ANNUAL REPORT 2014

# Delivering today
# Investing in tomorrow

BRITISH AMERICAN TOBACCO

We are a global company with over 200 brands sold in more than 200 markets. We employ more than 57,000 people and we make the cigarettes chosen by around one in eight of the world's one billion adult smokers.

The Group's diverse strengths – the geographic spread of the markets we operate in, our strong brands, our new product categories and our talented people – are the foundations of our continuing success.

We are a forward-looking company with a proven strategy that is delivering value for our shareholders. We are confident that our investments in both high-growth markets and next-generation products will ensure we continue to achieve sustainable growth in the future.

**British American Tobacco p.l.c. (No. 3407696)**
**Annual Report 2014**

This is the Annual Report of British American Tobacco p.l.c. (the Company) and the British American Tobacco Group, comprising the Strategic Report, Directors' Report and the audited Financial Statements, for the year ended 31 December 2014. It has been drawn up and is presented in accordance with, and reliance upon, applicable English company law. The liabilities of the Directors in connection with this 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 Africa branch register.

References in this publication to 'British American Tobacco', 'BAT', 'we', 'us', and 'our' when denoting opinion refer to British American Tobacco p.l.c. and when denoting tobacco business activity refer to British American Tobacco Group operating companies, collectively or individually as the case may be.

**Cautionary statement**

The Strategic Report and certain other sections of the Annual Report contain forward-looking statements that 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 that could cause actual results to differ materially from those currently anticipated.

GO ONLINE

## Explore the story of our year

Featuring downloadable versions of this Report, along with a video review, our Sustainability Summary Report and other content – all accessible on desktop, tablet and mobile.

**www.bat.com/review2014**

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# What you will find in this report

We have the right strategy for our business – it has served us well in a changing and challenging market environment and it continued to deliver for our shareholders in 2014.

**Nicandro Durante**
Chief Executive

Read our Chief Executive's review on page 06

OVERVIEW

# Chairman's introduction

## A strong underlying performance

> The Group's strong underlying growth is consistent with our performance in recent years and was achieved while we continued to invest in sustaining the future profitability of the business.

Richard Burrows
Chairman

**Our governance:** read the Chairman's introduction to our Governance section on page 46

**Welcome to our Annual Report for 2014. Your Company continued to perform extremely well last year despite difficult conditions in many of its markets.**

Reported adjusted diluted earnings were 208.1p per share, a decline of 3.9% on 2013 that was driven entirely by significant currency fluctuations which also impacted our other reported results.

On a constant currency basis, the Group delivered adjusted diluted earnings growth of 7.9% to 233.7p per share and grew overall market share, driven by an excellent performance by the Global Drive Brands.

The Group's strong underlying growth is consistent with our performance in recent years and was achieved while we continued to invest in sustaining the future profitability of the business, in areas such as next-generation products, operational efficiencies, marketing support for our brands and in recruiting and developing high-quality managers.

So your Company continues to perform strongly and because we remain confident about our strategy and future performance – while recognising the uncertainty and transactional costs caused by currency movements – we are proposing a 3.3% increase in the final dividend to 100.6p per share. This takes the total dividend for 2014 to 148.1p, an increase of 4.0% on 2013.

If approved at our Annual General Meeting, the final dividend will be paid on 7 May 2015 to shareholders on the register on 20 March 2015.

### Investing in Reynolds American

In July 2014, we announced an investment of US$4.7 billion in Reynolds American Inc. subject to the completion of its proposed acquisition of Lorillard. This will maintain our 42% equity position in a larger, more competitive Reynolds American. We also agreed, in principle, to extend our existing cooperation with Reynolds American to encompass collaboration on next-generation products.

To support this investment, the Group suspended its planned £1.5 billion share buy-back programme for 2014 on 30 July last year, by which point 23 million shares had been repurchased at a value of £795 million, excluding transaction costs.

## New Board members

I am delighted to welcome three new Non-Executive Directors who joined our Board in February 2015.

Sue Farr has had a distinguished career in communications and marketing with organisations such as the BBC and Vauxhall Motors; Pedro Malan is a former Finance Minister of Brazil and an expert in macro-economic policy; and Dimitri Panayotopoulos brings considerable consumer sector experience from his successful career at Procter & Gamble.

They will further strengthen the Board and our Group with their extensive marketing, business and geopolitical skills, while also enhancing the diversity of the people and experience on our Board.

My thanks are due to everyone at British American Tobacco, especially my Board colleagues, our Chief Executive and all the members of his management team, for their dedication and efforts to deliver these excellent results in a testing and difficult year.

## Confidence in the future

Sustainability is one of the key pillars of our strategy. Our commitment to delivering long-term value to our shareholders and ensuring a sustainable future for the Group underpins many of our business activities. These include developing less risky tobacco and nicotine products like e-cigarettes and tobacco heating products, supporting farmers' livelihoods and tackling illicit trade.

My confidence in the future of this Company is strong. We are investing significant sums to secure the long-term future of the business while continuing to deliver good results today.

**Richard Burrows**
Chairman

OVERVIEW

# Our year in numbers

**Group cigarette volume**

667bn

**-1.4%**
2013: 676bn

**Revenue**

£13,971m

**-8.4%**
2013: £15,260m

**Revenue at constant exchange rates[1]**

£15,682m

**+2.8%**
2013: £15,260m

**Profit from operations**

£4,546m

**-17.7%**
2013: £5,526m

**Adjusted profit from operations[2] at constant exchange rates[1]**

£6,075m

**+4.4%**
2013: £5,820m

**Adjusted diluted earnings per share[2]**

208.1p

**-3.9%**
2013: 216.6p

**Adjusted diluted earnings per share[2] at constant rates of exchange[1]**

233.7p

**+7.9%**
2013: 216.6p

**Basic earnings per share**

167.1p

**-18.6%**
2013: 205.4p

**Total dividends per share**

148.1p

**+4.0%**
2013: 142.4p

Notes:
1. Constant currency provides the information based on a re-translation, at prior year exchange rates, of the current year information.
2. Adjusted profit from operations is derived after excluding the adjusting items from the profit from operations. These items include restructuring and integration costs, amortisation and impairment of trademarks and similar intangibles, a gain on deemed partial disposal of a trademark and a payment and release of provision relating to non-tobacco litigation (see page 44).

OVERVIEW

# We are a global business with a proud history

## Our heritage

Founded in 1902, the Group was first listed in 1912 and today we are one of the top 10 companies on the London Stock Exchange. We also have a secondary listing on the Johannesburg Stock Exchange.

We are a global company with more than 200 brands sold in over 200 markets. We make the cigarettes chosen by around one in eight of the world's one billion adult smokers and we are market leaders in more than 60 countries.

Few companies with our long history are still going from strength to strength. We continue to deliver value to shareholders today while investing in our markets, our brands, our new product categories and our people to ensure a sustainable future for our business.

## Our products

### Traditional tobacco range

We continue to deliver good growth across our core tobacco product range. This includes cigarettes, Fine Cut (roll-your-own and make-your-own tobacco) and cigars. Using our understanding of consumers, we develop high-quality products and market-leading innovations to differentiate our brands.

### Next-generation products

We are investing in building a portfolio of innovative new tobacco and nicotine-based products alongside our traditional tobacco business. These next-generation products include e-cigarettes, medicinal nicotine products and tobacco heating products. We aim to provide adult consumers with a choice of less risky alternatives to regular cigarettes as part of our commitment to tobacco harm reduction.

## Our portfolio

Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans are our Global Drive Brands (GDBs). These famous brands continued to drive volume and share growth in our markets worldwide in 2014.

Our portfolio also comprises other popular international brands with strong market positions in many countries. They include Vogue, Viceroy, Kool, Peter Stuyvesant, Craven A, Benson & Hedges, John Player Gold Leaf, State Express 555 and Shuang Xi.

**110+**
Number of markets where Dunhill is sold

**Dunhill**
Dunhill's roots date back to 1907 when Dunhill Tobacco of London Limited was established on Gentlemen's Row. More than a century later, Dunhill is our premium international brand, embodying perfect taste, always.

**80+**
Number of markets where Kent is sold

**Kent**
Kent symbolises progress through technology in the cigarette category and stands out as the most innovative and forward-looking brand in the industry. It's a pioneering brand, which has led the way since 1952.

**70+**
Number of markets where Lucky Strike is sold

**Lucky Strike**
Based on its rich legacy dating back to 1871 when the brand was created by its founder RA Patterson, Lucky Strike stands for the true and original American cigarette.

**100+**
Number of markets where Pall Mall is sold

**Pall Mall**
Pall Mall is the third biggest cigarette brand in the world. For more than 115 years its core proposition has been centred on offering adult smokers round the world a combination of value and high quality.

**60+**
Number of markets where Rothmans is sold

**Rothmans**
Rothmans is an iconic brand established in London in 1890. A timeless classic with high-quality standards, Rothmans is finding increasing appeal among adult smokers worldwide thanks to a contemporary proposition.

## Our people

We employ more than 57,000 people worldwide. They work in a huge range of environments, from city offices to factories, from remote farms to research laboratories.

We have more than 20,000 people in our trade marketing and distribution teams who work with retailers to help them sell our products profitably and responsibly.

Our products are made all over the world and in 2014 we employed more than 17,000 people in our manufacturing operations.

The international nature of our business is reflected in the diverse range of nationalities of our people – in 2014, for example, 71 nationalities were represented at our London head office.

Although we don't employ them directly, we also work closely with over 100,000 independent tobacco farmers worldwide.

## Our sustainable approach

Sustainability is a key pillar of our strategy. It is about creating shared value for both our shareholders and our stakeholders in wider society.

We work with farmers and suppliers to manage our supply chain and the environment responsibly. Our companies adhere to the high standards of our voluntary marketing principles. As part of our commitment to harm reduction, we are developing a range of innovative tobacco and nicotine products with the aim of offering adult consumers a choice of less risky alternatives to regular cigarettes.

We play a significant role in countries around the world. In many countries we are a top employer and a company of choice for retailers, suppliers, farmers, distributors and other partners. In 2014, our subsidiaries enabled governments worldwide to collect approximately £30 billion in duty, excise and other taxes on our products, which is eight times the Group's profit after tax.

## Our geographic diversity

We have strong market positions in each of our four regions. Our key markets, shown here, account for around 80% of both our total volume and Group profit.

We also have two principal associate companies – Reynolds American Inc. in the US and ITC Ltd in India – and we have a joint operation, CTBAT, with subsidiaries of China National Tobacco Corporation.

**60+**

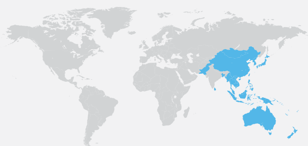
**countries where we are market leader**

**44**

**factories in 41 countries producing cigarettes and Other Tobacco Products**

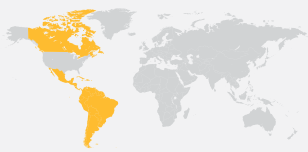
**Asia-Pacific**

Australia
Bangladesh
Indonesia
Japan
Malaysia
New Zealand
Pakistan
Philippines
South Korea
Taiwan
Vietnam



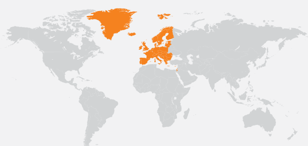
**Americas**

Argentina
Brazil
Canada
Chile
Colombia
Mexico
Venezuela



**Western Europe**

Belgium
Czech Republic
Denmark
France
Germany
Italy
The Netherlands
Poland
Romania
Spain
Sweden
Switzerland
United Kingdom



**Eastern Europe, Middle East and Africa**

Algeria
Egypt
The GCC
Iran
Kazakhstan
Morocco
Nigeria
Russia
South Africa
Turkey
Ukraine

OVERVIEW

## Chief Executive's review

# A winning strategy for today and tomorrow

**Our strategy continued to deliver in 2014, says Nicandro Durante in his Chief Executive's review. In a tough trading environment we achieved strong results while continuing to invest in our future.**

I am delighted with the excellent progress we have made in the four years since I became Chief Executive, during which we have enhanced our strategy with a sharpened focus on the consumer.

We have increased our share of the global cigarette market in this period by 70 basis points and grown our Global Drive Brands (GDBs) and share of key segments at an even faster rate, improving the underlying quality of our portfolio.

We are meeting consumer needs with differentiated products, including innovations which now make up nearly 50% of GDB volume.

Our focus on resource allocation is driving major investments in high-growth markets, particularly in EEMEA and Asia-Pacific regions, resulting in share growth in these markets.

By supporting pricing with strong brands and innovations, substantially reducing costs and improving productivity, we have increased our operating margin by more than 520 basis points over four years.

We are also making excellent progress towards our goal to lead across the various next-generation product categories.

This performance shows that we have the right strategy for our business – it has served us well in a changing and challenging market environment and it continued to deliver for our shareholders in 2014.

### We delivered another strong performance in 2014

Although currency movements significantly impacted our reported results for last year, at constant rates we continued to grow revenue (+2.8%), adjusted profit from operations (+4.4%) and adjusted diluted earnings per share (+7.9%). Excluding the transactional effect of foreign exchange, adjusted profit from operations would have increased by an estimated further £90 million or 1.5%.

Exchange rates continue to be volatile and in the current year, if rates were to stay where they are today, we would face a substantially larger transactional exchange headwind. This would impact our constant currency performance and would be in addition to any translational impact on reported numbers.

In 2014 we again increased our market share in our key markets driven by our GDBs' excellent performance. As a result, our cigarette volume decline of 1.4% was less than the overall industry decline, estimated at 2.5%.

These results were achieved despite a challenging external environment, with continued pressure on consumers' disposable income, fragile economic conditions in Europe and adverse exchange rates.

We maintained good pricing, despite an increase in competitive pricing activity in some key markets. We also achieved another good improvement in operating margin (over 50 basis points) – an excellent result given that we absorbed significant transactional costs caused by currency movements.

Nicandro Durante
Chief Executive

> We delivered value for our shareholders and our other stakeholders in 2014 while continuing to invest significantly in the future of our business.

This also demonstrates that we are becoming a more efficient and effective business as we address our cost base and drive productivity savings.

## We are investing in a sustainable future

We delivered value for our shareholders and our other stakeholders in 2014 while continuing to invest significantly in the future of our business.

The Group invested in growth opportunities in key markets and in building a pipeline of next-generation products. We developed our e-cigarette brand, Vype, in the UK with new product launches. We also made significant progress towards launching Voke, a nicotine inhalation product licensed as a medicine in the UK.

We plan to begin consumer trials of a tobacco heating product by the end of 2015 and have our first product in a test market in 2016.

As well as representing new commercial opportunities for the Group, these developments demonstrate our long-standing commitment to tobacco harm reduction by offering consumers a choice of high-quality, less risky products.

Within our business, we are making good progress in implementing standardised global systems. These will support consistent ways of operating that will make us a more efficient, effective and agile business.

We also continue to invest in attracting, retaining and developing people who will lead the successful delivery of our strategy today and in the future.

## We support balanced, evidence-based regulation

Tobacco regulation remains an ongoing challenge for our industry. We support effective, evidence-based regulation that meets public health objectives, does not impede our ability to compete and respects our legal rights.

That is why we oppose plain packaging. We believe the UK Government's decision to introduce this policy is a serious error of judgement due to the legal implications and given the evidence from Australia that plain packaging does not appear to be achieving its public health objectives.

Plain packaging and other measures such as excessive excise increases can create ideal conditions for illicit trade. In Australia, for example, the black market in tobacco products has increased since plain packaging was introduced.

We will continue to lead the industry in proactively and openly engaging with regulators and wider society on regulatory issues and seek to collaborate with governments and other organisations to combat illicit trade.

## We continue to deliver value to shareholders

Despite tough market conditions, the strengths of our business and our people ensured we achieved another competitive set of results and again delivered high single-figure earnings growth at constant exchange rates.

The Group recently announced that it is evaluating a possible public tender offer to acquire the remaining 24.7% of Souza Cruz shares that it does not currently own. This investment would further strengthen our presence in Brazil, a key strategic market where we are already market leader. It would also provide opportunities to leverage Souza Cruz's capabilities in areas such as leaf and for closer cooperation in research and development, while further integrating the business into our Americas region.

We expect the trading environment to remain difficult in 2015 and that foreign exchange headwinds will continue to have a significant impact on both a transactional and translational level.

However, I am confident that with our proven strategy, strong global presence, powerful brands, talented people and continued focus on efficiency we will deliver value to our shareholders in the short and long term.

**Nicandro Durante**
Chief Executive

BUSINESS PERFORMANCE

# Our Global Drive Brands in 2014

Our five Global Drive Brands (GDBs) had another successful year in 2014, growing volume and share in key markets.

## Share and volume

**2014 GDB overall market share growth**

+90bpts

bpts = basis points

**2014 GDB cigarette volume growth**

+5.8%

## Dunhill

| Volume | Market share |
|---|---|
| 55bn<br>+2.9%<br>2013: 54bn | +10bpts |

## Kent

| Volume | Market share |
|---|---|
| 64bn<br>-2.8%<br>2013: 65bn | Flat |

## Lucky Strike

| Volume | Market share |
|---|---|
| 31bn<br>+0.8%<br>2013: 31bn | +10bpts |

## Pall Mall

| Volume | Market share |
|---|---|
| 92bn<br>+5.6%<br>2013: 87bn | +30bpts |

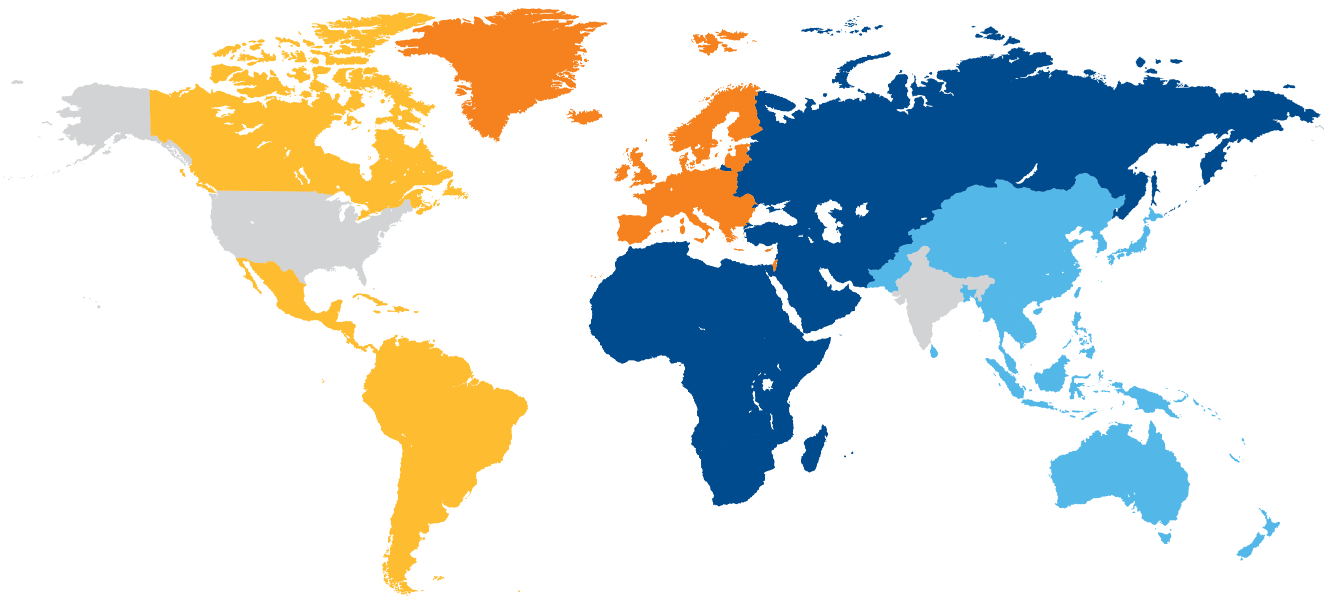
## Rothmans

| Volume | Market share |
|---|---|
| 36bn<br>+39.8%<br>2013: 26bn | +40bpts |

BUSINESS PERFORMANCE

# Our global performance

Adjusted profit from operations grew strongly at constant rates of exchange. As reported profit was adversely affected by exchange rate movements, the regional performance is presented at constant rates of exchange.



## Asia-Pacific

Share of Group revenue
27%

| Volume | Revenue At CC[2] |
|---|---|
| 197bn | £4,253m |
| +0.1% | +1.2% |
| 2013: 197bn | 2013: £4,203m |

| Profit[1] | Profit[1] At CC[2] |
|---|---|
| £1,548m | £1,713m |
| -8.6% | +1.2% |
| 2013: £1,693m | 2013: £1,693m |

## Americas

Share of Group revenue
22%

| Volume | Revenue At CC[2] |
|---|---|
| 131bn | £3,506m |
| -2.3% | +5.7% |
| 2013: 134bn | 2013: £3,317m |

| Profit[1] | Profit[1] At CC[2] |
|---|---|
| £1,286m | £1,475m |
| -5.7% | +8.1% |
| 2013: £1,364m | 2013: £1,364m |

## Western Europe

Share of Group revenue
23%

| Volume | Revenue At CC[2] |
|---|---|
| 112bn | £3,546m |
| -5.9% | -2.4% |
| 2013: 119bn | 2013: £3,635m |

| Profit[1] | Profit[1] At CC[2] |
|---|---|
| £1,189m | £1,262m |
| -6.6% | -0.9% |
| 2013: £1,273m | 2013: £1,273m |

## Eastern Europe, Middle East and Africa

Share of Group revenue
28%

| Volume | Revenue At CC[2] |
|---|---|
| 227bn | £4,377m |
| +0.3% | +6.6% |
| 2013: 226bn | 2013: £4,105m |

| Profit[1] | Profit[1] At CC[2] |
|---|---|
| £1,380m | £1,625m |
| -7.4% | +9.1% |
| 2013: £1,490m | 2013: £1,490m |

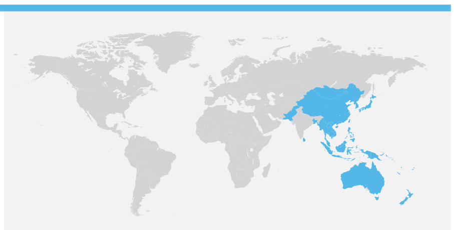
Notes:
1. Profit refers to adjusted profit from operations and is derived after excluding the adjusting items from the profit from operations. These items include restructuring and integration costs, amortisation and impairment of trademarks and similar intangibles, a gain on deemed partial disposal of a trademark and a payment and release of provision relating to non-tobacco litigation (see page 44).
2. Constant currency (CC) provides the information based on a re-translation, at prior year exchange rates, of the current year information.

BUSINESS PERFORMANCE

# Regional review

## Asia-Pacific

Jack Bowles
Director, Asia-Pacific



**Share of Group revenue**

27%

2013: 27%

**Adjusted profit from operations**
At CC

£1,713m

+1.2%
2013: £1,693m

Asia-Pacific performed well in 2014, with stable volume and higher market share. Profit grew, at constant rates of exchange, in a number of markets demonstrating the strength of our geographic diversity. GDBs performed well and I am delighted with the continued growth of Dunhill in Indonesia, while Kent delivered a strong performance in Japan.

Adjusted profit, at current rates of exchange, was down by £145 million at £1,548 million due to a combination of adverse foreign exchange rates and a challenging pricing environment in Australia, partly offset by strong profit performances in Bangladesh, Pakistan and South Korea. At constant rates of exchange, adjusted profit increased by £20 million or 1%. Volume was in line with 2013 at 197 billion, as increases in Bangladesh, Pakistan and Indonesia offset declines in Vietnam, Australia and South Korea.

### Australia
Volume was impacted by market contraction and higher illicit trade. A challenging pricing environment led to lower profit. Share was lower due to down-trading.

### Malaysia
Profit was higher, driven by strong pricing more than offsetting lower volume caused by industry contraction. Share was lower due to down-trading.

### Japan
Excellent growth in the Group's market share was driven by a strong performance by Kent, supported by innovations. Profit was down mainly due to negative mix.

### New Zealand
Volume and share fell due to pricing activity related to excise absorption, leading to lower profit.

### Bangladesh
Profit continued to increase strongly, driven by higher volume and significant share growth.

### Pakistan
Pall Mall grew volume and share, further strengthening the Group's leadership position. Total volume growth and pricing underpinned a strong profit performance.

### Vietnam
State Express 555 and Kent continued to grow share, but total share decreased due to share reductions in lower price segments. Profit declined reflecting lower volume, which was driven by significant growth in illicit trade and market contraction, caused by an excise-driven price increase and economic slowdown.

### South Korea
Although volume declined, Dunhill maintained its share of the market. Profit increased as cost savings more than offset the impact of lower volume.

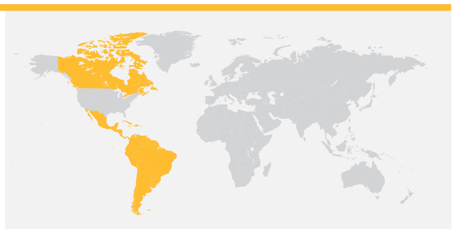
### Taiwan
Pall Mall and Lucky Strike drove share to record levels. Higher volume and pricing were offset by marketing investment leading to a decline in profit.

### Indonesia
Performance continued to reflect the focus on investment. Profitability improved driven by mix, as Dunhill volume increased significantly, more than offsetting declines in the Group's local brands.

### Philippines
Volume and market share were higher due to the launch of Pall Mall during the year, which further developed the portfolio following the Group's market entry in 2013.

