Balance sheet					
Non-current assets	**18,508**	18,812	13,399	12,401	13,093
Current assets	**8,106**	8,739	5,365	5,391	5,904
Total assets	**26,614**	27,551	18,764	17,792	18,997
Shareholders' funds	**7,613**	6,944	6,871	6,357	6,264
Minority interests	**299**	271	218	227	247
Total equity	**7,912**	7,215	7,089	6,584	6,511
Non-current liabilities	**11,786**	11,458	7,131	6,792	6,709
Current liabilities	**6,916**	8,878	4,544	4,416	5,777
Total liabilities	**18,702**	20,336	11,675	11,208	12,486
Total equity and liabilities	**26,614**	27,551	18,764	17,792	18,997

The balance sheets for 2005 to 2008 have been restated for the reclassification of certain derivatives, as explained in note 16.

HALF-YEARLY ANALYSES OF PROFIT

The figures shown below have been produced using average rates of exchange on a half-yearly basis since the beginning of the year. Thus the discrete half year to 30 June has not been restated for subsequent movements in foreign exchange rates during the year, which are reflected in the results for the subsequent half year to 31 December.

	6 months to		Year to
	30 Jun 2009 £m	31 Dec 2009 £m	31 Dec 2009 £m
Profit from operations	**2,111**	**1,990**	**4,101**
analysed as:			
– adjusted profit from operations	**2,164**	**2,297**	**4,461**
– restructuring and integration costs	**(29)**	**(275)**	**(304)**
– amortisation of trademarks	**(26)**	**(32)**	**(58)**
– gains on disposal of businesses and trademarks	**2**		**2**
	2,111	**1,990**	**4,101**
Net finance costs	**(219)**	**(285)**	**(504)**
Share of post-tax results of associates and joint ventures	**231**	**252**	**483**
analysed as:			
– adjusted share of post-tax results of associates and joint ventures	**279**	**262**	**541**
– trademark impairments	**(48)**	**(17)**	**(65)**
– health plan credit		**16**	**16**
– restructuring costs		**(9)**	**(9)**
	231	**252**	**483**
Profit before taxation	**2,123**	**1,957**	**4,080**
Earnings per share			
Basic	**73.2p**	**63.8p**	**137.0p**
Adjusted diluted	**77.3p**	**75.7p**	**153.0p**

	6 months to		Year to
	30 Jun 2008 £m	31 Dec 2008 £m	31 Dec 2008 £m
Profit from operations	1,724	1,848	3,572
analysed as:			
– adjusted profit from operations	1,757	1,960	3,717
– restructuring and integration costs	(33)	(127)	(160)
– Canadian settlement		(102)	(102)
– amortisation of trademarks		(24)	(24)
– gains on disposal of businesses and trademarks		141	141
	1,724	1,848	3,572
Net finance costs	(179)	(212)	(391)
Share of post-tax results of associates and joint ventures	293	210	503
analysed as:			
– adjusted share of post-tax results of associates and joint ventures	235	242	477
– trademark impairments		(20)	(20)
– additional ST income	13		13
– termination of joint venture	45		45
– restructuring costs		(12)	(12)
	293	210	503
Profit before taxation	1,838	1,846	3,684
Earnings per share			
Basic	62.5p	60.8p	123.3p
Adjusted diluted	62.0p	66.8p	128.8p

PRINCIPAL SUBSIDIARY UNDERTAKINGS

	% equity shares held
Centre Corporate Companies	
B.A.T (U.K. and Export) Ltd.	100
B.A.T Capital Corporation (incorporated in the United States of America)	100*
B.A.T. International Finance p.l.c.	100*
BATMark Ltd.	100*
British-American Tobacco (Holdings) Ltd.	100
British American Tobacco Holdings (The Netherlands) B.V. (incorporated in The Netherlands)	100
British American Tobacco International Ltd. (incorporated in Switzerland)	100
British American Tobacco (Brands) Inc. (incorporated in the United States of America)	100
British American Tobacco (Brands) Ltd.	100
British American Tobacco (GLP) Ltd.	100
British American Tobacco (Investments) Ltd.	100
Tobacco Insurance Company Ltd.	100
Asia-Pacific	
Australia	
British American Tobacco Australia Ltd.	100
Bangladesh	
British American Tobacco Bangladesh Company Ltd.	65
Indonesia	
PT BAT Indonesia Tbk ▲	78
PT Bentoel Internasional Investama Tbk ▲	99
Japan	
British American Tobacco Japan, Ltd.	100
Malaysia	
British American Tobacco (Malaysia) Berhad	50
New Zealand	
British American Tobacco (New Zealand) Ltd.	100
Pakistan	
Pakistan Tobacco Co. Ltd.	94
Singapore	
British-American Tobacco (Singapore) Pte Ltd.	100
British-American Tobacco Marketing (Singapore) Pte Ltd.	100
South Korea	
British American Tobacco Korea Ltd.	100
British American Tobacco Korea Manufacturing Ltd.	100
Vietnam	
B.A.T Vietnam Ltd. (incorporated in Great Britain)	100
British American Tobacco-Vinataba (JV) Ltd.	70
Americas	
Brazil	
Souza Cruz S.A.	75
Canada	
Imperial Tobacco Canada Ltd.	100
Chile	
Compania Chilena de Tabacos S.A.	96
Mexico	
British American Tobacco Mexico, S.A. de C.V.	100
Venezuela	
C.A. Cigarrera Bigott Sucs.	100

	% equity shares held
Western Europe	
Belgium	
British American Tobacco Belgium S.A.	100
Denmark	
House of Prince A/S	100
France	
British American Tobacco France SAS	100
Germany	
British-American Tobacco (Germany) GmbH	100
British American Tobacco (Industrie) GmbH ●	100
Hungary	
BAT Pécsi Dohánygyár Kft.	100
Italy	
British American Tobacco Italia S.p.A.	100
Netherlands	
British American Tobacco The Netherlands B.V.	100
Poland	
British-American Tobacco Group Polska S.A.	100
British American Tobacco Polska Trading Sp. z.o.o.	100
Spain	
British American Tobacco España, S.A.	100
Sweden	
British American Tobacco Sweden AB	100
Fiedler & Lundgren AB	100
Switzerland	
British American Tobacco Switzerland S.A.	100
Eastern Europe	
Romania	
British-American Tobacco (Romania) Trading SRL	100
Russia	
OJSC British American Tobacco – STF	99
OJSC British American Tobacco – Yava	99†
CJSC British American Tobacco – SPb	100†
CJSC 'International Tobacco Marketing Services'	100
Ukraine	
A/T B.A.T. – Prilucky Tobacco Co.	99
Africa and Middle East	
Nigeria	
British American Tobacco (Nigeria) Ltd.	100
South Africa	
British American Tobacco Holdings South Africa (Pty) Ltd.	100
Turkey	
British American Tobacco Tütün Mamulleri Sanayi ve Ticaret A.S.	100

The Company has taken advantage of the exemption under Section 410 (2) of the Companies Act 2006 by providing information only in relation to subsidiary undertakings whose results or financial position, in the opinion of the Directors, principally affected the financial statements. The listed subsidiary undertakings are therefore the main corporate entities in those countries which, in aggregate, contributed over 80 per cent of Group revenue and operating profit, and accounted for approximately 80 per cent of Group net assets.

A complete list of subsidiary and associated undertakings will be attached to the next British American Tobacco p.l.c. annual return to Companies House.

Subsidiary undertakings held directly by British American Tobacco p.l.c. are indicated thus *; all others are held by sub-holding companies. Unless otherwise stated, Centre Corporate Companies are subsidiary undertakings incorporated in the United Kingdom and the country of incorporation and operation of regional subsidiary undertakings is that under which the company is listed. All subsidiary undertakings are involved in activities related to the manufacture, distribution or sale of tobacco products.