## Americas

Ricardo Oberlander
Director, Americas



**Share of Group revenue**

22%

2013: 22%

**Adjusted profit from operations**
At CC

£1,475m

+8.1%
2013: £1,364m

We have delivered a strong performance despite industry contractions in a number of key markets. Our market share increased for the third year running, with significant growth in Mexico, Brazil and Colombia. The region delivered very robust profit growth at constant rates. Our GDBs also performed very well.

Adjusted profit, at current rates of exchange, declined by £78 million to £1,286 million, mainly due to exchange rate movements in Brazil, Canada and Venezuela. At constant rates, adjusted profit rose by £111 million or 8% driven by good performances from Brazil, Canada, Mexico, Venezuela and Chile. Volume was lower by 2.3% at 131 billion, mainly as a result of market contractions in Brazil, Canada, Chile and Argentina, partially offset by higher volume in Venezuela and Mexico.

### Brazil
Market share grew to a record high, with Dunhill performing particularly well in the premium sector. Total market contraction led to an overall volume decline. Good profit growth was driven by higher pricing and cost savings.

### Canada
Increases in federal and provincial excise led to lower volume. This was more than offset by higher pricing which led to increased profit.

### Chile
Profit was up strongly, driven by pricing partly offset by lower volume. While Pall Mall continued to perform well, Group volume was lower due to an overall market decline and an increase in illicit trade.

### Venezuela
Volume was higher, due to an excellent performance by Viceroy. Profit increased driven by volume and pricing, more than offsetting significant local inflation.

### Mexico
Share and volume increased, driven by the successful roll-out of Lucky Strike additive-free and the continued growth of Pall Mall capsules. Profit was significantly higher, driven by increased volume and pricing.

### Colombia
Good market share growth was driven by Kool, although industry decline led to lower volume. Profit declined due to increased marketing investment.

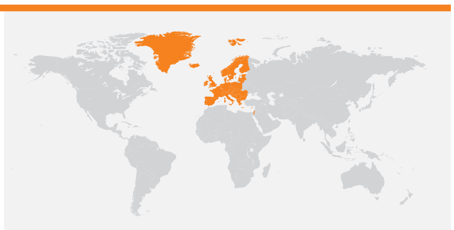
### Argentina
Pricing more than offset the impact of lower volume and led to an improvement in profitability. Lucky Strike continued to deliver good share growth in the premium segment.

BUSINESS PERFORMANCE

# Regional review continued

## Western Europe

Naresh Sethi
Director, Western Europe



**Share of Group revenue**

23%

2013: 24%

**Adjusted profit from operations**
At CC

£1,262m

-0.9%
2013: £1,273m

"The business performed well despite challenging trading conditions. I am most pleased with the continued growth of our GDB and Fine Cut volume, as well as our share gains in some key markets. These positive results reflect the improving strength of our portfolio."

Adjusted profit, at current rates of exchange, declined by £84 million to £1,189 million. At constant rates the decrease would have been £11 million or 1%, reflecting continued difficult trading conditions. Increased profit in Germany, Hungary and Belgium was offset by reductions in Denmark, Italy and France. Cigarette volume was 5.9% lower at 112 billion as lower volume in Denmark, Poland, Romania, Hungary and Germany was partly offset by growth in Spain and the UK. Fine Cut volume of 21 billion sticks equivalent was up 1.7% as a result of increases in Hungary, Belgium, Luxembourg and Germany.

### Germany
Higher pricing more than offset the impact of lower cigarette volume, resulting in an increase in profit for the year. Fine Cut volume continued to grow due to the performance of Pall Mall.

### Switzerland
Volume and profit were lower, driven by market contraction. However, Pall Mall's share of market increased.

### Italy
Although market share fell for the full year, share grew in the final quarter of the year as Rothmans continued to perform well. Volume was flat, but profit was lower following the industry absorption of a 2013 VAT increase.

### Romania
Market leadership was maintained although market contraction and down-trading led to a reduction in volume and lower profit.

### France
Total volume was down, driven by market contraction. Market share was higher as Lucky Strike showed good growth. Profit was lower as the industry absorbed an increase in excise.

### Denmark
Total volume was lower, due to trade de-stocking following a 2013 excise stock build. Market share was lower driven by competitive pricing activity at the low end of the market. These factors led to a significant reduction in profit.

### The Netherlands
Volume was higher as Lucky Strike and Pall Mall performed well. Profit was flat partly due to down-trading.

### Belgium
Profit was higher due to pricing and increased volume. Share was up driven by Lucky Strike. Fine Cut volume and share also increased.

### United Kingdom
Volume and share were higher due to the growth of Rothmans. Profit reduced as investment in the market increased.

### Spain
Volume was higher as Lucky Strike and Pall Mall continued to grow. Profit was stable as increased marketing investment offset the benefit of higher volume.

### Poland
The roll-out of a new distribution model drove higher share, especially in Pall Mall, and improved profitability. Total volume was down due to market contraction.

## Eastern Europe, Middle East and Africa (EEMEA)


**Share of Group revenue**

28%

2013: 27%

**Adjusted profit from operations**
At CC

£1,625m

+9.1%
2013: £1,490m

> We delivered a strong performance, with higher market share, increased volume and profit growth of 9% at constant rates of exchange. We achieved this success despite political and economic instability in a number of markets. GDBs have grown driven by Rothmans in Eastern Europe and Kent in Iran, offsetting the effect of market contraction, particularly in Russia.

Adjusted profit, at current rates of exchange, decreased by £110 million to £1,380 million. A strong performance in the Middle East and good pricing across the region were offset by competitive pricing activity in a number of markets, including South Africa, and significant adverse exchange rate movements, notably in Russia, South Africa, Nigeria and Ukraine. At constant rates of exchange, profit would have increased by £135 million or 9%. Volume (at 227 billion) was slightly ahead of 2013, with growth in Iran, Turkey and Ukraine more than offsetting the effect of industry volume contraction in Russia.

### Russia
Share continued to increase driven by the strong growth of Rothmans and Lucky Strike. Profit was higher driven by strong pricing and cost savings. This more than offset lower volume caused by market contraction.

### South Africa
Share fell in the second half of the year, driven by competitor pricing activity in the low price segment. Profit was lower as economic weakness and down-trading were not fully offset by pricing and significant cost reduction programmes.

### The GCC
Profit continued to increase as pricing, supported by strong growth in John Player Gold Leaf, more than offset lower Dunhill volume. Total market share declined.

### Nigeria
Profit was up driven by cost savings and higher Benson & Hedges volume, although total volume was lower.

### Iran
A very strong performance by Kent led to significantly higher volume and an increase in profit.

### Ukraine
Higher volume driven by Rothmans underpinned excellent growth in share. Profit was up driven by robust pricing and increased volume.

### Turkey
Volume growth and stable share were driven by excellent performances by Kent and Viceroy. Significant price competition in the market led to lower profit.

### Egypt
A good performance by Viceroy was more than offset by lower Rothmans volume, while excise changes led to down-trading, which adversely affected profit.

STRATEGIC MANAGEMENT

# Our vision and strategy

Our strategy enables our business to deliver growth today, while ensuring we generate the funds to invest in our future. Tobacco remains at the core of our business and will continue to provide us with opportunities for growth. We are also committed to developing and promoting a range of next-generation tobacco and nicotine products.

## Our vision

World's best at satisfying consumer moments in tobacco and beyond.

## Our mission

Delivering our commitments to society, while championing informed consumer choice.

## Strategic focus areas

The foundations upon which our strategy is built have been in place for many years, but we continue to refocus our activities in all four areas and constantly review our ways of working.

### Satisfying consumer moments

We believe that by being the world's best at satisfying consumer moments, we will become the leader in our industry. Consumers are at the core of everything we do and our success depends on addressing their evolving concerns, needs and behaviours.

### Tobacco and beyond

The second part of our vision – tobacco and beyond – recognises the strength of our traditional tobacco business and the opportunities we see in next-generation tobacco and nicotine products. There is a great potential business opportunity because consumers are looking for choices and product categories in which we are uniquely placed to succeed.

### Champion informed consumer choice

We need to continue to ensure that our adult consumers are fully aware of the choices they are making when they purchase our products. We recognise that we have a responsibility to offer a range of products across the risk continuum, but we will also defend people's right to make an informed choice.

### Deliver our commitments to society

As society changes and priorities and needs shift, we must be ready to meet new challenges and take advantage of new opportunities. We are a major international business and with this status comes responsibilities such as being open about the risks of our products, supporting rural communities worldwide and minimising our impact on the environment.

### Growth page 19

Developing brands, innovations and new products to meet consumers' evolving needs.

### Productivity page 22

Effectively deploying resources to increase profits and generate funds.

### Winning organisation page 24

Great people, great teams, great place to work.

### Sustainability page 26

Ensuring a sustainable business that meets stakeholders' expectations.

Read about our industry page 28

## Guiding Principles

Our Guiding Principles provide clarity about what we stand for.
They form the core of our culture and guide how we deliver our strategy.

### Enterprising Spirit

We value enterprise from all of our employees across the world, giving us a great breadth of ideas and viewpoints to enhance the way we do business. We have the confidence to passionately pursue growth and new opportunities while accepting the considered entrepreneurial risk that comes with it. We are bold and strive to overcome challenges. This is the cornerstone of our success.

### Open Minded

Our corporate culture is a great strength of the business and one of the reasons we have been and will continue to be successful. We are forward-looking and anticipate consumer needs, winning with innovative, high-quality products. We listen to and genuinely consider other perspectives and changing social expectations. We are open to new ways of doing things.

### Freedom Through Responsibility

We give our people the freedom to operate in their local environment, providing them with the benefits of our scale but the ability to succeed locally. We always strive to do the right thing, exercising our responsibility to society and other stakeholders. We use our freedom to take decisions and act in the best interest of consumers.

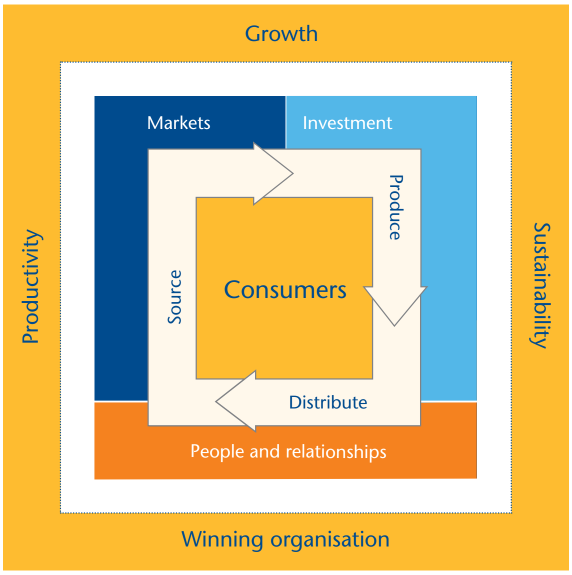
### Strength from Diversity

Our management population comprises people from approximately 140 nations, giving us unique insights into local markets and enhancing our ability to compete across the world. We respect and celebrate each other's differences and enjoy working together. We harness diversity – of our people, cultures, viewpoints, brands, markets and ideas – to strengthen our business. We value what makes each of us unique.

STRATEGIC MANAGEMENT

# Our business model

Our business model describes what we do and how we use our unique strengths and employ our resources and relationships to deliver sustainable value for our shareholders and stakeholders. It is built around meeting our consumers' evolving needs and is driven by our strategy (see pages 14 and 15) to ensure that we are delivering great results today and investing in our long-term future.




## What we do

We have been making and marketing cigarettes and other tobacco products for more than a century. More recently we have also started to develop and produce next-generation tobacco and nicotine products, such as e-cigarettes.

Our sustainable approach to sourcing, production and distribution helps us to create value for a wide group of stakeholders from crop to consumer. These include farmers and their communities, other suppliers, retail and wholesale trade partners, NGOs, governments and regulators.

## Source

We have a significant interest in tobacco growing and we have expert technicians out in the field who support over 100,000 directly contracted farmers. We manage our whole supply chain responsibly, including the sourcing of leaf and other materials, and work with suppliers to create a long-term shared understanding of our social, environmental and economic impacts.

**Working with farmers:** pages 22 and 26

Without tobacco leaf and other raw materials we would have no products. We aim to secure our long-term supply chain and bring real benefits to local communities, from promoting good agricultural practices to investing in community projects.

## Produce

Manufacturing tobacco products is a large-scale operation and we have state-of-the-art manufacturing facilities all over the world. We work to ensure that our costs are globally competitive and that we use our resources as effectively as possible. Our production facilities are designed to meet the needs of an agile and flexible supply chain – providing a world-class operational base that is fit for the future.

**Global scale:** page 22

Ensuring leaf and products are in the right place at the right time in our manufacturing process is a major logistical exercise. The nature of our business allows us to pool resources on a global scale and maximise efficiency.

## Distribute

Our well-developed distribution channels are critical enablers of our growth strategy, allowing us to roll out innovations on a global scale. We continuously review our route to market, including our relationships with wholesalers, distributors and logistics providers. Around half of our global volume is sold by retailers supplied through our direct distribution capability or exclusive distributors.

**Raising standards:** page 26

We are helping to raise standards by supporting effective and reasonable regulation of regular cigarettes and next-generation tobacco and nicotine products. It also means fighting the illegal tobacco market and supporting legitimate retailers and wholesalers.

## Consumers

We place consumers at the heart of our business. We invest in world-class research to understand changing consumer needs and buying behaviour. This drives our supply chain, product development, innovations, brands and trade activities. We aim to satisfy consumers while addressing expectations about how we should market our products.

**Developing solutions:** pages 19 and 20

We are developing innovative solutions to evolve our portfolio with more differentiated tobacco products as well as next-generation nicotine products. This supports our aim to champion consumer choice by providing a range of products across the risk continuum.

## What makes us different

Our business operates on a set of core strengths and qualities that makes us unique and ensures we can generate value over the long term. The quality of our people is a crucial factor in delivering this and our global presence enables us to leverage the value they create on a worldwide scale.

## Markets

### Brands

We have a successful brand marketing strategy based on sound consumer insights. It is driven by our Global Drive Brands – Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans – which account for over 40% of the cigarettes we sell. Our portfolio of more than 200 international, regional and local brands meets a broad array of consumer preferences around the world. We have continually improved and developed Vype, our first e-cigarette brand, since launching it in 2013.

### Products

We offer adult consumers a range of products to choose from, including: cigarettes and cigars; Fine Cut tobacco, as used in roll-your-own and make-your-own cigarettes; Swedish-style snus; and e-cigarettes. Our range of high-quality products covers all segments, from value-for-money to premium. We are also developing other next-generation tobacco and nicotine products, a significant new growth opportunity.

### Global presence

With over 110 years of operating, today we are one of the world's leading tobacco groups. Our brands are sold in more than 200 markets and our geographic diversity and strong positions in emerging markets are key strengths and continue to provide opportunities for growth. We are market leaders in more than 60 countries.

## Investment

### Innovation

We make significant investment in research and development to deliver innovations that satisfy or anticipate consumer needs and generate growth for the business. This involves cigarette innovations such as capsule products, additive-free products, tube filters and Reloc, our resealable pack technology. We also look outside the traditional cigarette market and research, develop and test innovative products such as e-cigarettes and tobacco heating products.

### Selected investments

Strategically and financially attractive acquisitions and specific targeted investments in new ventures, research and development, projects, equipment and services all play a role in our short-term success and in the long-term development of our organisation. They support our strategic ambitions of achieving sustainable growth and working more productively by opening up new ways of working, helping to define new product areas and providing new opportunities for our people.

### World-class science

We have an extensive scientific research programme. We have spent more than £480 million on research and development over the past three years. We are transparent about our science and publish details of our research programmes on our dedicated website, www.bat-science.com, and the results of our studies in peer-reviewed journals.

## People and relationships

### Our people

We employ more than 57,000 people worldwide – from securing our leaf supply through production and distribution, to our efforts to develop new products. Our workforce is strongly multicultural and we have a devolved structure, with each local company having responsibility for its operations. We encourage a culture of personal ownership and value our employees' talents. Their diverse perspectives help us to succeed.

### Our suppliers

We provide on-the-ground support and advice to more than 100,000 tobacco farmers worldwide. We work to enable prosperous livelihoods for all farmers who supply our tobacco leaf, benefiting rural communities and the environment. Our Social Responsibility in Tobacco Production programme encourages continual improvement of the social and environmental performance of the suppliers we buy tobacco leaf from.

### Our wholesalers, distributors and retailers

Trade marketing is a large part of our activity and involves managing business-to-business relationships with the retailers our consumers buy from. We place a strong emphasis on being a high-quality supplier to the trade. We work to operate in the most efficient and effective ways so that retailers worldwide can offer the products our adult consumers wish to buy, where and when they want them.

STRATEGIC MANAGEMENT

# Our KPIs and business measures

A summary of our KPIs (key performance indicators) and business measures and how we performed against them in 2014.

We use these measures and indicators to assess our performance. To ensure management's focus is aligned with the interests of our shareholders, our KPIs are reflected in our management incentive schemes. Although our business measures are not directly included in these incentives, they reflect our performance, improve the quality of our business and contribute to shareholder value.

## Key performance indicators

### Group share of key subsidiary markets

+10bpts

**Target:** To continue to grow market share (bpts = basis points).

Growth page 21

### Global Drive Brands' (GDBs) cigarette volume

278bn

+5.8%

**Target:** To increase our GDBs' share faster than the rest of our portfolio.

Growth page 21

### Net turnover at constant rates of exchange

£15,682m

+2.8%

**Target:** To grow net turnover by 2–5% per year.

Growth page 21

### Adjusted diluted earnings per share at current rates

-3.9%

**Target:** To grow at the rate of high single figures per annum, on average, over the medium to long term.

Growth page 21

### Total shareholder return (TSR) (compound annual growth rate)

11.4%

**Objective:** Increase shareholder value, which we measure by comparing our TSR to a FMCG peer group.

Growth page 21

### Adjusted profit from operations at constant rates

£6,075m

+4.4%

**Target:** The Group's medium- to long-term target is to grow adjusted profit from operations on average by 5–7% per year.

Productivity page 23

### Cash generated from operations at current rates

£2,660m

**Target:** A specific target is set each year for the cash flow from operations.

Productivity page 23

## Business measures

### Operating margin

38.7%

+54bpts

**Objective:** To increase operating margin by 50–100 basis points per annum.

Productivity page 23

### Free cash flow as a percentage of adjusted earnings (excl. non-tobacco litigation)

76%

**Target:** To convert around 80% of our adjusted earnings per share to free cash flow.

Productivity page 23

### Free cash flow as a percentage of adjusted earnings

64%

**Objective:** To convert around 80% of our adjusted earnings per share to free cash flow.

Productivity

### Employee engagement index

72%

**Objective:** To achieve a more positive score than the norm for FMCG companies in our benchmark group.

Winning organisation page 25

### Carbon dioxide equivalent ($CO_2e$) (tonnes $CO_2e$ per million cigarettes equivalent produced)

0.83

45% lower than 2000 baseline

**Target:** To reduce Group $CO_2e$ by 50% by 2030 from our 2000 baseline of 1.52 and by 80% by 2050.

Sustainability page 27

### Group energy use (gigajoules per million cigarettes equivalent produced)

10.26

13% lower than 2007 baseline

**Target:** To reduce energy use to 9.82 by 2017, 17% lower than our 2007 baseline.

Sustainability page 27

### Water use (cubic metres per million cigarettes equivalent produced)

3.69

24% lower than 2007 baseline

**Objective:** To reduce water use to 3.6 by 2017, 26% lower than our 2007 baseline.

Sustainability page 27

### Recycling (percentage of waste recycled)

92.6%

**Objective:** To recycle more than 85% of waste generated in each year.

Sustainability page 27

STRATEGIC MANAGEMENT

# Delivering our strategy

## Growth

### Our brands delivered further growth in 2014 as we continued to invest in opportunities in key markets and next-generation tobacco and nicotine products.

The Group grew revenue by 2.8% at constant rates of exchange, driven by a price mix of 4.2%. Strong pricing in a number of key markets was partly offset by increased competitive pricing activity and the growth of lower-priced segments in certain markets. At current rates of exchange, revenue decreased by 8.4%, reflecting the adverse impact of exchange rate movements.

We grew volume in a number of markets, including Bangladesh, Venezuela, China, Turkey, Ukraine, Pakistan and Iran.

However, volume was lower in Russia, Vietnam, Brazil and across Western Europe. Overall cigarette volume from subsidiaries was 667 billion, down by 1.4%, largely as a result of industry volume decline.

Total tobacco volume (including cigarettes and other tobacco products) was 1.3% lower than last year. Our Fine Cut tobacco business grew by 1.0%, driven by a good performance in Western Europe, where Fine Cut volume increased by 1.7%.

Our brands continued to perform well in 2014, with another strong contribution from our Global Drive Brands (GDBs) – Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans. They drove our share growth of 10 basis points in key markets.

### Another good year for our GDBs

Our continuing investment in our GDBs has seen their share of our global volume double to 42% since 2003.

GDB volume growth of 5.8% in 2014 was driven by Rothmans as well as the continued strong performance of our other GDBs. Our GDB market share grew by 90 basis points, with Rothmans and Pall Mall making particularly strong gains. GDB Fine Cut products performed well too, with volume increasing by 6.6% in 2014.

Innovations, such as capsules, re-sealable packaging, additive-free blends, new filter technologies and our more recent launch of tube filters, accounted for nearly one-quarter of our total cigarette volume in 2014.

Cigarettes with tube filters have been rolled out to 24 markets and have also established a presence in Global Travel Retail outlets.

We continue to be the market leader for capsule products, with a segment share of more than 40% in our key markets.

#### Dunhill

Dunhill delivered volume growth of 2.9% to 55 billion cigarettes in 2014. This result was driven by a very strong performance in Indonesia and growth in Brazil, partially offset by declines in Malaysia, South Korea and the Gulf Co-operation Council (GCC) countries.

Innovations accounted for 81% of Dunhill's 2014 volume, with 75% of all Dunhill cigarettes now sold in re-sealable packaging.

#### Kent

Kent volume in 2014 was 64 billion, down by 2.8% due to industry decline in Russia, Romania and Ukraine, partially offset by growth in Iran, Uzbekistan, Japan and Turkey. Innovations now account for 83% of the brand's global volume.

We continue to expand our offerings in the Kent HD range, featuring new tube technology which further enhances the brand and made up 36% of Kent volume in 2014.

#### Lucky Strike

Lucky Strike, our original American brand, saw volume growth of 0.8% to 31 billion cigarettes. The growth was driven by Mexico and an improved performance in Western European markets such as Spain, Belgium and France.

This was partially offset by volume decline in Chile, Poland and the Philippines. Innovations now account for 33% of Lucky Strike volume, including our additive-free offer which continues to grow strongly. Lucky Strike Fine Cut also had a successful year, with volume up by 12.7%, driven by gains in Luxembourg, Germany, France, Spain and Belgium.

#### Pall Mall

Pall Mall, our leading brand in terms of volume, grew by 5.6% in 2014, delivering a record volume of 92 billion cigarettes, as a result of increases in Pakistan, South Africa, Mexico and Chile. This was partially offset by lower volume in Italy, Russia, the UK and Belarus.

Innovations accounted for 20% of Pall Mall's cigarette volume, while Pall Mall Fine Cut volume was up by 5.4% in Western Europe, mainly driven by growth in Germany, Hungary, Belgium, the Netherlands and Luxembourg. Pall Mall remains the biggest Fine Cut brand in Western Europe.

#### Rothmans

Rothmans became part of our portfolio of GDBs at the start of 2014 recognising the brand's strategic value to the Group. The brand's volume was up by 39.8% in 2014 reaching a total of 36 billion cigarettes – adding 5.5 billion cigarettes in Russia alone, building on the brand's very successful launch there in 2012. Rothmans also achieved volume growth in Italy, Ukraine and the UK. Innovations accounted for 31% of Rothmans' cigarette volume, more than four times greater than in 2013, driven by successful launches in Eastern Europe.

### Premium growth

The Group delivered a strong performance in the premium segment in 2014. Our share of this segment grew by 30 basis points, mainly driven by Dunhill in Indonesia, Romania and Brazil, State Express 555 and Kent in Vietnam, John Player Gold Leaf in Pakistan and Lucky Strike in Argentina. This more than offset the impact of declines elsewhere – Kent in Russia, Lucky Strike, Kent and Dunhill in Chile and Dunhill in the GCC.

STRATEGIC MANAGEMENT

# Delivering our strategy continued

## Growth continued

### International brands

In addition to our GDBs, we continue to invest in a strong range of international brands that play an important role in many markets' portfolios.

Viceroy is the largest in volume terms. It experienced volume decline of 2.6% in 2014, due to market declines in Poland and Russia, partially offset by increases in Azerbaijan, Egypt and Turkey.

John Player Gold Leaf is a very important regional brand in Asia-Pacific and the Middle East. Its volume declined by 2.1% in 2014, due to decreases in Pakistan, Bangladesh and Sri Lanka partially offset by strong volume growth in the GCC.

Benson & Hedges grew in several markets, although overall volume fell slightly due to market declines in Bangladesh and Australia. Craven A was heavily impacted by market decline in Vietnam and in other markets in Asia-Pacific and EEMEA.

CTBAT International Ltd, our joint venture with subsidiaries of China National Tobacco Corporation, commenced operations in 2013. It owns and manages the worldwide international rights to State Express 555 as well as the rights outside China to the leading Chinese brand, Shuang Xi.