All companies' shares are ordinary shares or common stock except for those indicated thus †, which include preference shares.

● Financial year end is 30 November.

▲ On 1 January 2010 PT BAT Indonesia Tbk merged into PT Bentoel Internasional Investama Tbk. Subsequent to the merger, the percentage of equity shares held indirectly by British American Tobacco p.l.c. in PT Bentoel Internasional Investama Tbk (as the surviving company) is 99 per cent.

PRINCIPAL ASSOCIATE UNDERTAKINGS

		Latest published information	Total issued capital £m	% shares held
Americas				
United States of America				
Reynolds American Inc.	▼ Common Stock	31 Dec 2009	*	42
tobacco	▼ Preferred Stock		**	
Asia-Pacific				
India				
ITC Ltd.	▼ Ordinary	31 Dec 2009	50	31
FMCG including tobacco				
agri-business				
paperboard, paper and packaging				
hotels				

▼ Listed overseas.

*As at 31 December 2009, Reynolds American Inc. had issued 291,424,051 shares (US$0.0001 Common Stock), of which the Group held 122,518,429.

**As at 31 December 2009, Reynolds American Inc. had issued 1,000,000 shares (US$0.01 Preferred Stock), in which the Group held no interest.

PARENT COMPANY FINANCIAL STATEMENTS

PAGE

Report of the independent auditors 196

Independent auditors' report on the Parent Company financial statements.

Balance sheet 197

Summary of the Parent Company's assets, equity and liabilities.

Notes on the accounts 198

Detailed notes on the Parent Company accounts.

INDEPENDENT AUDITORS' REPORT
TO THE MEMBERS OF BRITISH AMERICAN TOBACCO p.l.c.

We have audited the Parent Company financial statements of British American Tobacco p.l.c. for the year ended 31 December 2009 which comprise the Balance sheet and the notes on the accounts. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of Directors and auditors

As explained more fully in the Responsibility of Directors statement set out on page 105, the Directors are responsible for the preparation of the Parent Company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the Parent Company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the Parent Company financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2009;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' report for the financial year for which the Parent Company financial statements are prepared is consistent with the Parent Company financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements and the part of the Remuneration report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matters

We have reported separately on the Group financial statements of British American Tobacco p.l.c. for the year ended 31 December 2009.

Richard Hughes (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom

24 February 2010

BALANCE SHEET – BRITISH AMERICAN TOBACCO p.l.c.
AT 31 DECEMBER

	Notes	2009 £m	2008 £m
Assets			
Fixed assets			
Investments in Group companies	2	**4,295**	4,063
		4,295	4,063
Current assets			
Debtors	3	**4,166**	4,240
		4,166	4,240
Total assets		**8,461**	8,303
Equity			
Capital and reserves			
Share capital		**506**	506
Share premium account		**58**	56
Capital redemption reserves		**101**	101
Other reserves		**90**	90
Profit and loss account		**3,173**	3,143
after deducting			
– cost of treasury shares		**(764)**	(741)
Shareholders' funds	4	**3,928**	3,896
Liabilities			
Creditors	5	**4,533**	4,407
Total equity and liabilities		**8,461**	8,303

The accompanying notes are an integral part of the Parent Company financial statements.

On behalf of the Board

Richard Burrows
Chairman

24 February 2010

NOTES ON THE ACCOUNTS

1 Accounting policies

Basis of accounting

The Parent Company financial statements have been prepared on the going concern basis under the historical cost convention except as described in the accounting policy below on financial instruments and in accordance with the Companies Act 2006 and UK Generally Accepted Accounting Practice.

The Company is a public limited company which is listed on the London Stock Exchange and the Johannesburg Stock Exchange and is incorporated and domiciled in the UK.

Cash flow statement

The cash flows of the Company are included in the consolidated cash flow statement of British American Tobacco p.l.c. which is included in this Annual Report. Consequently, the Company is exempt under the terms of FRS 1 (Revised) from publishing a cash flow statement.

Foreign currencies

Transactions arising in currencies other than sterling are translated at the rate of exchange ruling on the date of the transaction. Assets and liabilities expressed in currencies other than sterling are translated at rates of exchange ruling at the end of the financial year. All exchange differences are taken to the profit and loss account in the year.

Accounting for income

Income is included in the profit and loss account when all contractual or other applicable conditions for recognition have been met. Provisions are made for bad and doubtful debts, as appropriate.

Taxation

Taxation provided is that chargeable on the profits of the period, together with deferred taxation. Deferred taxation is provided in full on timing differences between the recognition of gains and losses in the financial statements and their recognition in tax computations. However, the Company does not discount deferred tax assets and liabilities.

Fixed asset investments

Fixed asset investments are stated at cost, together with subsequent capital contributions, less provisions for any impairment in value.

Dividends

Final dividend distributions to the Company's shareholders are recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders, while interim dividend distributions are recognised in the period in which the dividends are declared and paid.

Repurchase of share capital

When share capital is repurchased, the amount of consideration paid, including directly attributable costs, is recognised as a deduction from equity. Repurchased shares which are not cancelled, or shares purchased for the employee share ownership trusts, are classified as treasury shares and presented as a deduction from total equity.

Related parties

The Company has taken advantage of the exemption under paragraph 3(b) FRS 8 from disclosing transactions with related parties that are part of the British American Tobacco p.l.c. Group.

Financial instruments

The financial instrument disclosures of the Company are included in the Group financial statements which are included in this Annual Report. Consequently, the Company is exempt under paragraph 2D (b) of FRS 29 from publishing these financial instruments disclosures.

Financial guarantees are recorded at fair value less accumulated amortisation.

2 Investments in Group companies

The Company's directly owned subsidiaries are British American Tobacco (1998) Limited, B.A.T. International Finance p.l.c., B.A.T Capital Corporation, BATMark Limited and British American Tobacco QUEST Limited. During 2009, the Company disposed of BA Ventures Limited for a consideration of £2 to another Group company. British American Tobacco QUEST Limited was struck off the Register of Companies in February 2010.

The Directors are of the opinion that the individual investments in the subsidiary undertakings have a value not less than the amount at which they are shown in the balance sheet.

	2009 £m	2008 £m
1 January	**4,063**	4,047
Additions	**232**	16
31 December	**4,295**	4,063

On 10 February 2009, the Company purchased 230,000,000 £1 shares in B.A.T. International Finance p.l.c. for a consideration of £230 million. There were no other significant additions in 2009 or 2008.

3 Debtors

	2009 £m	2008 £m
Amounts due from Group undertakings	**4,166**	4,240

Included in debtors are amounts of £68 million (2008: £69 million) falling due after one year.

4 Shareholders' funds

	Share capital £m	Share premium account £m	Capital redemption reserves £m	Other reserves £m	Profit and loss account £m	Total £m
1 January 2009	**506**	**56**	**101**	**90**	**3,143**	**3,896**
Increase in share capital – share options		**2**				**2**
Profit for the year					**1,851**	**1,851**
Dividends and other appropriations ordinary shares *(note 8)*					**(1,798)**	**(1,798)**
Consideration paid for purchase of own shares held in employee share ownership trusts					**(90)**	**(90)**
Consideration received on the exercise of options over own shares held in employee share ownership trusts					**5**	**5**
Other movements					**62**	**62**
31 December 2009	**506**	**58**	**101**	**90**	**3,173**	**3,928**

Dividends paid are recognised in the year in which they are approved by shareholders, and dividends received are recognised in the year in which they are received. The final dividend which has been declared for the year ended 31 December 2009 is shown in note 8 to the Group financial statements and will be recognised in the financial statements for the year ended 31 December 2010.