State Express 555 volume was up by 24.7% in 2014, driven by increases in China, Cambodia and Global Travel Retail, partially offset by decline in Vietnam. Shuang Xi has been successfully launched in Pakistan, Russia, Poland, Hong Kong and Macau.


### We are committed to leading in next-generation products

The Group is committed to leading the market in next-generation tobacco and nicotine products.

We will complement our core tobacco business by offering adult consumers a wide choice of alternative products, including e-cigarettes, medicinal nicotine products and tobacco heating products.

The Group is investing significantly in this category because it will create long-term growth opportunities for the Group while meeting consumer demand for less risky alternatives to smoking.

We are well placed to deliver these new products. We understand the needs of smokers and we are investing substantially in the research, development and commercialisation of a pipeline of products.

#### Vype

In 2013, we were the first international tobacco company to launch an e-cigarette in the UK. Since then, we have further increased our understanding of the needs of consumers in this sector.

In 2014, we used these insights to develop the range. We launched two new innovative products to better meet consumer expectations – Vype eStick and Vype ePen.

We have also increased retail distribution and supported the brand with investment in responsible TV and cinema advertising aimed solely at adult smokers and users of other nicotine products.

We will use what we have learned in the UK market to support the launch of Vype in further markets.

#### Voke

We are also looking at nicotine products that are regulated as medicines, including a new nicotine inhalation product called Voke. This innovative product does not require batteries or any other energy source and is activated simply by inhaling. Following receipt of the relevant licences from the UK medicines regulator, we are the first tobacco company to have a nicotine product licensed as a medicine. We plan to commercialise and launch Voke in the UK by the end of 2015.

#### Tobacco heating products

Tobacco heating products heat tobacco rather than burning it, making them a potentially less risky option. We plan to begin consumer trials of a tobacco heating product by the end of 2015 and have our first product in a test market in 2016.

#### Regulation

We think overly restrictive regulation that treats products like e-cigarettes in the same way as traditional tobacco could be counterproductive. It could stifle innovation and the growth of the category and prevent smokers becoming aware of and accessing these new products. We support regulation that has high consumer safety and product quality standards and restricts sales to over 18s, while enabling companies to freely innovate and to distribute and market their products responsibly.

#### Standards

We uphold high standards for our products. We have a robust approach to quality and product testing for e-cigarettes. We voluntarily use appropriate warnings on packs and our marketing is directed at existing adult smokers or consumers of other nicotine products only.

## Key performance indicators (KPIs)

### Total shareholder return – annual %
(compound annual growth rate – CAGR)

# 11.4%

**Definition:** Total shareholder return (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.

**Objective:** The Group is focused on increasing shareholder value, which is measured using TSR compared to a fast-moving consumer goods (FMCG) peer group. The FMCG comparator group is reviewed annually to ensure it remains both relevant and representative.

### Group share of key subsidiary markets*
(Increase in % share)

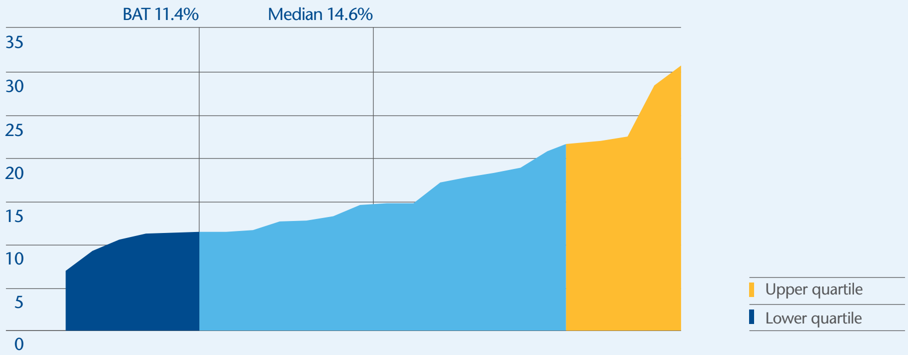
# +10bpts

**Definition:** This is our retail market share in the Group's key markets, which cover around 80% of the volumes of subsidiaries.

**Target:** To continue to grow market share.

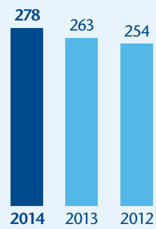
**Note:** *Share figures are rebased annually to reflect market and segment changes.

### FMCG Group – 1 January 2012 to 31 December 2014
The FMCG Group comparison is based on three months' average values




### Global Drive Brands' (GDBs) cigarette volume
(bn)

# 278bn
+5.8%

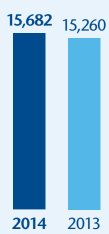



**Definition:** GDB volume is calculated as the total volumes of the five GDBs sold by our subsidiaries.

**Target:** To increase our GDBs' share faster than the rest of our portfolio. 2012 and 2013 figures have been re-stated to include Rothmans' volume.

### Net turnover (NTO) at constant exchange rates

# £15,682m
+2.8%




**Definition:** Gross turnover net of duty, excise and other taxes.

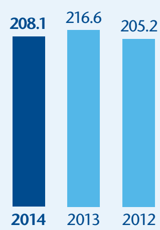
**Target:** To grow NTO by 2–5% per year.

### New KPI introduced

In 2014, we reviewed our KPIs and how they support our strategic objectives. The TSR indicator was reduced by discontinuing a FTSE 100 Index comparator and focusing solely on a FMCG comparator group. We have introduced net turnover as an indicator of organic growth.

### Adjusted diluted earnings per share at current rates
(pence)

# -3.9%




**Definition:** This is our adjusted diluted earnings per share (EPS) – the detail of the calculation and adjustments are explained in Note 7 in the Financial Statements.

**Target:** To grow adjusted diluted EPS at the rate of high single figures per annum, on average, over the medium to long term.

STRATEGIC MANAGEMENT

# Delivering our strategy continued

## Productivity

### We are becoming a more efficient and effective business, with global systems and ways of working, a responsive supply chain and a long-established approach to securing the highest quality leaf for our products.

By continually improving our productivity today, we are able to generate funds to invest in the growth of our business in the future.

In 2014, we continued to improve the Group's operating margin, with a 54 basis points increase to 38.7%. This is a good performance given that we absorbed significant increases in transactional costs caused by exchange rate movements.

It also demonstrates that we are becoming a more efficient, effective and globally aligned business, focused on reducing costs and complexity while making the best possible use of all of our resources.

### We're becoming a faster and more effective business

In 2012 the Group began a programme to implement a new operating model, which includes standardised systems, data, structures and ways of working, underpinned by a global SAP system. These are being implemented in phases throughout the global organisation and were ongoing throughout 2014.

With consistent ways of working, better information and higher levels of automation, we expect that our markets will be able to operate faster and more effectively and move more services above market.

By January 2015, Asia-Pacific and Western Europe regions and a significant proportion of EEMEA region were using the new global SAP system – a total of 85 markets and Group entities, such as above-market shared services. The system is now supporting around 60% of both the Group's profit and volume.

Our new global operating model has been introduced in over half of the Group and six of our 10 most important markets. Twenty-five factories and around 15,000 of our employees are now working with the common systems and processes.

The programme – the Group's largest ever business transformation programme – will take a further two years to fully roll out worldwide. In 2015 the focus will be on Africa, the Middle East and the Americas.

As the roll-out progresses, we expect to see further improvements in the way our people and business units work as they become even more integrated.

### We operate a globally integrated supply chain

The Group operates an integrated global supply chain focused on the effective and efficient delivery of market-leading products and innovations to our markets to satisfy consumers, drive share growth and create value for our business partners.

In 2014 this has seen the continued roll-out of capsules and an increased focus on introducing new cigarette tube filter innovations, which will continue in 2015.

The Group has continued to invest in new machinery and equipment in 2014 to support future growth, for example, by ensuring we can meet growing demand for cigarettes with tube filters and to support key markets such as Indonesia.

Our investment in global planning systems and processes supports our strategic focus on delivering products 'on time and in full' to ensure we can capitalise on growth opportunities in our diverse markets.

Having a clear global view of our plans means we can allocate resources in the right areas. It also improves our ability to react quickly in situations when speed to market will give us a competitive advantage.

Our leading factories supply multiple markets and produce a wide range of products across our brand portfolio. In recent years, we have reduced our manufacturing footprint by closing some factories and restructuring others.

We continued to optimise our manufacturing operations in 2014 and at the end of the year had 44 factories in 41 countries producing cigarettes and Other Tobacco Products. We recognise the impacts of these decisions on employees and work hard to mitigate the outcomes for them and the wider community.

We are continually looking to improve the efficiency of our supply chain. Last year we launched Integrated Work Systems, a new programme designed to maximise productivity in our factories while also ensuring we maintain high standards of product quality.

In 2014 we continued to drive cost savings in our supply chain in areas such as leaf and blends, wrapping materials, logistics, manufacturing and indirect procurement.

Savings such as these not only enhance our profitability, but also release funds that we can invest in activities that will deliver sustainable growth.

### We work with farmers to secure access to high-quality leaf

Tobacco leaf is the most essential part of our products. It's crucial to our business to ensure we have secure and sustainable sources of high-quality leaf that supports the Group's strategic focus on delivering superior products to our consumers.

The Group doesn't own tobacco farms or directly employ farmers. Instead, we buy more than 400,000 tonnes of tobacco from over 100,000 contracted farmers and third-party suppliers, mainly in developing countries and emerging economies in Africa, Asia and Latin America.

Our Global Leaf Pool, which is responsible for buying and supplying all tobacco leaf to the Group, provides economies of scale across the leaf supply chain.

We invest more than £65 million each year to support farmers. We have more than 1,000 leaf technicians worldwide who provide on-the-ground advice and training for farmers, helping them run successful, profitable and high-yielding farms.

Our cutting-edge research into tobacco plants and in advancing agricultural practices is reflected annually in the higher quality of the tobacco used in our products and increased productivity levels on farms.

We also guarantee to buy a certain amount of tobacco from our farmers each year – this gives them a regular income which they can invest in their farms to build successful businesses.

This approach benefits farmers by helping them to have prosperous livelihoods and encourages future generations to continue to farm and support their local communities and the environment. It helps our leaf operations to remain efficient and secures our supply chain for the future, while also ensuring the integrity and quality of our products to satisfy our consumers.

We review all our leaf suppliers through our Social Responsibility in Tobacco Production (SRTP) programme and publish their scores on our website (www.bat.com/SRTPdata).

SRTP sets out the minimum requirements we expect of our leaf suppliers and covers good agricultural practices and environmental management, such as soil and water conservation, sustainable wood sourcing and protecting biodiversity.

## We'll continue to focus on improving our productivity

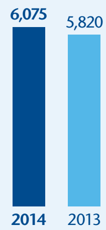
By continuing to improve our productivity in all areas of our supply chain, we can increase our profitability and continue to deliver returns to our shareholders.

But it's not just about today; it also underpins our future. The more efficient and effective we become, the more we are able to generate funds to invest in the things that will fuel future growth: our products, our innovations, our people, our markets and our next-generation products.

## Key performance indicators (KPIs)

### Adjusted profit from operations at constant exchange rates

£6,075m
+4.4%

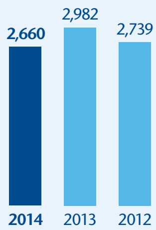



**Definition:** This is the adjusted profit from operations of the Group's subsidiaries – profit from operations at constant rates adjusted for the items shown as memorandum information on the Group Income Statement.

**Target:** The Group's medium- to long-term target is to grow adjusted profit from operations on average by 5–7% per year.

### Cash generated from operations at current rates

£2,660m



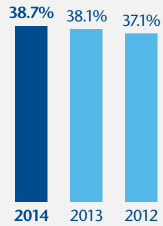

**Definition:** Cash generated from operations is defined as the free cash flow excluding restructuring costs and dividends and other appropriations from associates, per the alternative cash flow on page 42.

**Target:** A specific target is set each year for the cash flow from operations.

## Business measures

### Operating margin

38.7%
+54bpts

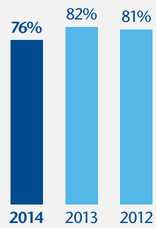



**Definition:** This is the percentage of adjusted profit from operations divided by revenue.

**Objective:** To increase operating margin by 50–100 basis points per annum.

### Free cash flow as a percentage of adjusted earnings (excl. non-tobacco litigation)

76%




**Definition:** This measures our free cash flow per share as a ratio of the adjusted diluted earnings per share.

**Target:** To convert around 80% of our adjusted earnings per share to free cash flow.

STRATEGIC MANAGEMENT

# Delivering our strategy continued

## Winning organisation

### A winning organisation is one with high-performing leaders inspiring diverse teams of committed and engaged people in a fulfilling, rewarding and responsible work environment.

The quality of our people is a major reason why the Group continues to perform well. They make us a winning organisation by using their expertise, experience and enterprise to respond to the challenges of the marketplace to deliver strong business results.

The way our people operate is embodied in our four Guiding Principles: Enterprising Spirit, Freedom Through Responsibility, Open Minded and Strength from Diversity. They underpin our culture and guide how we deliver our strategy (see page 15).

Our aim is to maintain a high-performing organisation that attracts, develops and retains talented people. We continue to invest in providing our people with a great place to work. So we are proud that in 2014 we were once again ranked as a top employer in many markets around the world, including Germany, Brazil and Southern Africa.

## Leadership capabilities

We are committed to ensuring the Group continues to develop high-performing managers who will lead the delivery of our strategy both now and in the future.

In 2014 we launched new leadership capabilities that provide our people with clarity on what we believe defines good business and people management at British American Tobacco. The capabilities centre around the expectation that our leaders are 'passionate owners, inspiring people to deliver outstanding results'.

They are designed to guide all aspects of our talent development lifecycle, including the qualities we look for in people when we recruit, plus how we develop leaders' skills, assess their performance and manage succession planning.

To help our people embrace this approach, we have launched an online global talent resource, refreshed our leadership training and established partnerships with leading business schools.

We are keen to develop our leaders from within our business. We want to provide talented people with rewarding career progression and, in doing so, retain valuable expertise and knowledge.

This commitment was demonstrated in 2014 when more than 80% of our senior appointments were people from within our business.

We also continued to improve our retention of high-performing leaders and to focus on succession plans for our critical leadership roles.

## Bring your Difference

When we do look to recruit, we seek to bring in people who will provide additional knowledge and skills that will strengthen our teams and ultimately make us a stronger business.

To do so, it is important that our Group stands out as an attractive employer in a highly competitive global recruitment market. So in 2014 we refreshed our employer brand, Bring your Difference.

We also launched a new-look global careers website (www.bat-careers.com) and established a stronger presence on social media, including LinkedIn, Facebook and Twitter.

## A share in our success

We offer our UK employees the chance to share in our success via our Sharesave Scheme, Partnership Share Scheme and Share Reward Scheme.

We also operate several similar schemes for senior management in our Group companies.

## We value diversity

Diversity matters to the Group because it makes good commercial sense – having a diverse workforce means we are better able to understand and meet the needs of consumers in more than 200 markets. It is also important to our reputation because of societal expectations around diversity.

Our specific diversity ambition is to achieve by 2020 a sustainable improvement in senior representation of women and nationalities that are key to our success.

The Group's broad geographic presence means we are well placed to attract talented people from many different countries and diverse nationalities are widely represented across the business, including at Board level.

### Nationalities represented

| | Total |
|---|---|
| Board level | **7** |
| Global headquarters | **71** |
| Management level globally | **137** |

One of the ways that we are supporting women's progression into senior roles is through a programme called Women in Leadership, which provides training, mentoring and other types of career support for high potential female employees. We continue to establish women's networks in markets, including South Korea and Australia.

In 2014, the proportion of women in all management roles across the organisation was 32%.

The table below sets out the gender breakdown within the Group as at 31 December 2014, comparing numbers for all employees, our most senior managers and the Main Board. With 30% female representation on our Main Board, we exceeded a target recommended by the UK Government.

| | Total | Male | Female | % Male | % Female |
|---|---|---|---|---|---|
| Main Board | **10** | 7 | 3 | 70 | 30 |
| Senior managers* | **212** | 183 | 29 | 86 | 14 |
| Total Group employees | **57,478** | 43,577 | 13,901 | 76 | 24 |

* 'Senior managers' are defined here as the members of the Management Board (excluding the Executive Directors) and the Directors of the Group's principal subsidiary undertakings. The principal subsidiary undertakings, as set out in the financial statements, represented approximately 83% of the Group's employees and contributed around 80% of Group revenue and profit from operations in 2014.

In February 2015 three new Non-Executive Directors joined our Main Board, which now comprises four women and nine men.

We aim to provide equal opportunities to all employees. We do not discriminate when making decisions on hiring, promotion or retirement on the grounds of race, colour, gender, age, social class, religion, smoking habits, sexual orientation, politics or disability, subject to the inherent requirements of the role to be performed. We are committed to providing training and development for employees with disabilities.

## Safe place to work

The Group's goal of zero accidents reflects our commitment to keeping our people as safe as possible at work. In 2014, accidents across the Group decreased by 19%, with 72% of our sites achieving zero accidents.

Sadly, the number of people who died increased from six in 2013, to eight in 2014 (includes employees and contractors). We deeply regret this loss of life and the suffering caused.

The fatalities occurred as a result of road traffic accidents and armed attacks on trade and distribution personnel in some challenging environments where there are security risks or poor transport infrastructure.

We review all accidents to identify actions to reduce the chances of similar events happening. We have launched a programme for our trade and distribution teams that provides tools, guidance and procedures for security and driver safety.

We also operate programmes to protect and promote the health and well being of employees and their families. These include medical services, healthy lifestyle and family-friendly initiatives, such as flexible working.

## We set high standards

The Group has clear policies and standards covering everything from health and safety to anti-bribery measures. Our Standards of Business Conduct set out our commitment to good corporate behaviour for our employees.

In 2014 we updated them to reflect new policies: 'Respect in the workplace' reinforces our commitment to treat each other with respect and as equals, including promoting diversity, while 'Human rights and our operations' defines our role as a good corporate citizen, setting out, for example, our commitments to no child labour.

## Employee engagement

We are committed to ensuring that our people are engaged with our business. We keep them informed about our strategy, performance and other developments via global communications cascades, face-to-face dialogue, presentations and our intranet.

Every two years we conduct a survey to measure employee engagement. Our most recent survey in 2014 had a response rate of 93% – 1 percentage point up on our last survey in 2012 and 11 percentage points higher than the average response rate for this type of survey.

We achieved an Employee Engagement Index score of 72% in the survey, ahead of a FMCG comparator norm of 69%. Broadly, this score combines employee satisfaction with their attitudes towards recommending us as a place to work, their desire to stay and their pride in working for us.

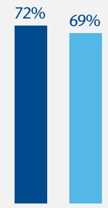
Our High Performance Index score rose three percentage points to 72%, indicating our continued focus on leadership and talent development is supporting our high-performance culture.

We will use feedback from the survey to address any areas of improvement in 2015, alongside our other initiatives to provide a workplace that will enable people to develop and contribute to the Group's success in the years ahead.

## Business measure

### Employee engagement index

72%




| | |
|---|---|
| BAT | 72% |
| FMCG Comparator Group | 69% |

**Definition:** Results from our biennial 'Your Voice' employee opinion survey, last carried out in 2014, enable us to calculate our employee engagement index – a measure that reflects employee satisfaction, advocacy and pride in the organisation.

**Objective:** To achieve a more positive score than the norm for 30-plus FMCG companies in our comparator benchmark group.

> The 'Your Voice' survey response rate was excellent. Clearly employees feel that the Group takes engagement very seriously as such a high participation level would not be possible without them seeing a real commitment from leadership to use the feedback.

**IBM, the 'Your Voice' survey provider**

STRATEGIC MANAGEMENT

# Delivering our strategy continued

## Sustainability

Sustainability has always been crucial to our business, but last year we sharpened our approach further to ensure we continue to generate long-term shared value for our consumers, our shareholders and our stakeholders.

In 2014, the Group developed a new sustainability agenda through a detailed materiality process. We identified three key areas of sustainability that are most significant to our business and stakeholders: harm reduction; sustainable agriculture and farmer livelihoods; and corporate behaviour.

### Harm reduction

At the heart of our strategy is our vision to satisfy consumers in tobacco and beyond. We are demonstrating this in our commitment to researching, developing and promoting a range of innovative tobacco and nicotine products to offer adult consumers a choice of less risky alternatives to regular cigarettes. This can ultimately benefit public health, while also supporting the future growth for our business.

We think we are best placed to deliver these alternative products. We understand what consumers want and we have world-class research and development capabilities, robust quality standards and global reach.

The Group is making significant progress in the development of e-cigarettes, medicinal nicotine products and tobacco heating products. You can read more about these in the Growth section of this Strategic Report (page 20).

### Sustainable agriculture

The farmers we work with are valued business partners and crucial to the success of our business – if they do well, we do well. We work to enable prosperous livelihoods for all farmers who supply our tobacco leaf, benefiting rural communities and the environment. Our approach to supporting farmers' livelihoods focuses on five key areas:

**Farm income** – helping our farmers to have profitable businesses, with tobacco grown alongside a diverse range of other crops.

**Natural resources** – preserving forests, water, soil health and biodiversity, all of which are essential for long-term agricultural productivity.

**Infrastructure and resources** – helping ensure tobacco-growing areas are viable places to live and work, by providing farmers with access to technology and investing in community projects.

**Skills, knowledge and labour** – promoting human rights, tackling child labour, protecting the health of farm workers and providing advice and training for running successful businesses.

**Community networks** – helping to build and strengthen farmer networks, by providing the support and opportunities farmers need to be able to share best practice and become more self-sufficient and resilient.

Like all crops, tobacco does have its impacts, but we work with farmers to mitigate them. For example, wood is often used as a fuel in tobacco-curing processes. So we're helping farmers to preserve natural forests through afforestation programmes, which provide a sustainable source of wood. As a result, 94.8% of the wood our farmers use for curing does not come from natural forest.

Exploitative child labour is a particularly important issue for any industry with an agricultural supply chain. Our Social Responsibility in Tobacco Production (SRTP) programme, against which all our leaf suppliers are reviewed, has a specific focus on child labour. We also co-founded the Eliminating Child Labour in Tobacco Growing (ECLT) Foundation and remain active members. The ECLT's activities include working with governments to improve access to education and social services for children.

### Corporate behaviour

We are committed to operating to the highest standards of corporate conduct and transparency across our business, benefiting governments, consumers, the environment and our people. All our tobacco marketing is governed by legal requirements in markets and our **International Marketing Principles (IMP)**, which in many cases go far beyond local laws. We're committed to 100% IMP compliance and put immediate actions in place if any incidents of non-adherence are identified.

Our **youth smoking prevention** (YSP) activities around the world include lobbying for minimum age laws of 18 where none exist and working closely with retailers. In 2014, YSP activities took place in 99% of markets where these are feasible and allowed.

With our experience and expertise we have much to offer governments and regulators when it comes to developing policies around tobacco. We've long supported the Organisation for Economic Co-operation and Development's Principles for Transparency and Integrity in Lobbying. In 2014, we published our **Principles for Engagement,** which provide even clearer guidance for our external engagement.

**Good environmental management** is vital to ensuring our business and local communities maintain access to natural resources. Using a mixture of performance management and risk assessments, we constantly monitor and reduce our direct environmental impacts and develop new ways of making our operations more efficient. We are especially focused on minimising our energy consumption and carbon emissions.

We continue to make good progress towards our long-term target to cut carbon dioxide equivalent ($CO_2e$) emissions by 50% by 2030 and by 80% by 2050 from our year 2000 baseline.

We use the Greenhouse Gas Protocol Corporate Standard to guide our $CO_2e$ reporting methodology, adopting an equity share approach to defining, consolidating and reporting our Scope 1, Scope 2 and Scope 3 $CO_2e$ emissions. The table below sets out our emissions for 2014.

| Emissions | 2014 | 2013 |
|---|---|---|
| Scope 1 $CO_2e$ emissions (tonnes) | **342,385** | 358,658 |
| Scope 2 $CO_2e$ emissions (tonnes) | **370,724** | 390,242 |
| Scope 3 $CO_2e$ emissions (tonnes) | **212,018** | 209,567 |
| Total (tonnes) | **925,127** | 958,467 |
| Intensity (per million cigarettes equivalent) | **0.83** | 0.84 |

The Group invests more than £50 million per year in **fighting the illicit trade in tobacco**. We are implementing supply chain security systems and engaging with governments and other international organisations to work together to address this global problem. We are working with the European Commission, providing funding of €134 million as part of a 20-year cooperation agreement to tackle illicit trade.

Our approach to **human rights** is based on our core belief that universally recognised fundamental human rights should be respected. In 2014, we strengthened our approach with a new Human Rights Policy in our revised Standards of Business Conduct (www.bat.com/sobc). The policy is aligned to the UN's Framework and Guiding Principles on Business and Human Rights and sets out our commitments to: eliminating child labour; no exploitation of labour; and freedom of association.

Our regional audit and CSR committees monitor the performance of our companies in managing human rights in the workplace and supply chain. This includes reviews of operations in countries of concern as identified by independent human rights risks analytics.

Our supplier reviews include human rights criteria. Our tobacco leaf suppliers are reviewed through our SRTP programme based on annual self-assessments which are independently validated by AB Sustain. In 2014, our suppliers scored 89% for activities to prevent child labour and AB Sustain conducted 12 on-site reviews in eight countries. Suppliers' SRTP scores are published on www.bat.com/SRTPdata. Our Business Enabler Survey Tool, which we use to review strategic suppliers of direct materials, also includes human rights criteria.