As permitted by Section 408 of the Companies Act 2006, the profit and loss of the Company has not been presented in these financial statements. The profit for the year ended 31 December 2009 was £1,851 million (2008: £2,033 million).

Details of Directors' remuneration, share options and retirement benefits are given in the Remuneration report. Details of key management compensation are included in note 29 of the Group financial statements. The Company had three employees at 31 December 2009 (2008: three). The cost of these employees are borne by another Group company.

Shareholders' funds are stated after deducting the cost of treasury shares which include £523 million (2008: £523 million) for shares repurchased and not cancelled and £241 million (2008: £218 million) in respect of the cost of own shares held in employee share ownership trusts.

Transaction costs deducted from equity for the year ended 31 December 2009 were £nil (2008: £3 million).

Share capital	Ordinary shares of 25p each Number of shares	Convertible redeemable preference shares of 25p each Number of shares	£m
Allotted, called up and fully paid			
1 January 2009	**2,025,031,151**		**506.26**
Changes during the year			
– share option schemes	**333,471**		**0.08**
31 December 2009	**2,025,364,622**		**506.34**

The concept of authorised share capital was abolished in October 2009 pursuant to the provisions of the Companies Act 2006; therefore authorised share capital has not been presented as at 31 December 2009.

NOTES ON THE ACCOUNTS CONTINUED

4 Shareholders' funds continued

Share capital	Ordinary shares of 25p each Number of shares	Convertible redeemable preference shares of 25p each Number of shares	£m
Authorised			
1 January 2008 and 31 December 2008	2,858,265,349	241,734,651	775.00
Allotted, called up and fully paid			
1 January 2008	2,024,504,341		506.13
Changes during the year			
– share option schemes	526,810		0.13
31 December 2008	2,025,031,151		506.26

Share premium

The increase of £2 million relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration report.

5 Creditors

	2009 £m	2008 £m
Amounts due to Group undertakings	**741**	610
Loans due to Group undertakings	**3,617**	3,617
Sundry creditors	**175**	180
	4,533	4,407

Included in creditors are amounts of £112 million (2008: £114 million) falling due after more than one year.

Loans due to Group undertakings are unsecured and bear interest at rates between 1.34 per cent and 6.32 per cent (2008: 4.96 per cent and 7.23 per cent).

6 Audit fees

	2009	2008
Fees payable to PricewaterhouseCoopers LLP		
– audit fees	**£30,000**	£30,000
– fees paid for other services	**£nil**	£nil

7 Contingent liabilities and financial commitments

British American Tobacco p.l.c. has guaranteed borrowings by subsidiary undertakings of £10,077 million (2008: £11,296 million) and total borrowing facilities of £17,133 million (2008: £18,240 million). The maturity of guarantees in relation to borrowings by subsidiary undertakings is as follows:

	2009 £m	2008 £m
Within one year	**466**	2,037
Between one and two years	**1,075**	508
Between two and three years	**1,805**	1,164
Between three and four years	**799**	1,205
Between four and five years	**582**	1,525
Beyond five years	**5,350**	4,857
	10,077	11,296

Performance guarantees given to third parties in respect of Group companies were £nil (2008: £1 million).

There are contingent liabilities in respect of litigation in various countries (note 30 to the Group financial statements).

SHAREHOLDER INFORMATION

PAGE

Shareholder and contact information 202

Detailed shareholder and contact information.

SHAREHOLDER AND CONTACT INFORMATION

Listings and shareholder services

Primary listing

London Stock Exchange (Share Code: BATS; ISIN: GB0002875804)

United Kingdom Registrar

Computershare Investor Services PLC
The Pavilions, Bridgwater Road, Bristol BS99 6ZZ
tel: 0800 408 0094; +44 870 889 3159
web-based enquiries: www.investorcentre.co.uk/contactus

www.computershare.com/uk/investor/bri

Access the web-based enquiry service for shareholders operated by Computershare Investor Services in the UK; view details of your British American Tobacco shareholding and recent dividend payments; and register for shareholder electronic communications to receive notification of British American Tobacco shareholder mailings by email.

www.computershare.com/dealing/uk

Go online or telephone 0870 703 0084 (UK) to buy or sell British American Tobacco shares traded on the London Stock Exchange. This service is only available to shareholders in countries where settlement can be made in sterling or euros.