## A sustainable future

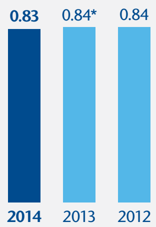
Our focus on sustainable practices has been recognised by our inclusion in the Dow Jones Sustainability Index for the past 13 years, 12 of them as industry leader. Our commitment to developing next-generation tobacco and nicotine products, sustainable agriculture and operating to the highest standards of corporate conduct are the right things to do. Delivering them will help to ensure that we have a sustainable future, one in which we can continue to generate value for our shareholders while also meeting the expectations of stakeholders in wider society.

## Business measures

### Carbon dioxide equivalent ($CO_2e$)
(tonnes $CO_2e$ per million cigarettes equivalent produced)

0.83

45%
lower than 2000 baseline




**Definition:** We track Group $CO_2e$ in tonnes per million cigarettes equivalent produced.

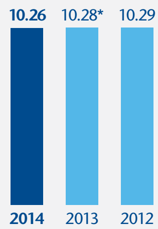
**Target:** To reduce Group $CO_2e$ by 50% by 2030 from our 2000 baseline of 1.52 and by 80% by 2050.

**Note:** *The previously reported 2013 figure of 0.83 is re-stated to take into account an amendment to freight data for our business in Colombia and an amendment to production volume data for our business in Peru.

### Group energy use
(gigajoules per million cigarettes equivalent produced)

10.26

13%
lower than 2007 baseline




**Definition:** We track Group energy use in gigajoules per million cigarettes equivalent produced.

**Target:** To reduce energy use to 9.82 by 2017, 17% lower than our 2007 baseline.

**Note:** *The previously reported 2013 figure of 10.17 is re-stated to take into account an amendment to freight data for our business in Colombia and an amendment to production volume data for our business in Peru.

### Water use
(cubic metres per million cigarettes equivalent produced)

3.69

24%
lower than 2007 baseline

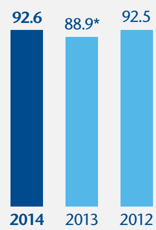

**Definition:** We track Group water use in cubic metres per million cigarettes equivalent produced.

**Objective:** To reduce water use to 3.6 by 2017, 26% lower than our 2007 baseline.

**Note:** *The previously reported 2013 figure of 3.65 is re-stated to take into account an amendment to production volume data for our business in Peru.

### Recycling
(percentage of waste recycled)

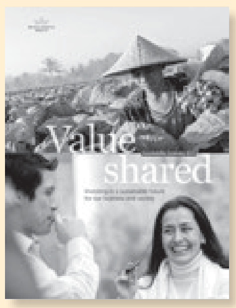
92.6%




**Definition:** We track the total percentage of Group waste re-used or recycled against total waste generated.

**Objective:** To recycle more than 85% of waste generated in each year.

**Note:** *The previously reported 2013 figure of 89.1% is re-stated to take into account an amendment to the recycling data for our business in Chile.




**Sustainability Summary report 2014**

Find out more about our focus on sustainability in our Sustainability Summary report 2014.

It is available on our corporate website **www.bat.com/sustainability**

BUSINESS ENVIRONMENT

# Industry insight

> We believe that global population growth, consumer demand for premium brands and innovative tobacco products and emerging next-generation product categories will continue to provide strong growth opportunities in the years to come.

## Global cigarette market

The global tobacco industry sells around 5,700 billion[1] cigarettes each year and the value of the global tobacco market is estimated at £450–£500 billion[1].

The four biggest international tobacco companies – British American Tobacco, Imperial Tobacco, Japan Tobacco and Philip Morris International – account for around three-quarters of the market outside China.

## Growth in tobacco and beyond

We operate in a challenging macro-economic environment that continues to impact consumer spending globally and we have seen pressure on pricing and volume in several markets. Political instability in many parts of the world, most notably in the Middle East, creates further challenges for the global industry.

However, while cigarette volume has continued to decline year-on-year in developed countries, the overall value of the tobacco market continues to grow.

We are confident that this will continue in the long term. Although there will be fewer smokers as a percentage of the population in the future, we believe that global population growth, consumer demand for premium brands and innovative tobacco products and emerging next-generation product categories will continue to provide strong growth opportunities in the years to come.

## Tobacco's economic contribution

The global tobacco industry contributes substantially to the economies of many countries and millions of people worldwide depend on it for employment. Even in countries that do not have tobacco manufacturing or leaf growing, tobacco retail and distribution is an important source of economic activity.

Tobacco taxes provide a major source of revenue for almost every government in the world. Unsurprisingly, when difficult economic times reduce a country's national budget, taxes on tobacco products are often viewed as a strong potential source of income. It is estimated that governments worldwide collect around £150 billion in excise on the sale of tobacco products each year.

British American Tobacco alone contributed approximately £30 billion to governments in excise and other taxes in 2014 – that's eight times the Group's profit after tax.

Less than 1% of the world's agricultural land is used for tobacco farming and only for part of the year, yet it is an important contributor to the agricultural economy in many countries. Farmers choose to grow tobacco because it is suitable for different growing conditions and can generate high profit margins.

## Tobacco litigation

There are a number of different types of claim that have been brought against the tobacco industry over the past few decades. The three most common are third-party reimbursement cases, class actions and individual lawsuits. In some cases, the plaintiff or plaintiffs may seek to recover what are known as punitive damages in addition to compensatory damages.

In the US and Canada, several special factors lead to litigation that are not replicated in other countries, which is why large volume and high-value litigation has largely not spread to other parts of the world.

While it is difficult to predict the outcome of every lawsuit in every country, tobacco companies worldwide continue to defend themselves against litigation, drawing confidence from the industry's exceptionally good record in this area.

## Regulating the tobacco market

Regulation of the tobacco industry continues to increase. Much of the tobacco regulation being proposed and introduced around the world is driven by the World Health Organization's Framework Convention on Tobacco Control. However, excessive regulation often has unintended consequences.

Measures such as sudden increases in excise can distort competition among tobacco companies and often result in consumers switching to cheaper, illegally trafficked products. Where evidence-based regulation of the tobacco industry is developed with all stakeholders involved – including the industry itself – it can help to ensure an orderly marketplace that serves the interests of both consumers and governments.

Australia introduced plain packaging in December 2012 and the UK Government recently announced that it plans to introduce similar regulations. However, there is no conclusive evidence that plain packaging has achieved its aims of reducing consumption or been effective in preventing youth smoking in Australia.

Notes:
1. Source: Euromonitor International and our internal estimates.

Plain packaging also breaches domestic, regional and international law, especially in relation to intellectual property rights. The governments of Ukraine, Cuba, Honduras, the Dominican Republic and Indonesia are challenging Australia's plain packaging laws at the World Trade Organization, with 36 countries joining as interested parties. Eleven EU Member States (representing over 40% of the EU's population) have formally raised concerns about the UK and Ireland's plans for plain packaging.

### Tobacco trafficking

The illegal market in tobacco products accounts for up to 600 billion[1] cigarettes every year globally, depriving governments of around £30 billion in legitimate taxes. This illegal trade is also a huge competitor for the legal tobacco industry itself, and takes away a significant amount of legitimate business each year. The profits often end up in the hands of criminals who don't pay tax and sell their products to anyone, including children.

Tobacco trafficking also has a negative impact on consumers, retailers and regulators. Counterfeit cigarettes mean no quality controls and no health warnings, while smuggled genuine products are unlikely to carry health warnings that meet local government regulations. The industry has worked together on initiatives across the whole supply chain that are designed to stop criminals. These include technological developments such as digital coding and tax verification, which help governments ensure taxes and duties are paid, and a track and trace system, which means we can monitor our products as they move through the supply chain. If products are found on the black market, the system can trace them back to their point of departure from the legitimate supply chain.

These measures will be most effective if the industry, regulators and enforcement authorities work together, supported by appropriate excise policies, sound regulation and effective enforcement.

### The case for next-generation products

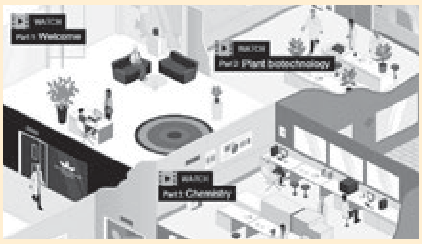
Scientists widely agree that it is the toxicants in tobacco smoke, not the nicotine, that pose the most health risks. E-cigarettes and other nicotine products are considered to be significantly less risky than smoking when manufactured to robust quality and safety standards.

In June 2014, 53 leading scientists and public health experts signed an open letter to the World Health Organization which stated that alternative nicotine products like e-cigarettes "offer reductions in risk of 95% or more compared to cigarettes".

The bringing to market of a range of products that meet the needs of adult consumers seeking less risky alternatives to cigarettes would also help to meet the objectives of many public health professionals.

It makes good commercial sense, too. At British American Tobacco, our aim is to research, develop and commercialise a pipeline of e-cigarettes and other nicotine products, including tobacco heating products. We believe our experience, capabilities and insights mean we are well placed to satisfy consumer needs in these emerging product categories. While for regulators and governments, endorsing less risky, alternative products could be a positive move towards making tobacco harm reduction a key public health policy objective.

## Step inside:
## Explore our R&D labs




We actively encourage regulators and other scientists to visit our research facilities in the UK. In 2014 we created a video tour and made it available on our corporate website and YouTube.

Take a look inside our state-of-the-art biology, chemistry and plant biotechnology labs and meet some of the scientists behind the science.

You can view the video tour at **www.bat.com/labtour** or at **www.youtube.com/welcometobat**

## They grow, we grow:
## Helping farmers to thrive


We work as partners with over 100,000 farmers worldwide, providing them with on-the-ground advice and support. Learn more about our work in supporting farmers in our leaf supply chain.

Watch our video to see this partnership in action in Lombok, Indonesia.

You can watch the video at **www.bat.com/farmervideo** or at **www.youtube.com/welcometobat**

BUSINESS ENVIRONMENT

# Key Group risk factors

## Overview

The key risk factors that may affect the Group are set out on the following pages.

Each risk is considered in the context of the Group's strategy, as set out in this Strategic Report on pages 14 and 15. Following a description of each risk, its causes and potential impact on the Group are summarised. We also explain the activities we are undertaking to mitigate each risk.

The Group has identified, actively monitors and is taking action to mitigate many different risks. This section does not include them all, but focuses on those risks that the Directors believe to be the most important ones that are currently faced by the business. Not all of these risks are within the control of the Group and other factors besides those listed may affect the Group's performance. Some risks may be unknown at present. Others, currently regarded as immaterial, could become material risks in the future.

The risk factors listed in this section and the activities being undertaken to mitigate them should be considered in the context of the Group's internal control framework. This is described in the section on risk management and internal control in the corporate governance statement on page 61. This section should also be read in the context of the cautionary statement set out on the right.

### Assessment of Group risk

The Board's assessment of the key risks and uncertainties facing the Group has remained broadly unchanged over the past year, particularly with regard to illicit trade, excise, tax and financial risk and regulation.

The Board has, however, increased its focus on the risks associated with the deployment of the Group's revised operating model and single IT operating system. The challenges to deliver the Group's pricing strategy in an increasingly aggressive competitor environment, the increased impact of market contraction, consumer down-trading and the risks of strategic litigation, were also considered by the Board. These are now listed as principal risks facing the business.

The risk that the Group is unable to access cash resources in a number of markets is no longer considered a principal risk for the purpose of this year's report.

The Board also revised its view of the primary causes of the risk of failure to lead developing next-generation products (referred to as the non-tobacco nicotine market in previous reports).

Details of each of these risks are set out in the following tables.

### Cautionary statement

The Strategic Report and certain other sections of this Annual Report contain forward-looking statements that 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 that could cause actual results to differ materially from those currently anticipated.

BUSINESS ENVIRONMENT

# Key Group risk factors continued

## Marketplace risk factors

### Competition from illicit tobacco trade

| Time frame | Strategic impact | Risk owner |
| --- | --- | --- |
| Long term | Growth (organic revenue growth) | Group Corporate and Regulatory Affairs Director |

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. Most illicit products are sold at the bottom end of the market and in contravention of applicable regulatory requirements.

Excise increases can encourage more consumers to switch to cheaper illegal tobacco products, providing greater rewards for smugglers. The risk is exacerbated where current economic conditions have resulted in high unemployment and/or reduced disposable incomes.

Global volume of illicit trade is estimated to be up to 12% of consumption. In the next decade, we believe that the problem is likely to increase, driven by the increased regulatory and compliance burden for legitimate manufacturers and further significant excise increases.

#### Principal causes

- Unexpected and significant excise increases and widening excise differentials between markets.
- Unintended consequences of regulation, e.g. plain packaging, graphic warnings, display bans and ingredients restrictions.
- Extra compliance costs imposed on the legitimate industry giving a competitive advantage to illicit manufacturers.
- Economic downturn.
- Lack of law enforcement and weak border controls.

#### Potential impact

- Erosion of brand value, with lower volumes and reduced profits.
- Reduced ability to take price increases.
- Investment in trade marketing and distribution is undermined.

#### Mitigation activities

- Dedicated Anti-Illicit Trade (AIT) teams operating at global and country levels and internal cross-functional coordination.
- Active engagement with key external stakeholders.
- Cross-industry and multi-sector cooperation on a range of AIT issues.
- Global AIT strategy 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) works with enforcement agencies in pursuit of priority targets.
- Strong internal business conduct and customer approval policies.

### Failure to lead developing next-generation products

| Time frame | Strategic impact | Risk owner |
| --- | --- | --- |
| Long term | Growth (revenue growth) and Sustainability (reduced-risk products) | Managing Director, Next-Generation Products |

The Group recognises the risk of not capitalising on the opportunities in developing and successfully commercialising consumer-appealing next-generation products, including those believed by scientific and regulatory authorities as posing substantially reduced risks to health.

#### Principal causes

- Regulations that stifle the category, including those pertaining to marketing freedom, product innovation, retail availability and excise.
- Failure to develop successful, consumer-appealing products and roll them out faster than competitors.

#### Potential impact

- Consumer base, market share, profitability and achievement of growth targets will be undermined if competitors are more successful in establishing new categories or if regulation impedes the growth of the category.
- While considered unlikely, equalisation of the regulatory framework for next-generation products with traditional cigarettes would tend to eliminate all business opportunities for the new category. Furthermore, equalising e-cigarettes to medicines would increase complexity, increase research and development (R&D) costs, reduce the size of the opportunity and hinder the ability to introduce innovations quickly.

#### Mitigation activities

- Exclusive focus by a wholly-owned Group subsidiary, Nicovations Limited, on the development and commercialisation of innovative regulatory approved nicotine products to enable the Group to offer a consumer-acceptable alternative to cigarettes with lower health risks.
- Establishment of a next-generation products group with the appointment of its own leadership team.
- Appointment of senior R&D and product development executives and the adoption of a portfolio approach to new technologies.
- Improved Vype product portfolio launched in the UK, with further market launches planned.
- Regulatory plans in place for key markets.
- Ongoing mergers and acquisitions dialogue on potential next-generation products opportunities.

BUSINESS ENVIRONMENT

# Key Group risk factors continued

## Marketplace risk factors continued

### Market size reduction and consumer down-trading

| Time frame | Strategic impact | Risk owner |
|---|---|---|
| Short term | Growth (organic revenue growth) | Regional Directors |

As a consequence of steep excise-led price increases and the continuing difficult economic and regulatory environment in many countries, market contraction and consumer down-trading are expected to remain principal risks facing the Group. A number of instances of market contraction have arisen, particularly in Europe, Australia, Brazil and Russia.

#### Principal causes

- Downturn in the economic climate impacting consumers' disposable incomes.
- Changes in the regulatory environment.
- Continued above-inflation price rises.
- Targeted growth of low-priced brands through aggressive pricing.

#### Potential impact

- Volume decline and portfolio mix erosion.
- Funds to invest in growth opportunities are reduced.

#### Mitigation activities

- Geographic spread mitigates impact at Group level.
- Quarterly brand reviews are presented to the Global Marketing Leadership Team as well as to the Management Board.
- Economic outlook embedded into quarterly performance reviews in markets.
- Key market reviews at Management Board meetings.
- Close monitoring of sales volume by segment to detect changes in consumer purchasing patterns in markets.
- Clear portfolio and pricing strategies, ensuring balanced portfolio of strong brands across key segments.
- Increased focus behind product quality and innovation across all segments to provide tangible differentiation and improve the price-value ratio.
- Overlap with many mitigation activities undertaken for other principal risks facing the Group, such as competition from illicit tobacco trade, significant excise increases or structure changes and inability to obtain price increases.

### Inability to obtain price increases and impact of increases on consumer affordability

| Time frame | Strategic impact | Risk owner |
|---|---|---|
| Short term | Growth (organic revenue growth) | Regional Directors |

Annual manufacturers' price increases are among the key drivers in increasing market profitability. The Group faces a risk that such price increases will not materialise.

#### Principal causes

- Increased regulation reduces the ability to build brand equity and enhance the value proposition to the consumer.
- Stretched consumer affordability arising from deteriorating economic conditions and rising prices.
- Sharp increase or change in excise structure reduces opportunities for manufacturer-led pricing.
- Competitor pricing activities.

#### Potential impact

- Not achieving strategic growth metrics.
- Funds to invest in growth opportunities are reduced.
- Volumes may reduce faster than anticipated due to accelerated market decline.
- Down-trading and growth of illicit trade.

#### Mitigation activities

- Key market and pricing reviews at Management Board meetings.
- Pricing, excise and trade margin committees exist in all markets with regional and global support.
- Robust business cases underpinning key innovative launches.
- Clear portfolio and pricing strategies, ensuring a balanced portfolio of strong brands across key segments.

BUSINESS ENVIRONMENT

# Key Group risk factors continued

## Excise and tax risk factors

### Significant excise increases or structure changes

| Time frame | Strategic impact | Risk owner |
|---|---|---|
| Short term and long term | Growth (organic revenue growth) | Regional Directors |

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 country by country and between different types of tobacco products.

A number of significant excise increases have taken place over the past three years, for example in Australia, Russia, Brazil, South Korea, Indonesia, Turkey, the Philippines and New Zealand. To date, the Group has been able to balance these increases with its geographic spread, and continues to develop effective measures to address the risk.

#### Principal causes

- Fiscal pressures for higher government revenues.
- Increases advocated within the context of national health policies.
- Insufficient opportunity to engage with stakeholders in meaningful dialogue.

#### Potential impact

- Consumers reject the Group's legitimate tax-paid products for products from illicit sources.
- Reduced legal industry volumes.
- Reduced sales volume and/or portfolio erosion.
- Some absorption of excise increases.

#### Mitigation activities

- Requirement for Group companies to have in place formal pricing and excise strategies including contingency plans, with annual risk assessments.
- Pricing, excise and trade margin committees in markets, with regional and global support.
- Engagement with local tax and customs authorities, where appropriate, in particular in relation to the increased risk to excise revenues from higher illicit trade.
- Portfolio reviews to ensure appropriate balance and coverage across price segments.
- Monitoring of economic indicators, government revenues and the political situation.
- Central team in place to define the excise management framework, develop training materials, monitor and engage with international financial institutions on excise and anti-illicit trade matters.

### Disputed taxes, interest and penalties

| Time frame | Strategic impact | Risk owner |
|---|---|---|
| Short term | Productivity (capital effectiveness) | Finance Director |

The Group may face significant financial penalties, including the payment of interest, in the event of an unfavourable ruling by a tax authority in a disputed area.

#### Principal causes

- Unfavourable ruling by tax authorities in disputed areas and aggressive auditing and/or pursuit of tax claims.

#### Potential impact

- Significant fines and potential legal penalties.
- Disruption and loss of focus on the business due to diversion of management time.
- Impact on profit and dividend.

#### Mitigation activities

- End market tax committees.
- Internal tax function provides dedicated advice and guidance, and external advice sought where needed.
- Engagement with tax authorities at Group, regional and individual market level.

BUSINESS ENVIRONMENT

# Key Group risk factors continued

## Finance risk factors

### Foreign exchange rate exposures

| Time frame | Strategic impact | Risk owner |
|---|---|---|
| Short term | Productivity (capital effectiveness) | Finance Director |

The Group faces transactional and translational foreign exchange (FX) rate exposures for earnings/cash flows from its global business. During periods of sterling strength and FX rate volatility, as seen in 2014, the Group's results can be impacted negatively.

#### Principal causes

- FX rate exposures arise from exchange rate movement against the functional currency and against sterling, the Group's reporting currency.

#### Potential impact

- Fluctuations in FX rates of key currencies against sterling introduce volatility in reported EPS, cash flow and the balance sheet driven by translation into sterling of our financial results.
- The dividend may be impacted if the payout ratio is not adjusted.
- Differences in translation between earnings and net debt may affect key ratios used by credit rating agencies.
- Volatility and/or increased costs in our business, due to transactional FX, may adversely impact financial performance.

#### Mitigation activities

- While translational FX exposure is not hedged, its impact is identified in results presentations and financial disclosures; earnings are re-stated at constant rates for comparability.
- Debt and interest are matched to assets and cash flows to mitigate volatility where possible and economic to do so.
- Hedging strategy for transactional FX and framework is defined in the treasury policy and signed off by the Board.
- Illiquid currencies of many markets where hedging is either not possible or uneconomic are reviewed on a regular basis.
- The treasury system provides visibility of FX exposures and the hedge portfolio.

## Operations risk factors

### Geopolitical tensions

| Time frame | Strategic impact | Risk owner |
|---|---|---|
| Long term | Growth (organic revenue growth) | Director, Legal |

Geopolitical tensions, social unrest, terrorism and organised crime have the potential to disrupt the Group's business in multiple markets.

#### Principal causes

- Regional and/or global conflicts.
- Terrorism and political violence.
- Criminal activity leading to attacks on our people, supply chain or other assets.
- Economic policy changes, including nationalisation of assets and withdrawal from international trade agreements.

#### Potential impact

- Potential loss of life, loss of assets and disruption to normal business processes.
- Increased costs due to more complex supply chain arrangements and/or the cost of building new facilities or maintaining inefficient facilities.
- Reputational impact of inability to protect staff and assets from serious harm.

#### Mitigation activities

- Globally integrated sourcing strategy and contingency sourcing arrangements.
- Security risk modelling, including external risk assessments and the monitoring of geopolitical and economic policy developments worldwide.
- Insurance cover and business continuity planning, including scenario planning and testing and risk awareness training.
- Security controls for field force, direct store sales and supply chain with an emphasis on the protection of Group employees.

BUSINESS ENVIRONMENT

# Key Group risk factors continued

## Operations risk factors continued

### Injury, illness or death in the workplace

| Time frame | Strategic impact | Risk owner |
|---|---|---|
| Short term | Sustainability | Director, Operations |

The Group is committed to operating responsibly by maintaining the necessary controls that safeguard the health, safety and welfare of the people who work for the Group and alongside it, as well as minimising the impact on the natural environment and the local communities in which the Group conducts business activities. The risk of injury, death or ill health to employees and those who work with the business is a fundamental concern of the Group and can have a significant effect on its operations.

#### Principal causes

- Failure to assess risk and implement appropriate control measures.
- Failure to monitor, assess and implement the requirements of regulations that apply to Group sites and operations resulting in non-compliance with environment, health and safety (EHS) standards.
- Insufficient information, instruction and training on health and safety at work.

#### Potential impact

- Serious injuries, ill health, disability or loss of life suffered by employees and the people who work with the Group.
- Exposure to civil and criminal liability and the risk of prosecution from enforcement bodies and the cost of associated fines and/or penalties.
- Interruption of Group operations if issues are not addressed quickly.
- High staff turnover or difficulty recruiting employees if perceived to have a poor EHS record.

#### Mitigation activities

- Risk control systems in place to ensure equipment and infrastructure are provided and maintained.
- An EHS strategy ensures that employees at all levels receive appropriate EHS training and information.
- Behavioural-based safety programme to drive Operations safety performance and culture closer to zero accidents.
- Analysis of incidents undertaken regionally and globally to identify increasing incident trends or high potential risks that require coordinated action to address.
- Focused programmes within Marketing to address specific risks associated with sales and distribution activities.
- Dedicated global team to support management of EHS risks.
- Key issues and incidents monitored regionally and reported globally to oversee compliance.

## Regulation risk factors

### Tobacco regulation inhibits growth strategy

| Time frame | Strategic impact | Risk owner |
|---|---|---|
| Long term | Growth (organic revenue growth) and Sustainability (balanced regulation) | Group Corporate and Regulatory Affairs Director; Director, Operations; and Director, Marketing |

The enactment of unreasonable regulation that prohibits the Group's ability to communicate with consumers, differentiate our products and launch future products. This increases business costs and complexity.

#### Principal causes

- Pressure from some international health organisations, governments and the tobacco control community to pursue regulation and policy that: is not evidence-based; is designed to eradicate tobacco and nicotine use; excludes the industry from the manufacture and sale of next-generation products or regulates them in a way that fails to incentivise their commercialisation; and fails to deliver legitimate public health objectives.

#### Potential impact

- Erosion of brand value through commoditisation, the inability to launch innovations, differentiate products, maintain or build brand equity and leverage price.
- Adverse impact on ability to compete within the legitimate tobacco industry and also with increased illicit trade.
- Reduced consumer acceptability of new product specifications, leading to consumers seeking alternatives in illicit trade.
- Shocks to share price on enactment of unduly onerous and restrictive regulation.
- Reduced ability to compete in future product categories and make new market entries.
- Constriction of the retail universe and limitations on product visibility.
- Increased scope and severity of compliance regimes in new regulation leading to higher costs, greater complexity and potential reputational damage or fines for inadvertent breach.

#### Mitigation activities

- Engagement and litigation strategy coordinated and aligned across the Group to drive a balanced global policy framework for tobacco control.
- Prioritisation of key current and emerging regulatory issues.
- Stakeholder mapping and prioritisation, developing robust compelling advocacy materials (with supporting evidence and data), and regulatory engagement programmes.
- Regulatory risk assessment of marketing plans to ensure decisions are informed by an understanding of the potential regulatory environments.
- Advocating the application of our integrated regulatory proposals to governments and public health practitioners based on the harm reduction principles.
- Development of an integrated regulatory strategy that spans conventional combustibles and includes next-generation products.

BUSINESS ENVIRONMENT

# Key Group risk factors continued

## Programmes and project risk factors

### Deployment of the Group's revised operating model and single IT operating system ('TaO')

| Time frame | Strategic impact | Risk owner |
|---|---|---|
| Short term | Productivity (globally integrated enterprise) | Director, Business Development |

Risks of delays to the on-time, in-full delivery of the Group's revised operating model and single IT operating system ('TaO'), due to the complexity involved in the deployment. This may result in increased costs and/or delaying the realisation of both qualitative and quantitative benefits.

#### Principal causes

- The scale of change required is large as the scope is more than SAP implementation and includes deploying the Group's revised Target Operating Model.
- Resource constraints within the programme and regions.
- Assumptions are not fully correct or the ways identified for achieving streamlined and uniform deployment are not sufficient.
- Planned infrastructure architecture and/or SAP application may not meet the performance needs of high-order-volume markets.
- Markets that have implemented TaO affected by system downtime due to potential lack of network resilience.

#### Potential impact

- Implementation of new ways of working may not be fully embedded until well after implementation – delaying the delivery of the benefits.
- Resource not being available for TaO or business as usual adversely impacting TaO benefits and/or business results.
- Deployment is delayed with a corresponding impact on TaO programme costs and benefits realisation.
- Benefits may not be realised due to failure to sustain the change post-TaO.
- Potential business disruption in the regions for a longer period of time, impacting operations and ability to deliver other programmes and activities.
- Poor response times in high volume markets could mean that batch transaction processes do not complete on time. This may impact key business processes, including sales.
- System downtime could render markets that have implemented TaO unable to manufacture, move or sell.

#### Mitigation activities

- Importance of TaO understood and supported by senior management.
- On-going stakeholder engagement and knowledge transfer at Regional senior management level.
- Regular monitoring of the integrated plan and key dependencies.
- Major risks and issues actively managed by TaO Leadership Team or within the relevant management layer as appropriate.

## Litigation risk factors

### Litigation

| Time frame | Strategic impact | Risk owner |
|---|---|---|
| Long term | Growth (revenue impact) | Director, Legal |

Product liability, regulatory or other significant cases may be lost or compromised resulting in a material loss or other consequence. Legal costs may increase significantly.

#### Principal causes

- Case lost by either a non-Group or Group company may set a precedent for the filing of future claims against the Group.
- Cases are brought on the basis of the reversal of the burden of proof which places the Group, as a defendant, at a disadvantage e.g. Health Care Recoupment cases.
- Aggressive court time line or approach that undermines defence preparation.

#### Potential impact

- Damages and fines, negative impact on reputation, disruption and loss of focus on the business.
- Consolidated results of operations, cash flows and financial position could be materially affected, in a particular fiscal quarter or fiscal year, by an unfavourable outcome or settlement of certain pending or future litigation.

#### Mitigation activities

- Consistent litigation strategy across the Group.
- Expertise and legal talent maintained both within the Group and with our external partners.
- Closer integration in Group litigation strategy and cost controls pursued.

FINANCIAL REVIEW

# Income Statement

Ben Stevens
Finance Director

### 2014 Highlights

- Group revenue was down as exchange rate movements and volume offset the impact of pricing. Revenue was 2.8% higher at constant rates of exchange.
- Adjusted profit from operations at constant rates of exchange increased by 4.4%.
- Adjusted diluted earnings per share fell by 3.9% to 208.1p per share.
- At constant rates, adjusted diluted earnings per share were 7.9% higher at 233.7p.
- Dividends for 2014 up by 4.0% to 148.1p per share.
- Free cash flow of £2,507 million with free cash flow per share equal to 64% of adjusted diluted earnings per share. Excluding non-tobacco litigation payments this was 76%.
- The Group will contribute US$4.7 billion to maintain its shareholding in Reynolds American Inc., after its acquisition of Lorillard. As a result the share buy-back was suspended in July 2014.

A strong Group performance despite adverse exchange rate movements and a difficult environment.

## Revenue and profit from operations

The results of the Group were impacted by the adverse movement of a number of key currencies and this is reflected in an adverse translational exchange rate movement of 11%. As a result, reported revenue was down by 8% from £15,260 million to £13,971 million. Exchange rate movements and one-off charges, mainly the cost in respect of the settlement of the Flintkote claims, resulted in profit from operations declining by 18% to £4,546 million.

To better understand the underlying performance of the business, management reviews the results by adjusting for a number of items relating to restructuring and integration costs and one-off charges, provisions and income (see page 44). We call the underlying profit after adjusting for these items, which are described further below, adjusted profit from operations. Adjusted profit from operations was £5,403 million, 7% lower than in 2013. In order to assess the underlying performance, we also have to view the business results at constant rates of exchange, excluding the translational impact of exchange rate movements. This does not adjust for the transactional effects of currency fluctuations on the cost of items such as leaf, filter tow and wrapping materials, which are estimated to be an additional £90 million negative.

The Group's strong underlying performance for the year is demonstrated by the growth of 2.8% in revenue and 4.4% in adjusted profit from operations, at constant rates. Excluding the above transactional exchange effect, adjusted operating profit would have increased by a further 1.5%.

## Operating margin

The Group continues to improve its operating margin through pricing, portfolio development through GDBs, tight cost control, factory rationalisation, the implementation of the new operating model, systems standardisation and productivity savings. In 2014, adjusted profit from operations, as a percentage of net revenue, improved to 38.7% compared to 38.1% in 2013. More details of the Group's adjusted operating performance can be found in the Regional review.

## Adjusting items

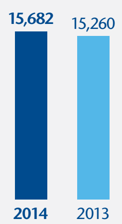
During 2014, the Group continued to incur costs that do not relate to the day-to-day operations of the business. The adjustments made to profit from operations are separately disclosed as memorandum information on the face of the Income Statement and in the segmental analysis.

The Group incurred restructuring and integration costs of £452 million in 2014 mainly in respect of the restructuring initiatives directly related to the implementation of the new operating model, the continuation of factory closures in Australia, Colombia and in the Democratic Republic of Congo, and restructurings in Argentina, Indonesia, Canada, Switzerland and Germany, offset by profits on the sale of land and buildings in Turkey and Congo. The costs also cover packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group.

The £246 million restructuring and integration charge in 2013 principally related to the implementation of the new operating model, the continuation of factory closures in Australia and Russia, and restructurings in the Democratic Republic of the Congo, Switzerland and Germany, offset by profits on the sale of land and buildings in Australia, Russia and Denmark. In addition, it also includes packages in respect of permanent headcount reductions in the Group.

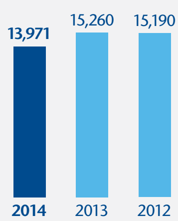
**Net turnover at constant rates of exchange**
(£ million)

+3%
2014
+4%
2013
+4%
2012



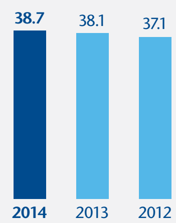

**Net turnover at current rates of exchange**
(£ million)

-8%
2014
0%
2013
-1%
2012




**Operating margin**
(%)

+54bpts
2014
+100bpts
2013
+160bpts
2012



FINANCIAL REVIEW

# Income Statement continued

## Analysis of revenue, profit from operations and diluted earnings per share

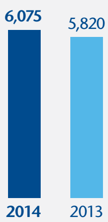
| Revenue | 2014 | | | 2013 |
|---|---|---|---|---|
| | Reported revenue £m | Impact of exchange £m | Revenue at CC[1] £m | Reported revenue £m |
| Asia-Pacific | 3,873 | 380 | 4,253 | 4,203 |
| Americas | 2,990 | 516 | 3,506 | 3,317 |
| Western Europe | 3,359 | 187 | 3,546 | 3,635 |
| EEMEA | 3,749 | 628 | 4,377 | 4,105 |
| **Total** | **13,971** | **1,711** | **15,682** | 15,260 |

| Profit from operations/Diluted earnings per share | 2014 | | | | | 2013 | | |
|---|---|---|---|---|---|---|---|---|
| | Reported profit[2] £m | Adjusting items £m | Adjusted profit[2] £m | Impact of exchange £m | Adjusted profit[2] at CC[1] £m | Reported profit[2] £m | Adjusting items £m | Adjusted profit[2] £m |
| Asia-Pacific | 1,360 | 188 | 1,548 | 165 | 1,713 | 1,672 | 21 | 1,693 |
| Americas | 1,197 | 89 | 1,286 | 189 | 1,475 | 1,303 | 61 | 1,364 |
| Western Europe | 1,018 | 171 | 1,189 | 73 | 1,262 | 1,133 | 140 | 1,273 |
| EEMEA | 1,318 | 62 | 1,380 | 245 | 1,625 | 1,418 | 72 | 1,490 |
| Total regions | 4,893 | 510 | 5,403 | 672 | 6,075 | 5,526 | 294 | 5,820 |
| Fox River[3] | 27 | (27) | | | | | | |
| Flintkote[3] | (374) | 374 | | | | | | |
| Profit from operations | 4,546 | 857 | 5,403 | 672 | 6,075 | 5,526 | 294 | 5,820 |
| Net finance costs | (417) | – | (417) | (39) | (456) | (466) | – | (466) |
| Associates and joint ventures | 719 | (7) | 712 | 50 | 762 | 739 | (16) | 723 |
| Profit before tax | 4,848 | 850 | 5,698 | 683 | 6,381 | 5,799 | 278 | 6,077 |
| Taxation | (1,455) | (69) | (1,524) | (174) | (1,698) | (1,600) | (46) | (1,646) |
| Non-controlling interest | (278) | (5) | (283) | (29) | (312) | (295) | (3) | (298) |
| Profit attributable to shareholders | 3,115 | 776 | 3,891 | 480 | 4,371 | 3,904 | 229 | 4,133 |
| Diluted number of shares | 1,870 | | 1,870 | | 1,870 | 1,908 | | 1,908 |
| Diluted earnings per share (pence) | 166.6 | | 208.1 | | 233.7 | 204.6 | | 216.6 |

Notes
1. CC: constant currencies.
2. Profit: profit from operations.
3. The Fox River credit in 2014 and the Flintkote charge in 2014 have not been allocated to any segment as they do not relate to current operations. They are presented separately from the segment reporting which is used to evaluate segment performance and to allocate resources.

### Adjusted profit from operations at constant rates of exchange (£m)

+4%
2014
+7%
2013
+8%
2012




### Percentage changes in revenue and in profit from operations

| | Revenue growth | Profit growth |
|---|---|---|
| As reported | -8.4% | -17.7% |
| Adjusted | | -7.2% |
| Adjusted at constant rates | +2.8% | +4.4% |

The acquisitions of Bentoel, Tekel, ST, Protabaco and CN Creative Limited, as well as the creation of CTBAT International Ltd, resulted in the capitalisation of trademarks and similar intangible assets, which are amortised over their expected useful lives, which do not exceed 20 years. The 2014 amortisation charge is £58 million, compared to £74 million in 2013.

The 2013 contribution of the State Express 555 brand to CTBAT International Ltd is accounted for at fair value in the arrangement resulting in a £26 million gain on deemed partial disposal of a trademark.

Subsequent to the 2014 Funding Agreement between a Group subsidiary and the parties in respect of the clean-up cost of the Fox River, a partial release of £27 million was made from the provision set up in 2011. A Group subsidiary agreed the settlement of the Flintkote asbestos related claims in 2014, and paid the settlement sum into an escrow account. The total cost, including legal fees, amounted to £374 million. More detail of these two settlements are provided in note 30 to the accounts.

## Net finance costs

Net finance costs at £417 million were £49 million lower than last year, principally reflecting the lower interest paid as a result of lower borrowing costs, the increased net fair value gains in the Group, and the impact of exchange rate movements.

## Associates

The Group's share of the post-tax results of associates, included at the pre-tax profit level under International Financial Reporting Standards (IFRS), fell by £20 million or 2.7% to £719 million.

In 2014, the Group's share of the adjusted post-tax results of associates decreased by 1.5% to £712 million (2013: £723 million), this was an increase of 5.4% at constant rates. The adjusting items for associates amounted to a net gain of £7 million (2013: £16 million).

The adjusted contribution from Reynolds American Inc. decreased by 3.1% to £427 million. At constant rates of exchange this would have been an increase of 2.0%. The adjusted contribution from our associate in India, ITC, was £270 million, up 2.1%. At constant rates of exchange, the contribution would have been 11.9% higher than last year.

The adjusting items for associates are explained in note 5 of the Financial Statements.

## Tax

Profit before tax was down £951 million at £4,848 million, reflecting the impact of higher adjusted profit from operations at constant rates of exchange and lower net finance costs, more than offset by one-off charges and the adverse exchange rate movements.

The tax rates in the Income Statement of 30.0% in 2014 and 27.6% in 2013 are affected by the inclusion of the share of associates' post-tax profit in the Group's pre-tax results and by adjusting items. Excluding these, the underlying tax rate for subsidiaries was 30.6% in 2014 and 30.7% in 2013. The slight decrease is the result of a change in the mix of profits.

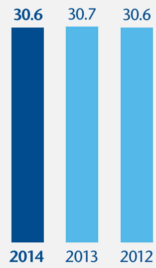
The Group's philosophy in respect of taxes is to:

- comply with all applicable laws and regulations in the countries where we operate;
- be open and transparent with tax authorities and operate with mature, professional relationships;
- seek to optimise shareholder return by structuring the business in a tax efficient manner;
- transact on an arm's length basis for all exchanges of goods and services between companies within the Group. Transfer pricing between Group companies is based on fair market terms and reflects the commercial nature of the transaction; and
- to engage in proactive discussions with tax authorities on occasions of differing legal interpretation to bring matters to as quick a resolution as possible. Where resolution is not possible, tax disputes may proceed to litigation.

Our tax footprint extends beyond corporation tax and we are obliged to pay other significant taxes such as employment taxes and customs and import duties. Apart from the taxes borne, the Group also collects taxes on behalf of governments, such as tobacco excise, employee taxes, VAT and other sales taxes. The total tax contribution therefore consists of both taxes borne and taxes collected. In 2014, the total cash tax contribution by the Group amounted to £29.7 billion (2013: £33.6 billion), with the contribution by each category as shown in the chart (right). The reduction is largely due to adverse movements in foreign exchange.

### Underlying tax rate
(%)

30.6%



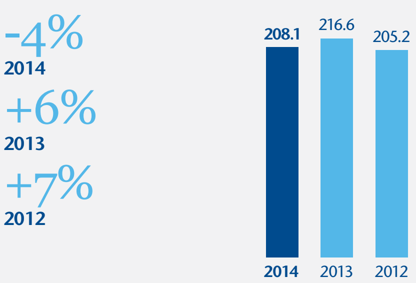

### Major taxes paid 2014
(£bn)


| | |
|---|---|
| Tobacco excise (collected) | 22.2 |
| Net VAT and other sales taxes (collected) | 5.2 |
| Corporation tax (borne) | 1.4 |
| Customs and import duties (borne) | 0.3 |
| Taxes paid by employee (collected) | 0.4 |
| Employment taxes (borne) | 0.2 |

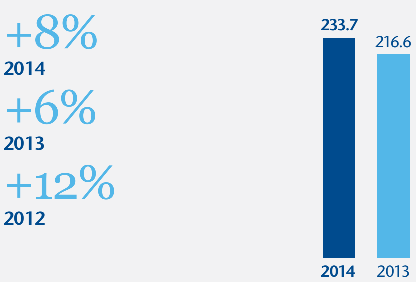
FINANCIAL REVIEW

# EPS, dividends and financing

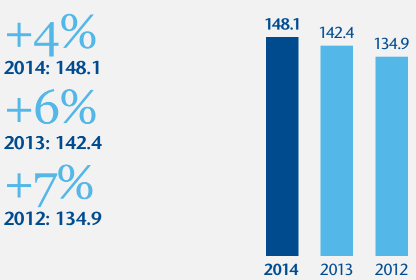
**Adjusted diluted EPS**
(pence)




**Adjusted diluted EPS at constant rates**
(pence)




**Dividends per share declared**
(pence)




In addition to these major taxes, there are a host of other taxes the Group bears and collects, such as transport taxes, energy and environmental taxes, banking and insurance taxes and property taxes.

The corporate tax charge (current tax) for 2014 was £1.45 billion (2013: £1.57 billion), which differs from the tax paid of £1.43 billion (2013: £1.44 billion) due to the timing of corporation tax instalment payments which often straddle different financial years.

## Earnings per share

Basic earnings per share for 2014 were 167.1p, down 19% (2013: 205.4p). With the impact 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 on the Financial Statements.

On this basis, the adjusted diluted earnings per share were 208.1p, a 3.9% decrease over 2013, as the strong operating performance of the Group and the impact of the share buy-back programme, were more than offset by adverse movement in exchange rates. When the impact of exchange rate movements are excluded, the adjusted diluted earnings per share (at constant rates) would have been 233.7p, a 7.9% increase on 2013.

## Dividends

The Group's policy is to pay dividends of 65% 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. In 2013, as a result of the restatement of the 2012 numbers after a change in accounting policy, the increase in dividends was kept at the same rate as the increase in earnings, leading to a dividend growth of 6% and a pay-out ratio of 65.7%.

With the recommended final dividend of 100.6p, the total dividends per share for 2014 are 148.1p, compared to the total dividend of 142.4p for 2013. This leads to a total dividend growth of 4% and a pay-out ratio of 71.2%.

Under IFRS, the recommended final dividend in respect of a year is only provided in the accounts of the following year. Therefore, the 2014 accounts reflect the 2013 final dividend and the 2014 interim dividend amounting to 144.9p (£2,712 million in total (2013: 137.7p – £2,611 million)). The table below shows the dividends declared in respect of 2014 and 2013.

Dividends are declared/proposed and payable in sterling except for those shareholders on the branch register in South Africa, whose dividends are payable in rand. A rate of exchange of £:R=17.76480 as at 24 February 2015, the closing rate for that day as quoted by Bloomberg, results in an equivalent final dividend of 1,787.13888 SA cents per ordinary share. Further details of the final dividend and key dates (and the South Africa branch register key dates) are set out in the other statutory and regulatory information section.

**Dividends declared/proposed**

| | **2014** | | 2013 | |
|---|---|---|---|---|
| Ordinary shares | **Pence per share** | **£m** | Pence per share | £m |
| Interim | **47.5** | **881** | 45.0 | 846 |
| Final | **100.6** | **1,866** | 97.4 | 1,831 |
| | **148.1** | **2,747** | 142.4 | 2,677 |

## Treasury operations

The Treasury function 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 oversight to the Finance Director and the Treasury function. The policies include a set of financing principles and key performance indicators.

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. The Group's treasury position is monitored by a Corporate Finance Committee chaired by the Finance Director. Treasury operations are subject to periodic independent reviews and audits, both internal and external.

The Group continues to maintain investment-grade credit ratings and was upgraded during 2013 by Moody's. Since then, and as at 31 December 2014, the ratings from Moody's/S&P were A3 (stable outlook)/A- (stable outlook). The strength of the ratings has underpinned debt issuance and the Group is confident of its ability to successfully access the debt capital markets.

All contractual borrowing covenants have been met and none are expected to inhibit the Group's operations or funding plans.

## Liquidity

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% of centrally managed debt maturing in a single rolling year. As at 31 December 2014, the average centrally managed debt maturity was 6.8 years (2013: 7.2 years) and the highest proportion of centrally managed debt maturing in a single rolling 12-month period was 18.7% (2013: 18.3%).

It is Group policy that short-term sources of funds (including drawings under both the US$2 billion commercial paper programme and the £1 billion euro commercial paper programme) are backed by undrawn committed lines of credit and cash. At 31 December 2014, £160 million of commercial paper was outstanding (2013: £521 million).

In May 2014, the Group through B.A.T. International Finance p.l.c. negotiated a new central banking facility of £3 billion with a final maturity of May 2019 (with two additional one-year extensions at the option of the banks). This facility is provided by 22 banks. The new facility is on significantly improved terms compared to the previous central banking facility of £2 billion, with a maturity of December 2015, which was cancelled at the same time. The new facility was undrawn as at 31 December 2014 (2013: undrawn).

In September 2014, the Group signed a one-year bridge facility of US$4.7 billion with an extension option of up to one year for its proposed investment in Reynolds American Inc.

In the year ended 31 December 2014, the Group continued with transactions in the capital markets. In September 2014 the Group repaid a maturing €600 million bond, this repayment was financed from Group cash balances. In September 2014, the Group issued a new CHF 350 million bond with a maturity of 2016; a new CHF 400 million bond with a maturity of 2021 and a new CHF 250 million bond with a maturity of 2026.

In August 2014 the Group repaid a maturing MYR 250 million note, this repayment was financed from Group cash balances. In June 2014, the Group purchased and cancelled an existing US$40 million bond with a maturity of 2029; this purchase was financed from Group cash balances. In March 2014, the Group issued a new €400 million bond with a maturity of 2018 and a new €600 million bond with a maturity of 2029.

In March 2013, the Group issued a US$300 million bond with a maturity of March 2016 and €650 million bond with a maturity of March 2025. In July 2013, the Group repaid a €519 million bond from the Group's cash balances. In September 2013, the Group issued a new £650 million bond with a maturity of 2026. In November 2013, a maturing US$300 million bond was repaid and in December 2013, a maturing £152 million bond was repaid. These repayments were financed from Group cash balances.

The Group has drawn US$225 million in 2013 and 2014 against a Chilean peso facility, maturing in 2016.

## Capital structure

The Group defines capital as net debt and equity. 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 times. The Group targets a gross interest cover, as calculated under its key central banking facilities, of greater than five. For 2014 it is 12.0 times (2013: 12.3 times). The Group assesses its financial capacity by reference to cash flow, net debt and interest cover. Group policies include a set of financing principles and key performance indicators including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital structure is managed and, in particular, the policies on dividends and share buy-backs are decided.

FINANCIAL REVIEW

# Alternative cash flow

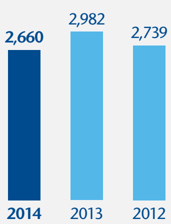
## Cash flow and net debt movements

| | 2014 £m | 2013 £m |
|---|---|---|
| Adjusted profit from operations | **5,403** | 5,820 |
| Depreciation, amortisation and impairment | **396** | 392 |
| Other non-cash items in operating profit | **45** | 30 |
| Profit from operations before depreciation and impairment | **5,844** | 6,242 |
| Increase in working capital | **(309)** | (375) |
| Net capital expenditure | **(627)** | (547) |
| Gross capital expenditure | **(689)** | (720) |
| Sale of fixed assets | **62** | 173 |
| **Operating cash flow** | **4,908** | 5,320 |
| Pension funds' shortfall funding | **(140)** | (190) |
| Net interest paid | **(426)** | (443) |
| Tax paid | **(1,433)** | (1,440) |
| Dividends paid to non-controlling interests | **(249)** | (265) |
| Cash generated from operations | **2,660** | 2,982 |
| Restructuring costs | **(325)** | (310) |
| Non-tobacco litigation: Flintkote and Fox River | **(437)** | – |
| Dividends and other appropriations from associates | **609** | 699 |
| **Free cash flow** | **2,507** | 3,371 |
| Dividends paid to shareholders | **(2,712)** | (2,611) |
| Share buy-back (including transaction costs) | **(800)** | (1,509) |
| Net investment activities | **(6)** | (19) |
| Net flow from share schemes and other | **108** | (79) |
| **Net cash outflow** | **(903)** | (847) |
| | | |
| **Movements on net debt** | | |
| Exchange rate effects* | **270** | (163) |
| Change in accrued interest and other | **(17)** | (32) |
| **Change in net debt** | **(650)** | (1,042) |
| **Opening net debt** | **(9,515)** | (8,473) |
| **Closing net debt** | **(10,165)** | (9,515) |

* Including movements in respect of debt-related derivatives.

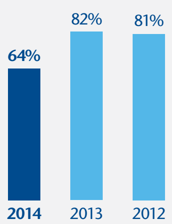
**Cash generated from operations at current rates**

£2,660m
-11%



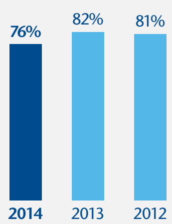

**Free cash flow as a percentage of adjusted earnings**

64%




**Free cash flow as a percentage of adjusted earnings (excluding non-tobacco litigation)**

76%



## Return on capital employed

The Group's return on capital employed has increased from 23% in 2009 to 30% in 2014. This is calculated as the adjusted profit from operations, divided by the average total assets net of average current liabilities.