Secondary listing

JSE (Share Code: BTI)

Shares are traded in electronic form only and transactions settled electronically through Strate.

South Africa Registrar

Computershare Investor Services (Pty) Ltd
PO Box 61051, Marshalltown 2107, South Africa
tel: 0861 100 925; +27 11 870 8222
email enquiries: web.queries@computershare.co.za

American Depositary Receipts

NYSE Alternext U.S. (Symbol: BTI; CUSIP No. 110448107)

British American Tobacco sponsors an American Depositary Receipt (ADR) programme in the United States. Each ADR represents two of the Company's ordinary shares.

Enquiries regarding ADR holder accounts and payment of dividends should be directed to:
Citibank Shareholder Services
PO Box 43077, Providence, Rhode Island 02940-3077, USA
tel: 1-888 985 2055 (toll-free) or +1 781 575 4555
email enquiries: citibank@shareholders-online.com
website: www.citi.com/dr

Publications

Copies of current and past Annual Reports are available on request. Copies of the Group corporate descriptive booklet About Us are also available. Highlights from these publications can be produced in alternative formats such as Braille, audio tape and large print, contact:
British American Tobacco Publications
Unit 80, London Industrial Park, Roding Road, London E6 6LS
tel: +44 (0)20 7511 7797; facsimile: +44 (0)20 7540 4326
email: bat@team365.co.uk

Alternatively contact Computershare Investor Services (Pty) Ltd in South Africa using the contact details shown opposite.

Our website – www.bat.com

Access comprehensive information about British American Tobacco and download shareholder publications at the corporate website; visit the Investor Centre for valuation and charting tools and dividend and share price data; and subscribe to the email and SMS alert services for key financial events in the British American Tobacco financial calendar.

Dividend Reinvestment Plan

Available to the majority of shareholders on the UK register, this is a straightforward and economic way of utilising your dividends to build up your shareholding in British American Tobacco; contact Computershare Investor Services in the UK for details.

Individual Savings Accounts (ISAs)

A British American Tobacco sponsored ISA, contact:
The Share Centre
PO Box 2000, Aylesbury, Bucks HP21 8ZB
tel: 0800 800 008; +44 (0)1296 414 141
email enquiries: service@share.co.uk
website: www.share.co.uk

Capital gains tax

Fact sheet for British American Tobacco historical UK capital gains tax information; contact the British American Tobacco Company Secretarial Department, tel: +44 (0)20 7845 1000 or access the Investor Centre at www.bat.com/investorcentre/cgt.

Final dividend 2009 – dates in 2010

25 February	Dividend announced (including amount of dividend per share in both sterling and rand, applicable exchange rate and conversion date)
5 March	Last day to trade (JSE)
8-12 March	No transfers between UK main register and South African branch register; no shares may be dematerialised or rematerialised
8 March	Ex-dividend date (JSE)
10 March	Ex-dividend date (LSE)
12 March	Record date (LSE and JSE)
6 May	Payment date (sterling and rand)

Financial calendar 2010

28 April	Interim Management Statement
28 April	Annual General Meeting, The Mermaid Conference & Events Centre, London EC4V 3DB
28 July	Half-Yearly Report
27 October	Interim Management Statement

Analyses of shareholders

The high and low prices at which the Company's shares are recorded as having traded during the year on each of the LSE and the JSE are as follows:

	High	Low
LSE	2,032.5p	1,495.0p
JSE	R278.5	R197.5

At 31 December 2009 there was a total of 2,025,364,622 ordinary shares in issue held by 112,660 shareholders. These shareholdings are analysed as follows:

(a) by listing as at 31 December 2009:

Register	Total number of shares	Percentage of issued share capital	Number of holders
UK	1,785,291,348	88.15	54,156
South Africa	240,073,274	11.85	58,504

(b) by category of shareholder and size of shareholding as at 31 December 2009:

UK Register

Category of UK shareholder	Number of UK holders	Percentage of total UK holders	Number of UK ordinary shares	Percentage of UK ordinary share capital
Individuals	45,879	84.72	57,635,336	3.23
Financial institutions/ pension funds	291	0.54	13,694,582	0.77
Nominee companies	7,595	14.02	1,664,337,547	93.22
Other corporate holders	390	0.72	20,663,829	1.16
Treasury shares (UK)	1	<0.01	28,960,054	1.62

South African Register

Category of SA shareholder	Number of SA holders	Percentage of total SA holders	Number of SA ordinary shares	Percentage of SA ordinary share capital
Individuals	42,845	73.23	28,449,284	11.85
Financial institutions/ pension funds	1,520	2.60	163,221,201	67.99
Nominee companies	11,665	19.94	33,440,313	13.93
Other corporate holders	2,474	4.23	14,962,476	6.23

Combined registers

Category of shareholder	Number of holders	Percentage of total holders	Number of ordinary shares	Percentage of issued ordinary share capital
Individuals	88,724	78.75	86,084,620	4.25
Financial institutions/ pension funds	1,811	1.61	176,915,783	8.73
Nominee companies	19,260	17.10	1,697,777,860	83.83
Other corporate holders	2,864	2.54	35,626,305	1.76
Treasury shares (UK)	1	<0.01	28,960,054	1.43

UK Register

	Number of holders	Percentage of UK ordinary share capital
1 – 1,999	43,970	1.31
2,000 – 9,999	8,047	1.69
10,000 – 199,999	1,579	4.11
200,000 – 499,999	224	4.11
500,000 and over	335	87.16
Treasury shares (UK)	1	1.62

South African Register

	Number of holders	Percentage of SA ordinary share capital
1 – 1,999	52,014	7.60
2,000 – 9,999	4,760	8.03
10,000 – 199,999	1,583	25.79
200,000 – 499,999	97	12.11
500,000 and over	50	46.47

Combined Registers

	Number of holders	Percentage of issued ordinary share capital
1 – 1,999	95,984	2.05
2,000 – 9,999	12,807	2.44
10,000 – 199,999	3,162	6.68
200,000 – 499,999	321	5.06
500,000 and over	385	82.34
Treasury shares (UK)	1	1.43

SHAREHOLDER AND CONTACT INFORMATION
CONTINUED

Registered office
Globe House, 4 Temple Place, London WC2R 2PG
tel: +44 (0)20 7845 1000; facsimile: +44 (0)20 7240 0555

Incorporated in England and Wales No. 3407696

Secretary
Nicola Snook

General Counsel
Neil Withington

Investor relations
Enquiries should be directed to
Ralph Edmondson or Maya Farhat
tel: +44 (0)20 7845 1180/1977

Press office
Enquiries should be directed to
Fran Morrison or David Betteridge
tel: +44 (0)20 7845 2888
email: press_office@bat.com

Auditors
PricewaterhouseCoopers LLP
1 Embankment Place, London WC2N 6RH

READ OUR ANNUAL REPORT 2009 ONLINE
WWW.BAT.COM/ANNUALREPORT2009

www.bat.com/annualreport2009

The paper used for this report is Revive 50:50 silk, comprising 25% post-consumer and 25% pre-consumer waste, and 50% virgin wood fibre sourced from well managed forests independently certified according to the rules of the Forest Stewardship Council. This document is recyclable. Designed and produced by Likemind. Photography by Mike Abraham, Stuart Freedman and Matthew Ford. Printed in the UK by St Ives Westerham Press Ltd. ISO14001:2004, FSC certified and CarbonNeutral®.