## Cash flow

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

Operating cash flow decreased by £412 million, or 8%, to £4,908 million, reflecting the growth in underlying operating performance at constant currency being more than offset by adverse exchange movements. Lower payments relating to pension funds, net interest paid, dividends to non-controlling interests and taxation offset the fall in appropriations from associates following the completion of the Reynolds American share buy-back programme (£94 million in 2014 and £189 million in 2013). These, combined with the increase in restructuring costs and payments for Flintkote and Fox River, led to the Group's free cash flow decreasing by £864 million or 26% to £2,507 million.

The conversion of adjusted operating profit to operating cash flow remained strong at 91% (2013: 91%). However due to payments in relation to Flintkote and Fox River, the ratio of free cash flow per share to adjusted diluted earnings per share fell to 64% (2013: 82%).

Below free cash flow, the principal cash outflows for 2014 comprise the payment of the prior year final dividend and the 2014 interim dividend, which was £101 million higher at £2,712 million, as well as a £800 million outflow due to the on-market share buy-back programme. This was down £709 million on 2013 as the buy-back was suspended from 30 July 2014 due to the proposed investment in Reynolds American.

During 2014, the cash outflow from net investing activities was £6 million relating to various entities in which the Group already has an interest. In 2013, the cash outflow was mainly for the acquisition of CN Creative and amounted to £19 million.

The other net flows principally relate to shares purchased by the employee share ownership trusts and cash flows in respect of certain derivative financial instruments.

These flows resulted in a net cash outflow of £903 million (2013: £847 million outflow). After taking account of other changes, especially exchange rate movements, total net debt was £650 million higher at £10,165 million at 31 December 2014 (2013: £9,515 million).

## Net debt

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:

| | 2014 £m | 2013 £m |
|---|---|---|
| Net debt due within one year | | |
| Borrowings | (2,479) | (1,980) |
| Related derivatives | 79 | 55 |
| Cash and cash equivalents | 1,818 | 2,106 |
| Current available-for-sale investments | 50 | 54 |
| | (532) | 235 |
| Net debt due beyond one year | | |
| Borrowings | (9,779) | (9,716) |
| Related derivatives | 146 | (34) |
| | (9,633) | (9,750) |
| Total net debt | (10,165) | (9,515) |

## Retirement benefit schemes

The Group's subsidiaries operate around 170 retirement benefit arrangements worldwide. 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 present total value of funded scheme liabilities as at 31 December 2014 was £6,609 million (2013: £5,921 million), while unfunded scheme liabilities amounted to £385 million (2013: £337 million). The schemes' assets increased from £5,780 million in 2013 to £6,266 million in 2014.

After excluding unrecognised scheme surpluses of £13 million (2013: £19 million), the overall net liability for all pension and health care schemes in Group subsidiaries amounted to £741 million at the end of 2014, compared to £497 million at the end of 2013.

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 environments.

## Share buy-back programme

The Board had approved the continuation of the on-market share buy-back programme in 2014 with a value of up to £1.50 billion, excluding transaction costs. However, the Group suspended, with effect from 30 July 2014, the buy-back programme. This was as a result of the Group's announcement of 15 July 2014 that it planned to invest US$4.7 billion as part of Reynolds American Inc.'s proposed acquisition of Lorillard. During 2014, 23 million shares were bought at a value of £795 million, excluding transaction costs of £5 million.

## Changes in the Group

On 30 August 2013 the Group announced that CTBAT International Ltd (CTBAT), a joint investment incorporated in Hong Kong between subsidiaries of China National Tobacco Corporation (CNTC) and British American Tobacco, had commenced official business operations. It owns and manages the worldwide international cigarette trademark State Express 555, and also owns the worldwide right outside China to the leading CNTC brand Shuang Xi.

CTBAT is reported as part of the Asia-Pacific Region with the majority of its international sales (non-China domestic sales) made through existing Group end markets in that region. The Group recognises its share (50%) of the assets, liabilities, income and expenses of the arrangement on a line-by-line basis in the consolidated financial statements.

The impact of the arrangement on operating results for 2014 and 2013 is not material.

On 8 July 2013, the Group announced a joint venture in Myanmar with I.M.U. Enterprise Limited to manufacture, distribute and market the Group's brands. Under the terms of the agreement, the Group has contributed plant and machinery and cash to the venture in return for a controlling stake.

FINANCIAL REVIEW

# Non-GAAP measures and other information

## 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 the users of the Financial Statements in helping them understand the underlying business performance.

The principal non-GAAP measures which the Group uses are adjusted profit from operations and adjusted diluted earnings per share, which are reconciled to profit from operations and 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 joint operations 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 the previous year's average rates of exchange. Other than in exceptional circumstances, this does not adjust for the normal transactional gains and losses in operations which are generated by exchange movements. As an additional measure to indicate the impact of exchange rate movements on the Group results, adjusted diluted earnings per share is also shown at constant rates of exchange.

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

Due to the secondary listing of the ordinary shares of British American Tobacco p.l.c. on the JSE Limited (JSE) in South Africa, the Group is required to present headline earnings per share and headline diluted earnings per share.

## Post balance sheet date announcement

On 23 February 2015, the Group announced that it was evaluating a possible public tender offer to acquire up to all of the 24.7% of Souza Cruz shares which are not currently owned by British American Tobacco and to delist the company.

An offer for Souza Cruz's shares would be at a price per share of R$26.75, to be paid in cash, in Brazilian reais, and to be reduced by any dividend paid by Souza Cruz. A price of R$26.75 per share would represent a premium of 30.0% to Souza Cruz's volume weighted average closing price over the three months to Friday 20 February 2015.

## Accounting policies

The application of the accounting standards and the accounting policies adopted by the Group, are set out in the Group Manual of Accounting Policies and Procedures (GMAPP). GMAPP includes the Group instructions in respect of the accounting and reporting of business activities, such as revenue recognition, asset valuations and impairment testing, adjusting items, the accrual of obligations and the appraisal of contingent liabilities, which includes taxes and litigation. Formal processes are in place whereby central management and end market management confirm adherence to the principles and the procedures and to the completeness of reporting. Central analyses and revision of information is also done to ensure and confirm adherence.

## Accounting developments

The Group has prepared its annual consolidated financial statements in accordance with IFRS, as adopted by the EU.

There were no material changes to the accounting standards applied in 2014 from that applied in 2013.

Future changes applicable on the accounting standards that will be applied by the Group are set out in the Notes on the Accounts (Note 1 – Accounting Policies). However, the impact is not expected to be material to the Group results.

## Going concern

A description of the Group's business activities, its financial position, cash flows, liquidity position, facilities and borrowings position, together with the factors likely to affect its future development, performance and position, are set out in this Annual Report.

The key Group risk factors include analyses of financial risk and the Group's approach to financial risk management. 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 this report, sufficient existing financing available for its estimated requirements for at least the next 12 months. This, together with the 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 geographical 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 and that it is therefore appropriate to continue to adopt the going concern basis in preparing the Annual Report.

## 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 | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| US dollar | **1.648** | 1.564 | **1.559** | 1.656 |
| Canadian dollar | **1.819** | 1.612 | **1.806** | 1.760 |
| Euro | **1.241** | 1.178 | **1.289** | 1.202 |
| South African rand | **17.861** | 15.099 | **18.039** | 17.347 |
| Brazilian real | **3.874** | 3.381 | **4.145** | 3.908 |
| Australian dollar | **1.827** | 1.623 | **1.905** | 1.851 |
| Russian rouble | **63.412** | 49.853 | **93.555** | 54.424 |
| Japanese yen | **174.223** | 152.715 | **186.946** | 174.080 |
| Indian rupee | **100.529** | 91.707 | **98.424** | 102.447 |

**Ben Stevens**
Finance Director

GOVERNANCE

# Directors' Report

## Chairman's introduction

Richard Burrows
Chairman

### Dear Shareholder

In 2014, the Group continued to perform well and to follow the strategy set out in the previous year. Reported results bear the effects of currency values changing as the pound sterling strengthened substantially against the currencies of many of our important markets.

This movement in currency values was the reason we decided to review our long-term remuneration policy, a task the Remuneration Committee undertook in the autumn. Details of this and our discussions with shareholders are set out fully in the Remuneration Report.

Following on from our Board effectiveness reviews, and the identification of ways of strengthening our Board, the Nominations Committee engaged in the identification and recruitment of three new Non-Executive Directors who joined the Board on 2 February 2015. These three newcomers, Sue Farr, Pedro Malan and Dimitri Panayotopoulos, add significant consumer goods marketing experience, and business and geopolitical skills to our Board, as well as strengthening the Board's diverse composition.

An important function of the Board is to approve major policy. This year we approved changes to our Standards of Business Conduct Policy by introducing new provisions in relation to human rights and mutual respect in the workplace. Our Group Employment Principles already contained these provisions but they are now given greater weight by being included in our global policy. They underline the principles of workplace human rights which are equality, diversity and mutual respect, and supply chain human rights, particularly with regard to the elimination of child labour.

Risk management forms an important part of the Board agenda as well as the agendas for our Audit Committee and CSR Committee. Your Board has confidence that the Group's processes strike a good balance between encouraging entrepreneurship in management and safeguarding the Company's assets and its shareholders' investment. Risk appetite for the Group will continue to be addressed by the Audit Committee and the Board and our required 'viability statement' will also be formally addressed by them in the year ahead.

As usual, the key Group risk factors are reported upon in detail in our Strategic Report on pages 30–36, and the Audit Committee reports in this Governance section, on page 59, on the significant issues it considered in relation to the Annual Report.

We carried out our Board effectiveness review as an internal exercise this year. This self-assessment found that the Board is continuing to function well and that its members, individually and collectively, are effective in discharging their duties and responsibilities. Detailed comments on this review are set out in this section of the Annual Report, on pages 56 and 57, with comment on further action points.

Board policy is to reflect the diversity of the geographic and consumer profile of our business at the Board. Full details of this are also set out in this section on page 54.

I have had useful engagement with shareholders over the course of the year. Meetings with shareholders took place in the period before our last AGM and also more recently when I accompanied the Chairman of the Remuneration Committee on his consultation with shareholders in connection with the remuneration policy.

I value these meetings which are, of course, only a small part of our annual investor relations programme. It is important to us as a Board that we are fully aware of the views of our shareholders on the business and on governance issues and can reflect these in our decision making. As reported in the Remuneration Report, such feedback from investors in relation to our remuneration proposals has now resulted in these being withdrawn.

Finally, at the end of this section, your Directors state their belief that this Annual Report presents a fair, balanced and understandable assessment of the Company and its prospects. In making this statement we reconsidered and confirmed our confidence in the long-established processes that underpin its production. The Audit Committee also fulfils a role in considering its accuracy, key messages and tone.

**Richard Burrows**
Chairman

### Compliance statement

Throughout the year ended 31 December 2014 and to the date of this document, we applied the Main Principles of the UK Corporate Governance Code adopted in June 2012 (the Code). The Company was compliant with all provisions except C.3.7, as the Group had not, during 2014, submitted its audit to a tender process within the last 10 years. See page 60.

An updated version of the Code was issued in September 2014, which will apply to accounting periods beginning on or after 1 October 2014. With regard to the changes relevant to risk management and internal control, the Audit Committee's workplan for 2015 will include reviewing its objectives against the revised Code. The Remuneration Committee will also focus on its future obligations under the revised Code during 2015.

The Board considers that this Annual Report, and notably this section, provides the information shareholders need to evaluate how we have complied with our current obligations under the Code.

For ease of reference, we prepare a separate annual compliance report by reference to each provision of the Code. This report is available at www.bat.com/governance.

We comply with the Disclosure Rules and Transparency Rules requirements for corporate governance statements by virtue of the information included in this section, together with the information contained in the Other Corporate Disclosures section.

GOVERNANCE

# Leadership and effectiveness

## Governance framework

### The Board

The Board is collectively responsible for the Group's vision and strategic direction, its values and its governance. The Board is accountable to shareholders for the performance of the business and the Group's long-term success. It provides the leadership necessary for the Group to meet its performance objectives within a framework of internal controls.

**Board responsibilities:**
- Group strategy.
- Group policies.
- Major corporate activities.
- Annual Report approval.
- Governance framework.
- Group budget.
- Board succession plans.
- Risk management and internal control.
- Periodic financial reporting.
- Dividend policy.

### Board Committees

The Board has established four principal Board Committees listed below, to which it has delegated certain responsibilities. The roles, membership and activities of these Committees are described in detail in their individual reports in this section. Each Committee has its own terms of reference, available at www.bat.com/governance, which are updated regularly, most recently in December 2013.

Audit Committee page 58
CSR Committee page 64
Nominations Committee page 66
Remuneration Committee page 67

### Board programme

Our annual Board programme is designed to enable the Board to monitor and review the delivery of strategy across all the elements of the Group's business model, which is set out in our Strategic Report on pages 14 and 15. The key activities of the Board in 2014, grouped under the Group's four strategy pillars: Growth, Productivity, Sustainability and Winning Organisation, are set out in the accompanying table on pages 52 and 53. The Board's strategic priorities for 2015 are identified within the key performance indicators set out in our Strategic Report on page 18.

The Board devotes considerable attention to corporate governance matters relating to the Group's internal controls and compliance activities. It receives verbal updates from the chairmen of the Audit, Remuneration and CSR Committees following each Committee meeting. Copies of the minutes of the Audit and CSR Committees are circulated to all members of the Board.

### Management Board

The Management Board, chaired by the Chief Executive, is responsible for overseeing the implementation of the Group's strategy and policies set by the Board, and for creating the framework for the successful day-to-day operation of the Group's operating subsidiaries. Alongside the Finance Director, its other members, at the date of this Report, comprise 12 senior Group executives whose biographies appear on pages 50 and 51.

**Principal Management Board role:**
- Developing Group strategy for approval by the Board.
- Monitoring Group operating performance.
- Developing guidelines for the Group's regions and functions.
- Ensuring regional and functional strategies are effective and aligned and managing the central functions.
- Reviewing regional and functional budgets.
- Overseeing the management and development of talent.

### Next-Generation Products (NGP) Board

The NGP Board, chaired by the Chief Executive, focuses exclusively on the Group's non-combustible tobacco and nicotine-based businesses. Its other members are the Finance Director and Managing Director, NGP. It also included Des Naughton, previously Managing Director of Nicoventures, who was a member of the Management Board until his departure from the Group on 28 February 2015.

**Principal NGP Board role:**
- Developing strategy on non-combustible tobacco and nicotine-based products for approval by the Board.
- Monitoring the overall performance of the NGP businesses.
- Making recommendations to the Board on NGP matters.
- Overseeing the NGP businesses' portfolio of programmes and projects.
- Overseeing the management and development of talent within the NGP businesses.

### Leadership roles and responsibilities

#### Leadership

**Chairman**
- Leadership of the Board.
- Ensure Board effectiveness.
- Facilitate contribution of Directors.
- Set Board agenda.
- Interface with shareholders.
- Ensure effective shareholder engagement.

**Chief Executive**
- Overall responsibility for performance.
- Leadership of the Group.
- Stewardship of Group assets.
- Enable planning and execution of objectives and strategies.

#### Oversight

**Non-Executive Directors (NEDs)**
- Help develop strategy.
- Review management proposals.
- Scrutinise performance of management.
- Bring an external perspective to the Board.
- Monitor performance.

**Senior Independent Director (SID)**
- Lead review of Chairman's performance.
- Preside at Board in Chairman's absence.
- Intermediary for other Directors.
- Available to meet with major shareholders.

GOVERNANCE

# Board of Directors

## Richard Burrows
Chairman (69)

**Nationality:** Irish

**Position:** Chairman since November 2009; Non-Executive Director since September 2009; Chairman of the Nominations Committee.

**Key appointments:** NED and member of the Remuneration and Nominations Committees of Rentokil Initial plc; a Supervisory Board member, member of the Audit Committee and Chairman of the Remuneration Committee at Carlsberg A/S.

**Skills and experience:** Chief Executive of Irish Distillers; Co-Chief Executive of Pernod Ricard; Governor of the Bank of Ireland; Fellow of the Institute of Chartered Accountants of Ireland.

## Christine Morin-Postel
Senior Independent Director (68)

**Nationality:** French

**Position:** Senior Independent Director since April 2013; Non-Executive Director since 2007; member of the Audit, Nominations and Remuneration Committees.

**Key appointments:** NED and member of the Nominations and Remuneration Committee of Groupe Bruxelles Lambert S.A.

**Skills and experience:** 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.; studied political sciences and graduated from the Institut de Contrôle Gestion.

## Nicandro Durante
Chief Executive (58)

**Nationality:** Brazilian/Italian

**Position:** Chief Executive since 2011.

**Key appointments:** Non-Executive Director and member of the Nominations and Remuneration Committees of Reckitt Benckiser Group plc.

**Skills and experience:** COO from 2008; Regional Director for Africa and Middle East and member of the Management Board from 2006; senior general management roles in Brazil (including President of Souza Cruz) and in the UK and Hong Kong; has wide experience in senior international finance and management roles within the Group. Holds a degree in finance, economics and business administration.

## Ben Stevens
Finance Director (55)

**Nationality:** British

**Position:** Finance Director since 2008.

**Key appointments:** No external appointments.

**Skills and experience:** Senior Group finance and general management roles; Head of Merger Integration following the merger with Rothmans; Chairman and Managing Director of the Pakistan Tobacco Company and British American Tobacco Russia; appointed to the Management Board in 2001 as Development Director becoming Director, Europe in 2004. Holds a BA (Hons) in Economics from Manchester University and an MBA from Manchester Business School.

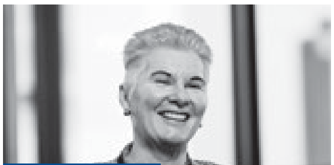
## Sue Farr
Non-Executive Director (58)

**Nationality:** British

**Position:** Non-Executive Director since February 2015; member of the Corporate Social Responsibility and Nominations Committees.

**Key appointments:** Director, Strategic and Business Development, Chime plc since 2003; NED of Dairy Crest Group, member of the Remuneration and Corporate Social Responsibility Committees; NED of Millennium & Copthorne Hotels, member of the Remuneration and Nominations Committees; NED of Accsys Technologies and member of the Nominations, Remuneration and Audit Committees.

**Skills and experience:** Former Chairwoman of both the Marketing Society and the Marketing Group of Great Britain; considerable expertise in marketing, branding and consumer issues developed during her career including roles with the BBC and Vauxhall Motors.



## Ann Godbehere
Non-Executive Director (59)

**Nationality:** Canadian/British

**Position:** Non-Executive Director since 2011; member of the Audit, Nominations and Remuneration Committees.

**Key appointments:** NED, member of the Nominations Committee and Chair of the Audit Committee of Rio Tinto plc and Rio Tinto Limited; NED, member of the Audit Committee and Chair of the HR and Compensation Committee of UBS Group AG and UBS AG; NED, member of the Nominations and Risk Committees and Chair of the Audit Committee of Prudential plc.

**Skills and experience:** Chief Financial Officer of Swiss Re Group; Chief Financial Officer of Northern Rock during the initial phase of its public ownership; Fellow of the Certified General Accountants of Canada and Fellow of the Chartered Professional Accountants.

## Savio Kwan
Non-Executive Director (66)

**Nationality:** British

**Position:** Non-Executive Director since January 2014; member of the Corporate Social Responsibility and Nominations Committees.

**Key appointments:** Co-Founder and CEO of A&K Consulting Co Ltd, advising entrepreneurs and their start-up businesses in China; Visiting Professor at Henley Business School.

**Skills and experience:** Extensive business leadership experience in Greater China and Asia, gained at General Electric, BTR plc and Alibaba Group, China's largest internet business, where he was both Chief Operating Officer and, later, a Non-Executive Director. Holds an MSc from Loughborough University and an MBA from London Business School.

## Dr Pedro Malan
Non-Executive Director (72)

**Nationality:** Brazilian

**Position:** Non-Executive Director since February 2015; member of the Corporate Social Responsibility and Nominations Committees.

**Key appointments:** Chairman of the International Advisory Board of Itaú Unibanco; Member of the Advisory Board of EDP – Energias do Brasil SA; NED of Mills Estruturas e Servicos de Engenharia SA; Trustee of the Thomson Reuters Principles and member, Temasek International Panel.

**Skills and experience:** Former Chairman of Unibanco bank. Previously NED, Companhia Souza Cruz SA (2010-2015) and Minister of Finance for Brazil (from 1995 to 2002), President of the Central Bank of Brazil from 1993 to 1994, Chief External Debt Negotiator for Brazil from mid-1991 to 1993.

### Dr Gerard Murphy
Non-Executive Director (59)

**Nationality:** Irish

**Position:** Non-Executive Director since 2009; Chairman of the Remuneration Committee; member of the Nominations Committee.

**Key appointments:** Member and Chairman of the Executive Committee of The Blackstone Group International Partners LLP; NED of Merlin Entertainments plc; Board member of Jack Wolfskin and Intertrust Group.

**Skills and experience:** Chief Executive Officer of Kingfisher plc, Carlton Communications plc, Exel plc, Greencore Group plc; senior operating roles at Grand Metropolitan plc (now Diageo plc). Holds a BSc and PhD in food technology from University College Cork and a MBS in Marketing from University College Dublin.

### Dimitri Panayotopoulos
Non-Executive Director (63)

**Nationality:** Greek/Tanzanian

**Position:** Non-Executive Director since February 2015; member of the Nominations and Remuneration Committees.

**Key appointments:** Senior Advisor, Boston Consulting Group since April 2014; Board member, Logitech.

**Skills and experience:** Former Vice Chairman and Advisor to the Chairman and CEO of Procter & Gamble. Significant international sales and brand building expertise in Switzerland, Germany, Egypt and China. Led on significant breakthrough innovations and continued to focus on this, speed to market and scale across all of Procter & Gamble's businesses while Vice Chairman of all the Global Business Units. Retired from Procter & Gamble in January 2014.

## Attendance at Board meetings in 2014

| Name | Director since | Attended/ Eligible to attend |
|---|---|---|
| Richard Burrows | 2009 | 9/9 |
| Christine Morin-Postel | 2007 | 9/9 |
| Nicandro Durante | 2008 | 9/9 |
| Ben Stevens | 2008 | 9/9 |
| Sue Farr[1] | 2015 | N/A |
| Ann Godbehere | 2011 | 9/9 |
| Savio Kwan[2] | 2014 | 8/9 |
| Dr Pedro Malan[1] | 2015 | N/A |
| Dr Gerry Murphy | 2009 | 9/9 |
| Dimitri Panayotopoulos[1] | 2015 | N/A |
| Kieran Poynter[3] | 2010 | 8/9 |
| Karen de Segundo | 2007 | 9/9 |
| Dr Richard Tubb | 2013 | 9/9 |
| John Daly[4] | 2010–2014 | 1/1 |
| Anthony Ruys[5] | 2006–2014 | 2/3 |

Notes:
1. Sue Farr, Pedro Malan and Dimitri Panayotopoulos were appointed to the Board on 2 February 2015 so did not attend any meetings during 2014.
2. Savio Kwan missed one ad hoc Board meeting, arranged at short notice, due to a prior engagement.
3. Kieran Poynter missed one ad hoc Board meeting, arranged at short notice, due to a prior engagement.
4. John Daly retired as an Executive Director on 6 April 2014.
5. Anthony Ruys missed one Board meeting as it coincided with a previously arranged Board meeting of the Supervisory Board of NV Luchthaven Schiphol, of which he was Chairman at the time. Anthony retired as a Non-Executive Director at the conclusion of the AGM on 30 April 2014.
6. The Board held nine meetings in 2014. Six of these were scheduled. Two meetings were held off-site, one over two days and devoted to strategy and the second was held in Hong Kong to review the Group's Asia-Pacific regional businesses. Six Board meetings are scheduled for 2015.
7. The Board of Directors is shown as at the date of this Annual Report.

### Kieran Poynter
Non-Executive Director (64)

**Nationality:** British

**Position:** Non-Executive Director since 2010; Chairman of the Audit Committee; member of the Nominations and Remuneration Committees.

**Key appointments:** NED and member of the Audit and Compliance and Safety Committees of International Consolidated Airlines Group S.A.; Non-Executive Chairman and Chair of the Nominations, Audit and Compliance and Risk and Remuneration Committees of F&C Asset Management plc; and Non-Executive Chairman of Nomura International PLC.

**Skills and experience:** Chartered Accountant; Chairman and Senior Partner of PricewaterhouseCoopers until 2008; served on the President's Committee of the Confederation of British Industry and as member of an advisory committee for the Chancellor of the Exchequer.

### Karen de Segundo
Non-Executive Director (68)

**Nationality:** Dutch

**Position:** Non-Executive Director since 2007; Chair of the Corporate Social Responsibility Committee; member of the Nominations Committee.

**Key appointments:** Supervisory Board Member and member of the Finance & Investment and Nomination Committees at E.ON SE; and member of the Board and member of the Audit Committee of Pöyry Oyj.

**Skills and experience:** Former NED of Lonmin Plc until 29 January 2015. Senior executive roles before retiring as CEO Shell International Renewables and President Shell Hydrogen in 2005. Holds a Masters degree in Law from Leiden University, an MBA from Michigan State University and is a Council Member of the Anglo Netherlands Society.

### Dr Richard Tubb
Non-Executive Director (55)

**Nationality:** US

**Position:** Non-Executive Director since January 2013; member of the Corporate Social Responsibility and Nominations Committees.

**Key appointments:** White House Physician Emeritus; member of the Board of Reference for Project Rescue; Senior Managing Director, Shoreland, Inc; and advisory position at Lonsdale.

**Skills and experience:** White House Physician from 1995 to 2009, including Physician to the President of the United States from 2002 until retirement in 2009; Clinical Assistant Professor at the Uniformed Services University (retired); Brigadier General (retired), US Air Force and various medical positions in the US Air Force. Awarded his Doctor of Medicine in 1985; Specialty Certification 1988.

GOVERNANCE

# Management Board

## Jerome Abelman

Group Corporate and Regulatory Affairs Director (51)

**Nationality:** US

Jerry joined the Management Board as Group Corporate & Regulatory Affairs Director in January 2015. He has been with the British American Tobacco Group for 12 years and has held a number of roles in the Legal function. Jerry was most recently Regional General Counsel, Asia-Pacific from 2010 to 2014, before becoming Assistant General Counsel – Corporate & Commercial. With effect from 1 May 2015, Jerry will replace Neil Withington and will be appointed to the combined role of Group General Counsel and Legal and Corporate Affairs Director.

## Jack Bowles

Regional Director, Asia-Pacific (51)

**Nationality:** French

Jack became Regional Director for Asia-Pacific in January 2013. Joining the Group in 2004, he was Chairman of British American Tobacco France in 2005 before taking up the role of Managing Director of British American Tobacco Malaysia in 2007. He joined the Management Board as Regional Director for Western Europe in October 2009 before becoming Regional Director for the Americas in October 2011.

## Alan Davy

Director, Operations (51)

**Nationality:** British

Alan was appointed to the Management Board as Group Operations Director in March 2013. He joined the Group in 1988 and has held various roles in manufacturing, supply chain and general management. Alan previously held the position of Group Head of Supply Chain.

## Giovanni Giordano

Director, Group Human Resources (49)

**Nationality:** Italian/US

Giovanni joined the Management Board of British American Tobacco in June 2011. He is an international human resources executive with wide experience from senior roles at Procter & Gamble and Ferrero, where he was Chief Corporate Officer.

## Andrew Gray

Director, Marketing (50)

**Nationality:** Brazilian/British

Andrew was appointed Marketing Director in September 2014. Joining Souza Cruz as an intern in 1986, he went on to hold a number of senior management positions in South America and the Caribbean (including President of Souza Cruz) and also in Malaysia. He joined the Management Board as Regional Director for Africa and the Middle East in January 2008 before being appointed Regional Director for Eastern Europe, Middle East and Africa (EEMEA) in January 2011.

## Tadeu Marroco

Director, Business Development (48)

**Nationality:** Brazilian

Tadeu joined the Management Board as Business Development Director in September 2014. In addition to his role leading Strategy and M&A, Tadeu is responsible for IT, including the roll-out of the Group's new operating model and global IT solution. Tadeu joined British American Tobacco in Brazil 22 years ago. He has held various senior finance positions, including Regional Finance Controller, EEMEA and Group Finance Controller.

**Dr David O'Reilly**
Group Scientific Director (48)

**Nationality:** British

David was appointed Group Scientific Director in January 2012. He is currently Head of Group Research & Development (GR&D), has been with British American Tobacco for over 20 years and has held various positions in GR&D. He has led the Group's R&D efforts to develop reduced toxicant products and has also been Head of International Public Health & Scientific Affairs, responsible for engagement with the scientific, medical and public health communities.

**Ricardo Oberlander**
Regional Director, Americas (51)

**Nationality:** Brazilian

Ricardo joined the Management Board as Regional Director for the Americas in January 2013. He joined Souza Cruz in May 1989 and has held various roles including Marketing Director of our Malaysian business, Regional Marketing Manager for the Americas, General Manager in France and Global Consumer Director. Ricardo joined the Board of the Group's associate company, Reynolds American Inc. in December 2014.

**Naresh Sethi**
Regional Director, Western Europe (48)

**Nationality:** Australian/Indian

Naresh was appointed Regional Director for Western Europe in January 2013. He has over two decades of experience in the tobacco industry, holding various marketing roles in India, Indonesia, West Africa and Australasia before moving to Japan. He was Marketing Director in Japan and then the Group's General Manager. He became Group Head of Strategy and Planning and was appointed Director, Group Business Development in 2012.

**Johan Vandermeulen**
Regional Director, Eastern Europe, Middle East and Africa (47)

**Nationality:** Belgian

Johan joined the Management Board as Regional Director for Eastern Europe, Middle East and Africa in September 2014. He has been with British American Tobacco for more than 20 years and was previously General Manager in Russia, General Manager in Turkey and Global Brand Director for Kent.

**Kingsley Wheaton**
Managing Director, Next-Generation Products (42)

**Nationality:** British

Kingsley was appointed Managing Director, Next-Generation Products in January 2015. He joined the Group in 1996 and has held a number of roles in Marketing. He was Marketing Director in Nigeria and Russia, before becoming General Manager in Russia. He was then the Global Brand Director responsible for Kent and Vogue before taking his place on the Management Board in January 2012 as Deputy Corporate and Regulatory Affairs Director. In June 2012 he was appointed Director, Corporate and Regulatory Affairs. Kingsley is also a member of the Next-Generation Products Board.

**Neil Withington**
Director, Legal and General Counsel (58)

**Nationality:** British

Neil was appointed to the Management Board as Legal 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 with ICI. He was a Director of Reynolds American Inc. from July 2004 to December 2014. Neil will retire from the Management Board and leave the Group on 30 April 2015.

GOVERNANCE

# Board activities in 2014

## Growth

**The Group's plans for continued investment in high-growth markets, in combustibles and in non-combustibles, is central to the Board's annual agenda, ensuring that growth remains our key strategic focus.**

### Activities in 2014

Consideration of industry trends, competitor environment, the outlook for tobacco products and next-generation products (NGPs) and the innovation pipeline for combustible products;

Reviewing the implementation of the Group strategy and satisfying itself that its delivery was being accelerated given the current regulatory environment and industry trends;

Receiving updates on the strategic and tactical opportunities for inorganic growth and the M&A strategy objectives;

Receiving updates on the Group's NGP business, the strategy for tobacco heating products and the innovation pipeline in this area. Discussing challenges faced in the development of nicotine delivery solutions and reaffirming the objective to develop products that satisfy the consumer in performance and taste;

Reviewing the impact of foreign exchange rates on the Group's financial performance;

Considering the trade marketing and distribution strategy and how this will contribute to growth;

Receiving updates on the Group's joint venture with the China National Tobacco Corporation (China Tobacco), which began operations in 2013, and market initiatives in Myanmar, the Philippines, Morocco and Bangladesh;

Discussing the Group's Risk Register, improving the Board's understanding of Group-wide and regional risks, and determining the Group's risk appetite in the context of specific growth opportunities; and

Reviewing the quarterly financial performance of the Group's associate companies, Reynolds American Inc. and ITC Ltd.

## Productivity

**The Board pays close attention to the Group's operational efficiency and our programmes aimed at delivering a globally integrated enterprise with cost and capital effectiveness, including access to financial markets.**

### Activities in 2014

Consideration of a review of the Group's centre and regional organisational structures, which identified opportunities for standardisation of processes, elimination of duplication and simplification of structures;

Closely monitoring the continued roll-out of the Group's new Operating Model and Global IT solution, which will contribute to the growth and productivity agendas;

Receiving reports on the significant improvements that have been made in delivering speed and scale of product distribution, reducing out of stocks and ensuring better product quality at the point of sale;

Benchmarking the Group's trade marketing and distribution resources against best practice to identify cost savings and to ensure that the Group achieves a good return on its investments with retailers as well as in relation to its distribution infrastructures;

Regularly reviewing the Group's liquidity, confirming that the Company was conforming with its financing principles, and noting planned refinancing activities for the year ahead; and

Continually keeping the Group's annual share buy-back under review and then suspending it upon the announcement of the Reynolds American deal.

## Board strategy days

### Delivering growth

In September 2014, the Board held a two-day off-site meeting in the UK to discuss Group strategy.

It addressed the need to accelerate delivery across our strategic pillars given the current industry and regulation trends.

The Director, Marketing presented significant consumer trends, new tools and methodologies to gain consumer insights and opportunities for future growth.

The Board considered the related benefits and likely timeframe with regard to the acquisition of Lorillard by the Group's associate company, Reynolds American Inc.

The Board also received updates on how nicotine-based products are being further developed for commercialisation, after the launch of the Group's Vype product.

### Board meeting in Hong Kong

This meeting, held in October, gave the Board the opportunity to review the businesses in the Asia-Pacific Region. The Board received presentations from each of the Region's key markets and had the opportunity to visit a number of outlets in central Hong Kong where the Group's brands are sold.

**For more information on our Group Strategy**
see pages 14 and 15 of our Strategic Report

## Sustainability

**The Board places considerable emphasis on the need for our business to be sustainable for the long term, to meet the expectations of our stakeholders and inform our commitments to society.**

### Activities in 2014

Approving changes to our Standards of Business Conduct Policy to introduce provisions in relation to human rights and respect in the workplace, including diversity, giving our existing commitments in these areas the status of a global policy. Our code of conduct now underlines that workplace human rights (equality, diversity and mutual respect) and supply chain human rights (particularly child labour) are part of our internal risk and compliance frameworks;

Approving a revised Sustainability Agenda with a focus on: harm reduction; sustainable agriculture and farmer livelihoods; and corporate behaviour;

Reviewing progress on the Group's activities to improve its relationships with its contracted farmers in key markets;

Reviewing the progress made by the Group in securing regulatory approvals for its pipeline of nicotine products;

Reviewing planned investor relations activities for the year ahead, including initiatives to improve engagement with the Group's principal shareholders;

Reviewing the Group's regulatory strategy in the context of the current regulatory landscape, including plain packaging proposals within the EU and their potential implications for the business; and

Receiving updates on complex legacy litigation in relation to pollution in the US and a case involving asbestos claims.

## Winning organisation

**Setting the 'tone from the top' is an important part of the Board's role, helping to foster a culture centred around our Guiding Principles and which harnesses diversity.**

### Activities in 2014

Receiving updates on the progress being made in developing leaders in the Group, in particular the drive for a high performance culture and progress being made with the Executive Development Programme;

Receiving updates on the successful building of the Group's talent brand, particularly on social media sites;

Reviewing the application of the Group's Remuneration Policy during 2014;

Reviewing the progress being made on meeting the Group's diversity ambitions through the specific action plans and enablers put in place to promote diversity within the Group both in relation to women and focus nationalities. Diversity has now been built into all leadership and development programmes and unconscious bias training has been developed and rolled out across the Group;

Reviewing the talent pipeline to the Management Board and confirming proposed appointments, in consultation with the Nominations Committee;

Discussing the role of international assignments in career development plans for senior management; and

Reviewing detailed succession planning at Board level and the need for additional skills and experiences in the next round of Board refreshment, resulting in the appointments of Sue Farr, Pedro Malan and Dimitri Panayotopoulos.

### Sustainability

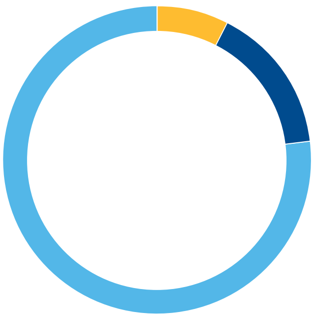
During the strategy meeting in September, the Board reviewed the emerging regulations for the e-cigarette category around the world. An external speaker, an expert in the world of harm reduction, presented his views to the Board and highlighted the strategic opportunities for the Group to help shape the future regulatory environment in this area.

The Board re-emphasised its focus areas, centring around our efforts to deliver safer products, improve consumer information, support evidence-based regulation, maintain transparent business practices and build stakeholder relationships.

GOVERNANCE

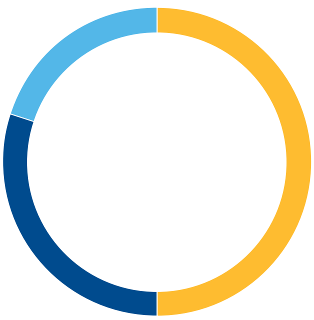
# Board effectiveness

### Balance of Non-Executive Directors and Executive Directors



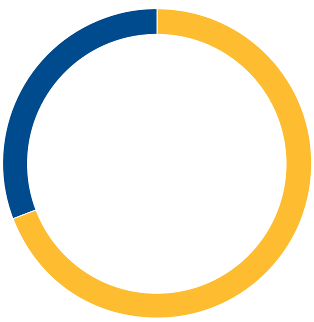
| | |
|---|---|
| Chairman | 1 |
| Executive Directors | 2 |
| Independent Non-Executive Directors | 10 |

### Length of tenure of Non-Executive Directors



| | |
|---|---|
| 0–3 years | 5 |
| 3–6 years | 3 |
| 6–9 years | 2 |

### Gender split of Directors



| | |
|---|---|
| Male | 9 |
| Female | 4 |

Note:
The above graphics reflect the composition of the Board as at the date of this report.

## Balance and diversity

### A balanced Board

Our Non-Executive Directors come from broad industry and professional backgrounds, with varied experience and expertise aligned to the needs of our business. Women constitute over 30% of our Board. Short biographies of the Directors, including details of relevant skills and experience, and nationalities, are set out in the Board of Directors pages in this section (pages 48 and 49).

### Promoting diversity

The Board appreciates the benefit of diversity in all its forms, within its own membership and at all levels of the Group. The Board promotes diversity and is encouraging initiatives to improve gender diversity in senior management roles. You can read our diversity policy, including the proportion of women in our total workforce and in senior management, in the winning organisation section of our Strategic Report on pages 24 and 25.

## Independence and conflicts of interest

### Independence

The Board considers all Non-Executive Directors to be independent, as they have not previously been employed in Group management roles and are free from any business or other relationships that could interfere materially with, or appear to affect, their judgement.

### Conflicts of interest

The Board has formal procedures for managing conflicts of interest in accordance with the Companies Act 2006 and may authorise situational conflicts under the Company's Articles of Association. Directors are required to give advance notice of any conflict issues to the Company Secretary, and these are considered either at the next Board meeting or, if the timing requires it, at a meeting of the Board's Conflicts Committee.

Each year, the Board considers afresh all previously authorised situational conflicts. Directors are excluded from the quorum and vote in respect of any matters in which they have an interest. No material conflicts were reported by Directors in 2014.

## Information and professional development

### Board induction

On joining the Board, all Directors receive a full induction. 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, the Company Secretary and other senior executives. The expected time commitment from Non-Executive Directors for their induction is formalised in our standard letter of appointment and visits to an overseas factory location and the Group's R&D facilities in Southampton are required elements.

Following his appointment in 2014, Savio Kwan received a comprehensive induction including a visit to the Group's R&D facilities in the UK and participation in a market visit to Mexico at the end of March 2014. Induction programmes will also be put in place for Sue Farr, Pedro Malan and Dimitri Panayotopoulos, who were appointed to the Board in February 2015. These will include briefings covering the Group's strategy, organisational structure, business functions (including next-generation products), statutory reporting cycle, financing principles, IT strategy and legal and regulatory issues. They will also attend sessions on corporate governance, internal control and risk management.

### Training and development

Non-Executive Directors are encouraged to attend meetings of the Group's regional Audit and CSR committees, so that they have a good sense of the Group's regional operations as well as the Group's Corporate Audit Committee to gain a better understanding of the Group's central functions such as IT, Finance and Corporate and Regulatory Affairs. The Non-Executive Directors are also each invited to attend a scheduled market visit alongside a Regional Director, so that they gain exposure to the Group's business on the ground. In 2014, Non-Executive Directors visited Romania and Mexico. In addition, a Board meeting was held in Hong Kong.

The Board and its Committees receive regular briefings on legal and regulatory developments. The Board was also briefed on changes to the UK Corporate Governance Code which will impact the reporting cycle for 2015 and the transitional timetable and steps required in identifying and managing a change in external auditors introduced by EU regulation.

The Chairman meets each Non-Executive Director individually, in the latter part of each year, to discuss their individual training and development plans.

**For the Board's access to information and advice** see 'Information and advice' in the Other Corporate Disclosures section on page 110

## Shareholder engagement

### Commitment to dialogue

The Board is committed to high-quality dialogue with shareholders. The Executive Directors lead in this respect, facilitated by the Head of Investor Relations. The Chairman also contacts major shareholders periodically, and in advance of the AGM each year, so he can hear their views and ensure that they are communicated to the Board. The Senior Independent Director and other Non-Executive Directors are available to meet with major shareholders on request. In 2014, Richard Tubb met with an institutional investor following one such request. In early 2015, both the Remuneration Committee Chairman and the Chairman met a number of key shareholders to engage further in relation to the Group's Remuneration Policy. Details of the rationale for proposing changes before the third anniversary of the Policy agreed last year are set out in the Remuneration Report. Following careful consideration of shareholders' responses in relation to these proposals, however, no policy changes are being put forward this year.

### Annual programme

A full programme of engagement with shareholders, potential investors and analysts, in the UK and overseas, is undertaken each year by the Head of Investor Relations. On occasions he is accompanied by one or more Executive Directors and Management Board members. Every two years, combined investor meetings are held over two days with the Management Board in attendance. The next such meeting will be in 2015.

In 2014, as part of the annual programme, 495 meetings were held with over 310 of the Company's institutional shareholders in 20 countries, spanning five continents. In terms of percentage shareholding, the Company engaged with the owners of the majority of its shares. The Chairman had 11 personal meetings with major shareholders in the year. Regular investor presentations were also given, and these together with the results presentations are all published on www.bat.com. All results presentations are available to shareholders by webcast.

In addition, there is a micro site on www.bat.com for debt investors, with comprehensive bondholder information on credit ratings, debt facilities, outstanding bonds and maturity profiles.

The AGM is an opportunity for further shareholder engagement and for the Chairman to explain the Company's progress and, along with other members of the Board, to answer any questions. All Directors attend, unless illness or pressing commitments prevent them. All Directors attended the AGM in 2014, with the exception of Karen de Segundo who was attending the AGM of another company of which she is a Non-Executive Director. Details of our 2015 AGM are set out in the Other Corporate Disclosures section.

Twice a year, the Head of Investor Relations reports to the Board on investor relations activities, identifying key issues raised by institutional shareholders as well as a commentary on share price performance. The Board receives a report at each meeting on any changes to the holdings of the Company's main institutional shareholders.

### Topics of discussion

This year, shareholders were keen to hear more about the Group's NGP strategy and the development of the e-cigarette sector. Developments in industry regulation, including the impact of plain packaging in Australia and the potential impact of more plain packaging regulation in other countries was also of interest, as was the continued roll-out of the Group's new Operating Model and Global IT solution. Macro economic issues, specifically with regard to developments in the Eurozone continue to be key issues for institutional investors. At a market level, continued concerns were expressed about pricing and excise and the impact on the Group, especially with regard to illicit trade.

## Board evaluation

### Evaluation process

In 2014, the Board conducted an internal review of its effectiveness and that of its Committees, the Executive and Non-Executive Directors, and the Chairman. This followed an external review that had been undertaken in 2013. The evaluation was conducted through questionnaires and in-depth interviews with each Board member by the Company Secretary.

A report was prepared for the Board on the results of this exercise, and the principal Committees also considered reports on their own effectiveness, drawn from questionnaires relating specifically to those Committees as well as from comments made in the Board Report.

While the Board and each of its Committees are considered to be fully effective, fresh action points were identified. A summary of the findings is set out in the accompanying table. Our progress against 2014 action points is also included in the summary.

### Constructive feedback

In addition, the Chairman received reports from the Company Secretary on the performance of each of the Executive and Non-Executive Directors. A report on the Chairman's own performance was prepared for the Senior Independent Director. Individual feedback was given by the Chairman to all Board members. All Board members continued to perform well, and each was considered to be making an effective contribution to the Board.

**For disclosures required by paragraph 7.2.6 of the Disclosure and Transparency Rules and the Companies Act 2006** see the Other Corporate Disclosures section on pages 108–114

GOVERNANCE

# Board effectiveness continued

## Board evaluation 2014

### Leadership

#### Findings

The Board is considered to have a clear understanding of the Group's business and the environment within which it operates;

Market visits are particularly appreciated as a useful tool, allowing Non-Executive Directors to see the Group's strategy in action;

The Board understands the regulatory environment within which it operates and receives excellent briefings in this area; and

On strategy, the focus on the long term, particularly on next-generation products, strategic M&A and evolving markets was applauded.

#### Action for 2015

The more recently appointed Non-Executive Directors need to become more familiar with the Company and the industry. Detailed induction plans, as well as market visits, will ensure that all Non-Executive Directors are made aware of the principal challenges and opportunities facing the Group.

#### Progress in 2014

In 2014, the format of market visits was changed to allow the Directors to gain greater insight into a specific aspect of the business. The Chairman, Savio Kwan, Gerry Murphy and Richard Tubb visited Mexico, a commercial and manufacturing hub for the local market and for export to Canada. Christine Morin-Postel, Ann Godbehere and Kieran Poynter accompanied the Chairman on a visit to Romania and reviewed its direct sales delivery operation as well as the support services function for finance.

### Oversight

#### Findings

The Board as a whole is effective in tracking delivery of strategy and in providing the necessary oversight;

The Board has a good view of the Group's activities through participation in the Audit/CSR Committee framework, and risk is monitored by the Board in this context; and

The formal risk management process highlights the key risks to the business. The Non-Executive Directors appreciate that there are also other opportunities for them to consider risks, including at the regional Audit and CSR committees, Corporate Audit Committee and at the in-depth strategy days.

#### Action for 2015

How the Group sets its appetite for risk will be reviewed in the context of the Financial Reporting Council's revised Guidance on Risk Management which was issued in September 2014; and

Time with individual members of the Management Board will further develop the Board's confidence in effective oversight, as well as helping with succession planning.

#### Progress in 2014

Improved risk mapping, including an annual review of stakeholder maps by the CSR Committee, is a good example of how the overall risk profile is being tracked; and

The format change to the market visits has also helped to improve oversight, providing effective deep dives into specific areas of the business, including a focus on relevant CSR and sustainability issues.

### Meetings

#### Findings

The annual Board programme is considered to be comprehensive, agendas to be properly prioritised and papers are of a high quality; and

Issues are debated openly and fully with searching and robust questions posed to management, when necessary.

#### Action for 2015

Regional/functional reviews that deal with specific areas of the Group's business will be included in the Board programme.

#### Progress in 2014

Non-Executive Director feedback on end market visits has become a regular agenda item at Board meetings and generates and informs debates relating to business activities; and

Stakeholder mapping is now incorporated as an annual item on the agenda of the CSR Committee.

### Collective decision making

The Chairman seeks a consensus at Board meetings but, if necessary, decisions are taken by majority. If any Director has concerns on any issue that cannot be resolved, such concerns are noted in the Board minutes. No such concerns arose in 2014.

When required, the Non-Executive Directors, led by the Chairman, meet prior to Board meetings and without the Executive Directors present. The Executive and the Non-Executive Directors also meet annually, led by the Senior Independent Director and without the Chairman present, in order to discuss the Chairman's performance.

## Support

### Findings

The Non-Executive Directors expressed their satisfaction with the induction process and were comfortable with the ongoing level of training and support they receive in performing their duties;

The Non-Executive Directors receive sufficient, relevant and up-to-date information about the Group's business on a regular basis; and

Directors are briefed regularly on their legal duties, the relevant areas of corporate governance and opportunities are given for further training. As mentioned on page 55, the Chairman meets each Non-Executive Director individually, each year, to discuss their training and development plans.

### Action for 2015

Responsiveness and effectiveness to be maintained; and

Using feedback from Sue Farr, Pedro Malan and Dimitri Panayotopoulos following their induction, the induction process will be refined and improved further.

### Progress in 2014

Guidance and support has been provided throughout the year, as required, in the operation of the Board software system and settings have been amended to allow a library of Board papers to be generated.

## Composition

### Findings

All Directors are aware of the current Board refreshment exercise and the need for additional Non-Executive Directors with specific skills and experience; and

At Board level the Group has a relatively good gender balance. However, the Board is concerned to see improved diversity at Executive and senior management level.

### Action for 2015

Planning will commence for the next Board refreshment, which is likely to be required in 2016.

### Progress in 2014

Recognising the strength of the Board's culture and dynamics, the composition matrix considered by the Nominations Committee factored in the balance of individual approaches and styles in addition to specific experience. Recent Board appointments have taken this into account;

The Board throughout 2014 continued to scrutinise plans to promote gender diversity in senior management roles and diversity in its broadest sense across the business; and

Significant progress was made reviewing potential candidates during 2014 leading to the appointment in February 2015 of: Pedro Malan (expertise in finance and extensive experience in Brazil and Latin America); Sue Farr (brand marketing and communications experience); and Dimitri Panayotopoulos (FMCG experience at senior executive level).

## Working together

### Findings

There is an even contribution by all Directors across the variety of topics discussed at Board meetings;

Differences of opinion have been discussed candidly at Board level and a better understanding of different perspectives obtained;

Feedback on the views of institutional investors is accurate and all stakeholder views are taken into account in the Board's decision making; and

Shareholder views have been particularly influential over the Board's consideration of remuneration proposals.

### Action for 2015

The Non-Executive Directors are committed to building good relationships with all members of the Management Board, including those recently appointed, as this will help them with succession planning; and

Market visits and continued attendance by Non-Executive Directors at regional Audit and CSR committees and the Corporate Audit Committee will continue to improve their understanding of the business.

### Progress in 2014

The Chairman held a number of meetings with the Non-Executive Directors without the Executive Directors present throughout the year. These helped to facilitate better working relationships between members of the Board.

GOVERNANCE

# Audit and accountability

Kieran Poynter
Chairman of the Audit Committee

### Audit Committee current members

Kieran Poynter (Chairman)
Ann Godbehere
Christine Morin-Postel

### Attendance at meetings in 2014

| Name | Member since | Attendance/Eligible to attend |
|---|---|---|
| Ann Godbehere[1] | 2012 | 5/5 |
| Christine Morin-Postel[2] | 2014 | 5/5 |
| Kieran Poynter[1] | 2012 | 5/5 |
| Anthony Ruys[3] | 2006–2014 | 2/2 |

Notes:

1. Kieran Poynter and Ann Godbehere have recent and relevant financial experience.
2. Christine Morin-Postel joined the Committee on 6 January 2014. She also served as a member of the Committee from 2007 to 2012.
3. Anthony Ruys ceased to be a member upon his retirement as a Non-Executive Director at the AGM on 30 April 2014.
4. The Finance Director attends all meetings of the Committee but is not a member. Other Directors may attend by invitation. The Group Head of Audit and Business Risk, the Director, Legal and the external auditors also attend meetings on a regular basis.
5. The Committee meets alone with the external auditors and, separately, with the Group Head of Audit and Business Risk, at the end of most meetings.
6. The Committee held five meetings in 2014. All of these were scheduled.

**For the Committee's terms of reference visit**
www.bat.com/governance

## Role

### The Audit Committee monitors and reviews:

- the integrity of the Group's financial statements and any formal announcements relating to the Company's performance, considering any significant issues and judgements reflected in them, before their submission to the Board;
- the consistency of the Group's accounting policies;
- the effectiveness of, and makes recommendations to the Board on, the Group's accounting, risk and internal control systems;
- the effectiveness of the Company's internal audit function; and
- the performance, independence and objectivity of the Company's external auditors, making recommendations as to their reappointment (or for a tender of audit services), and approving their terms of engagement and the level of audit fees.

## Key activities in 2014

### Regular work programme:

- the Group's 2013 results, 2014 half-year results, the external auditors' reports for these, and interim management statements;
- the 2015 Internal Audit Plan;
- periodic reports from the Group's regional Audit and CSR committees and Corporate Audit Committee;
- the Group's Risk Register;
- changes in and application of accounting standards;
- periodic reports from the Group Head of Audit and Business Risk on international audits and the management responses and action plans being put in place to address any concerns raised;
- in-depth reviews of specific risk topics (see further below);
- a report from the Head of Group Security on security risks and frauds and losses arising during the preceding year;
- quarterly reports on compliance with the Group's Standards of Business Conduct;
- the steps taken to validate the 'Going Concern' assessment at half-year and year-end (see 'Going Concern' in the Financial Review);
- the results of the annual goodwill impairment assessment;
- an annual review of the external auditors' independence; and
- reporting on the processes implemented in 2014 following a review in 2013 with regard to the information flows and drafting and approval processes for the preparation of the Annual Report, facilitating the Committee's advice to the Board that the 2014 Annual Report is fair, balanced and understandable.

### Further specific matters considered by the Committee:

- the Group's position and the progress made in tax litigation cases in various jurisdictions;
- the results of the external quality assessment of internal audit, conducted by Ernst & Young LLP at the end of 2013. The function had been reviewed against the global Institute of Internal Auditors standards, as well as a peer benchmarking exercise. Overall, the Group's internal audit function was found to be broadly in line with peer organisations and is leading in some areas, for example, in the use of data analytics to drive a risk-focused and efficient audit process;
- the impact of the Russia/Ukraine conflict on the Group's business with particular regard to the likely disruption to and changes required for continuation of supply;
- the risk of fraud to the Group, undertaken at the Committee's request by Group Security and Internal Audit. Robust controls are in place to prevent and identify fraud and, where evidence of it exists, action is taken against the individuals concerned, including dismissal and the involvement of the relevant authorities. Improvements to existing processes have been identified;
- the regulatory position with regard to the mandatory rotation of external auditors. The Committee agreed the timetable for the rotation of both tax advisers and external auditors. In the ordinary course of business, these are required by 2017 and 2023 respectively;
- the impact on the accounts of the proposal to settle a long-running dispute over dividend payments and asbestos claims with Flintkote, a former Group US company that sold products containing asbestos. Flintkote sued the Group's Canadian subsidiary in 2006 over issues stemming from its acquisition of Genstar Corp., Flintkote's parent company. The terms of the settlement included a payment of US$575 million (£374 million) and the Group also sought to obtain protection from current and potential future Flintkote-related asbestos-liability claims in the US; and
- claims against Sequana and others in relation to the Fox River matter following the assignment of these claims to BTI 2014 LLC, a Group subsidiary and the possible impact of these claims on auditor independence (see page 60).

### Risk topics considered by the Committee:

- **deployment of the Group's revised operating model and single IT operating system** and the realisation of associated benefits, which led to the significant accounting judgement as detailed below;
- **delivery of the Group's pricing strategy** relating to the risk that annual manufacturers' price increases do not materialise;
- **market size and changes to consumer preferences** in an economically challenging climate with steep excise-led price increases;
- **cyber security** and management's approach to the threat of such attacks; and
- **principal causes of risk and the status of risk management activities** including changes to the Group's principal risks over the last year, and reviewing the emerging risk dashboard prepared by an external advisory agency to assess the areas from which new risks to the Group might arise.

### Significant accounting judgements considered by the Committee in relation to the 2014 accounts:

- **the continuing roll-out of the Group's revised operating model and single IT operating system:** given the level of investment, complexity and strategic importance to the Group, the Committee received regular updates from management, internal audit and the external auditors on progress with the roll-out throughout the year (including programme governance, risk and compliance activities). The Committee examined the capitalisation of the IT template as an intangible asset on the Group balance sheet (see note 9 in the Notes on the Accounts), amortisation of IT assets generated as part of the programme, and adjusting items in relation to implementation costs (see note 3(e) in the Notes on the Accounts), and was satisfied that the accounting treatment and disclosure of these matters was appropriate;
- **the Group's significant corporate tax exposures and related provisions:** the Committee was updated periodically on corporate tax issues throughout the year. The Committee considered a report from the Group Head of Tax on the current status of issues in various markets, including significant tax disputes in Brazil, South Africa, Turkey and the Netherlands and a favourable outcome in Canada, and agreed with management's proposed provisions and extended disclosures in respect of them (see note 30 in the Notes on the Accounts);
- **contingent liabilities in connection with ongoing litigation:** the Committee reassessed the provision in respect of the Fox River clean-up costs and related legal expenses subsequent to a funding agreement in relation to the sharing of the costs. As a result, £27 million of this provision has been released (see note 3 in the Notes on the Accounts). However, inherent uncertainties remain (see note 30 in the Notes on the Accounts). The Committee agreed that no provision should be recognised at this point in time in respect of the Kalamazoo River claim. The Committee also agreed that the settlement in the Flintkote claim of £374 million should be recognised as an adjusting item (see note 3 in the Notes on the Accounts);
- **Reynolds American Inc. (RAI) treatment:** during the year the Committee reviewed the accounting treatment of RAI, the Group's US associate company, in which it holds a 42% shareholding. The Group's accounting treatment of RAI as an associate was confirmed. The Group has enhanced disclosures of the key judgements in respect of this matter for 2014 (see note 11 in the Notes on the Accounts); and
- **foreign exchange and restricted cash:** as the Group has operations in certain territories with severe currency restrictions, where foreign currency is not readily available, the Committee satisfied itself that the methodologies used to determine appropriate exchange rates for accounting purposes remained appropriate (for restricted cash, see the footnote to note 19 in the Notes on the Accounts).

GOVERNANCE

# Audit and accountability continued

## External auditors

PricewaterhouseCoopers LLP (PwC) has been the Company's auditors since it listed on the London Stock Exchange in September 1998. The Committee considers that the relationship with the auditors is working well and remains satisfied with their effectiveness.

The Group's implementation of its revised Operating Model and single IT operating system (the TaO Project) is the largest change management project to be conducted for some considerable time. The accelerated roll-out plan spans five years and will, in due course, impact the ways of working for every company within the BAT Group. Consistency of audit approach was therefore the overriding consideration of the Committee in its initial decision not to put the Group's external audit out to tender during 2014 or 2015, the two years covering the biggest deployment groups in the TaO Project. Under the transitional provisions of the Competition and Markets Authority Order on mandatory tendering and audit committee responsibilities, the Group is not required to complete its mandatory tender until mid-2023, a time frame which would allow completion of the TaO Project and the new ways of working to become fully embedded within the Group. However, circumstances arose which prompted the Group to reconsider this position and an audit tender process will now be completed during the first quarter of 2015 (see below). There are no contractual obligations restricting the Company's choice of auditors.

The external auditors are required to rotate the audit partner responsible for the Group audit at least every five years, and those responsible for the subsidiary audits at least every seven years.

### Auditor independence policy

The Committee has an established policy aimed at safeguarding and supporting the independence and objectivity of the Group's external auditors. The key principle of the policy is that the Group's external auditors may be engaged to provide services only in cases where those services do not impair their independence and objectivity, and provided that the total annual fees for non-audit services are below the sum of annual fees for audit and audit-related services.

The external auditors may not be engaged to provide services if the provision of such services would result in the external auditors:

- having a mutual or conflicting interest with any Group company;
- being placed in the position of auditing their own work;
- acting as a manager or employee of any Group company; or
- being placed in the position of advocate for any Group company.

Subject to the above, the external auditors may provide certain tax and other non-audit services. The Committee recognises that using the external auditors to provide such services is often of benefit due to their detailed knowledge of our business, although such services must be put to tender if expected spend exceeds specified limits, unless a waiver of this requirement is agreed by the Finance Director and notified to the Committee.

The Committee also reviews, typically prior to the year-end, a work plan identifying the total fees for all audit-related services, tax services and other non-audit services that it is expected will be undertaken by the external auditors in the following year. Tax services and other non-audit services in excess of the tender thresholds referred to above must be itemised. Updated work plans are also submitted to the Committee at the mid-year and year-end, so that it has full visibility of the Group spend on non-audit services.

A breakdown of audit, audit-related and non-audit fees paid to PricewaterhouseCoopers firms and associates in 2014 is provided in note 3(d) in the Notes on the Accounts and is summarised as follows:

**Services provided by PricewaterhouseCoopers and associates**

| | 2014 £m | 2013 £m |
|---|---|---|
| Audit services | **9.3** | 9.4 |
| Audit-related assurance services | **0.3** | 0.3 |
| **Total audit and audit-related services** | **9.6** | 9.7 |
| Other assurance services | **0.1** | 0.1 |
| Tax advisory services | **3.8** | 2.9 |
| Tax compliance | **0.8** | 1.0 |
| Other non-audit services | **0.2** | 0.6 |
| **Total non-audit services** | **4.9** | 4.6 |

Note:
In 2014 non-audit fees paid to PricewaterhouseCoopers amounted to 51% of the audit and audit-related assurance fees paid to them (2013: 47%).

### Annual assessment

In the ordinary course of business, each year, the Committee assesses the qualification, expertise and resources, and independence of the Group's 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. Ninety surveys were completed this year. Issues were raised with regard to the planning and organisation of the audit of the UK subsidiaries. Following feedback in this area the external audit team have made a number of changes to improve performance.

The Finance Director, General Counsel, Group Head of Internal Audit and Business Risk, Company Secretary and the Committee Chairman all meet with the external auditors throughout the year to discuss relevant issues as well as the progress of the audit. Significant issues are included on the Committee's agenda.

The question of PwC's independence was considered at the December 2014 meeting of the Audit Committee, due to proposed litigation by a Group subsidiary company against the audit firm.

This had been prompted by proceedings, which had, at that time, been issued but not served, by a Group company on PwC. The potential claims against PwC, which have been assigned to the Group, arose from the work carried out by PwC in relation to the audit of the accounts of a third party. This third party is a defendant in other proceedings being brought by the Group. The claim had been issued against PwC, prior to any decision to actively pursue the proceedings, in order to meet the statute of limitations deadline.

PwC and the Group were satisfied that in accordance with the Auditing Practices Board's Ethical Standards, it has been in the interests of shareholders for PwC to complete the 2014 audit. However, it is now likely that legal proceedings against PwC will be pursued. PwC has notified the Group that, in these circumstances, it would not seek re-appointment as the Group's auditors at the AGM on 29 April 2015.

The Audit Committee agreed to conduct an audit tender and for the new appointment to be submitted to shareholders at the AGM in the normal way. The Committee has therefore commenced an audit tender process and it is expected that the successful audit firm will be selected prior to the issue of the Notice of Meeting for the AGM on 27 March 2015.

## Risk management and internal control

### Overview

The Company maintains its system of risk management and 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 Company's objectives. It cannot, and is not designed to, eliminate them entirely. The system therefore provides a 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 our Strategic Report on pages 30–36.

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

### Board oversight

The Board is responsible for determining the nature and extent of the significant risks that the Group is willing to take to achieve its strategic objectives and for maintaining sound risk management and internal control systems. With the support of the Audit Committee, it carries out a review of the effectiveness of the Group's risk management and internal control systems annually and reports to shareholders that it has done so.

This review covers all material controls including financial, operational and compliance controls and risk management systems. As part of its review in 2014, the Board noted that despite a number of changes to the Group Risk Register, which demonstrated its dynamic nature, the Group's risk profile remained stable. As mentioned by the Chairman in this section of the Annual Report, the required 'viability statement' will be formally addressed in the year ahead by the Audit Committee and the Board.

### 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 through the Group, with committees covering locally listed Group entities in certain markets, and covering 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. The Group's regional audit and CSR committees (which are all chaired by an Executive Director and attended by one or more Non-Executive Directors) are in turn supported by area and/or local audit and CSR committees. The Corporate Audit Committee focuses on the Group's risks and control environment that falls outside the regional committees' remit, for example head office central functions, global programmes and projects. It comprises members of the Management Board, is chaired by a Regional Director, and is also attended by one or more of the Non-Executive Directors.

External and internal auditors attend meetings of these committees and have private audiences with members of the committees after every meeting. Additionally, central, regional and individual market management, along with internal audit, supports the Board in its role of ensuring a sound control environment.

## Risk management

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. Information on prevailing trends, for example whether a risk is considered to be increasing or decreasing over time, is provided in relation to each risk and all identified risks are assessed at three levels (high/medium/low) by reference to their impact and likelihood. Mitigation plans are required to be in place to manage the risks identified. The risk registers and mitigation plans are reviewed on a regular basis. Regional and above-market risk registers are reviewed regularly by the relevant regional audit and CSR committee or the Corporate Audit Committee, as appropriate.

At Group level, specific responsibility for managing each identified risk is allocated to a member of the Management Board. The responsible Management Board member is identified in relation to each of the Key Group risk factors set out in our Strategic Report. The Group Risk Register is reviewed regularly by a committee of senior managers, chaired by the Finance Director. In addition, it is reviewed annually by the Board and twice yearly by the Audit Committee. The Board and the Audit Committee review changes in the status of identified risks, assessing the changes in impact and likelihood. The Audit Committee also spends time focusing on selected key risks in detail.

**For more information on risk factors** see the Key Group risk factors section in our Strategic Report on pages 30–36

GOVERNANCE

# Audit and accountability continued

## Internal control

Group companies and other business units are required annually to complete a checklist, called Control Navigator, of the key controls that they are expected to have in place. Its purpose is to enable them to self-assess their internal control environment, assist them in identifying any controls that may need 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.

The results of these reviews are reported to the relevant regional Audit and CSR committees or to the Corporate Audit Committee and, where appropriate, to the Audit Committee to ensure that appropriate remedial action has been, or will be, taken where necessary.

### Internal audit function

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. An external quality assessment of the function was carried out at the end of 2013 and reviewed during 2014, as described at page 59.

### Financial reporting controls

The Group has in place a series of policies, practices and controls in relation to the financial reporting and consolidation process, which are designed to address key financial reporting risks, including risks arising from changes in the business or accounting standards. The Group Manual of Accounting Policies and Procedures sets out the Group accounting policies, its treatment of transactions and its internal reporting requirements. The internal reporting of financial information in order to prepare the Group's quarterly interim management statements and half-yearly and year-end financial statements is signed off by the heads of finance responsible for the Group's markets and business units. The heads of finance responsible for the Group's markets and all senior managers must also confirm annually that all information relevant to the Group audit has been provided to the Directors and that reasonable steps have been taken to ensure full disclosure in response to requests for information from the external auditors. The effectiveness of the Group's financial reporting controls are assessed as part of the Control Navigator exercise described above and evaluated by internal audit in the context of the annual audit plan.

The integrity of the Group's public financial reporting is further supported by a number of additional processes and steps introduced in early 2014, for the 2013 Annual Report, and continued this year, to provide assurance of the completeness and accuracy of the content of the Report and Accounts, and in particular, to assess whether it is "fair, balanced and understandable" in accordance with the regulatory requirements. This resulted in the Chairman of the Committee attending at least one of the internal drafting meetings and engaging with the Finance Director during the drafting process.

### Standards of Business Conduct

The Committee is responsible for monitoring compliance with the Company's Standards of Business Conduct (the Standards), which underpin the Group's commitment to good corporate behaviour. The Standards require all staff to act with high standards of business integrity, comply with applicable laws and regulations, and ensure that standards are never compromised for the sake of results.

Every Group company and all staff worldwide, including senior management and the Board, are expected to live up to the Standards. Guidance on them is provided across the Group, including through training and awareness programmes. All Group companies have adopted the Standards or local equivalents.

As reported in the CSR Committee's report on page 64, this year changes to the Group Standards of Business Conduct Policy were made, introducing new provisions in relation to human rights and respect in the workplace, which also embraces diversity.

Information on compliance with the Standards is gathered at a regional and global level and reported to the regional Audit and CSR committees and to the Committee.

The Standards, and information on the total number of incidents reported under them in 2014 (including established breaches), is available at www.bat.com/governance. The number of incidents is reviewed by Ernst & Young LLP as part of its process for providing assurance of our annual Sustainability Report. Its full assurance statement is available at www.bat.com/assurance.

In the year to 31 December 2014, 56 instances of suspected improper conduct contrary to the Standards (excluding non-material employee fraud and theft against Group companies) were reported to the Committee (2013: 22). The increase is considered to be attributable to an awareness campaign launched following the adoption of the revised Standards in 2014.

Twenty were established as breaches and appropriate action taken (2013: 9). In 31 cases, an investigation found no wrongdoing (2013: 10). In five cases, the investigation continued at the year-end (2013: 3). No instances involved sums or matters considered material to the Group.

### Whistleblowing

The Standards also set out the Group's whistleblowing policy, enabling staff, in confidence, to raise concerns without fear of reprisal. The policy is supplemented by local procedures throughout the Group and at the Group's London headquarters, providing staff with further guidance and enabling them to report matters in a language with which they are comfortable. The Committee receives quarterly reports on whistleblowing incidents. It remains satisfied that the Group's policy and procedures enable proportionate and independent investigation of matters raised and ensure appropriate follow-up action is taken.

Of the total number of business conduct incidents reported in 2014, set out above, 42 were brought to management's attention through whistleblowing reports from employees, ex-employees, third parties or unknown individuals reporting anonymously (2013: 18). The increase is also considered to be a result of the increased awareness training offered during 2014.

### Political contributions

The Committee is responsible for reviewing donations made for political purposes throughout the Group. British American Tobacco Japan Limited reported contributions totalling Japanese yen 560,000, (approx. £3,214) for the full year 2014 (2013: nil). This expenditure is reported as a political contribution although it related specifically to the purchase of tickets to receptions hosted by Members of Parliament (MPs). Representatives from British American Tobacco Japan Limited engaged with these MPs at the receptions on local tobacco tax issues. No other political donations were reported.

## Annual 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 risk management and internal control. The processes described above, and the reports that they give rise to, enable the Board and the Committee to monitor the risk management and internal control framework on a continuing basis throughout the year and to review its effectiveness at the year-end. The Board, with advice from the Committee, has completed its annual review of the effectiveness of the system of risk management and internal control for 2014.

No significant failings or weaknesses were identified and the Board is satisfied that, where areas for improvement were identified, processes are in place to ensure that remedial action is taken and progress is monitored. The Board is satisfied that the system of risk management and internal control accords with the Guidance.

GOVERNANCE

# Corporate social responsibility


Karen de Segundo
Chairman of the CSR Committee

## CSR Committee current members

| | |
|---|---|
| Karen de Segundo (Chairman) | Dr Pedro Malan |
| Sue Farr | Dr Richard Tubb |
| Savio Kwan | |

## Attendance at meetings in 2014

| Name | Member since | Attendance/Eligible to attend |
|---|---|---|
| Sue Farr[1] | 2015 | n/a |
| Savio Kwan[2] | 2014 | 2/2 |
| Dr Pedro Malan[1] | 2015 | n/a |
| Christine Morin-Postel[3] | 2012 | n/a |
| Karen de Segundo | 2008 | 2/2 |
| Dr Richard Tubb | 2013 | 2/2 |

Notes:
1. Sue Farr and Pedro Malan became members of the Committee on 2 February 2015 following their appointments as Non-Executive Directors.
2. Savio Kwan became a member of the Committee on 6 January 2014 following his appointment as a Non-Executive Director on that date.
3. Christine Morin-Postel ceased to be a member of the Committee on 6 January 2014.
4. The Chairman, Chief Executive and the Management Board members responsible for Corporate and Regulatory Affairs and Global Operations regularly attend meetings by invitation but are not members.
5. The Committee held two meetings in 2014. Both were scheduled.

**For the Committee's terms of reference visit**
www.bat.com/governance

## Role

### The CSR Committee monitors and reviews:

- the Company's management of CSR and the conduct of business in accordance with our Statement of Business Principles, making appropriate recommendations to the Board on CSR matters;
- the effectiveness of the Group's strategy for, and management of, significant social, environmental and reputational issues;
- the Group's sustainability plans and activities; and
- the effectiveness of CSR governance including, on an exceptional basis, reports from the regional Audit and CSR committees.

## Key activities in 2014

### CSR governance and compliance

- considering Group risks in the countries that are of potential concern from a human rights perspective, and reviewing the measures and controls in place to mitigate those risks;
- considering feedback from the regional Audit and CSR committees and considering CSR-related internal audit reports and recommendations, including in relation to the Group's approach to environmental, health and safety (EHS) issues;
- reviewing the Group's EHS strategy, measures, targets and performance data;
- reviewing the progress of the Group's leaf strategy, aimed at enhancing farmers' livelihoods and sustainable agriculture;
- reviewing the potential reputational impact arising from incidents of non-compliance with the Standards of Business Conduct;
- monitoring adherence to the Group's International Marketing Principles (IMP);
- reviewing the Group's youth smoking prevention (YSP) activities, and analysis of their global reach and impact; and
- reviewing the Group's corporate social investment strategy, plans and activities.

### Sustainability planning and reporting

- approving a revised Group Sustainability Agenda developed through a detailed materiality process;
- reviewing an update of the Group's stakeholder mapping and classification process and in line with the 2013 Board evaluation action points, reviewed the results of the Group 2014 stakeholder map;
- reviewing the 2013 Sustainability Summary and the two Sustainability Focus Reports on harm reduction and supporting farmers' livelihoods published on 3 and 17 November 2014 respectively;
- assessing progress against the Group's sustainability goals and commitments; and
- considering the Group's 2015 sustainability reporting plans.

## Group sustainability agenda

Our sustainability agenda is an integral part of delivering the Group strategy. The sustainability agenda aims to build shared value for our consumers, our shareholders and our stakeholders. This concept of shared value underpins our whole approach.

Through a detailed materiality process, including stakeholder dialogue and research, the Group's sustainability agenda was sharpened in 2014. The new agenda covers the three key areas that have the greatest significance to our business and our stakeholders.

These are:

- **harm reduction:** we are committed to researching, developing and promoting a range of innovative tobacco and nicotine products to enable adult consumers to have a choice of less risky alternatives to regular cigarettes;
- **sustainable agriculture and farmer livelihoods:** we are committed to working to enable prosperous livelihoods for all farmers who supply our tobacco leaf, benefiting rural communities and the environment; and
- **corporate behaviour:** we are committed to operating to the highest standards of corporate conduct and transparency, benefiting government, consumers, the environment and our people.

**For information on our greenhouse gas emissions see**
the sustainability section of our Strategic Report on pages 26 and 27

## Upholding high standards and supporting human rights

A central part of being a sustainable business is operating with integrity and responsibility. Effective governance is critical to ensuring that we live up to our principles and standards and also that we deliver on our sustainability agenda. We have clear policies and standards in place that set the standard for the way we do business and how we behave.

The Group's Statement of Business Principles sets out the expectations for responsible management of the Group's business. It was developed in 2002 in consultation with stakeholders, supported by the Institute of Business Ethics.

The Statement comprises three principles – Mutual Benefit, Responsible Product Stewardship and Good Corporate Conduct – and 18 Core Beliefs explaining each principle in more detail.

**To view our Statement of Business Principles visit**
www.bat.com/governance

Our Standards of Business Conduct are an integral part of the Group's governance and, together with our Business Principles, underpin our commitment to high standards of corporate responsibility. While the Statement of Business Principles sets out our beliefs and values as an organisation, the Standards of Business Conduct apply those values and principles to specific situations that may arise in day-to-day business life.

When the UN published its 'Guiding Principles on Business and Human Rights' in 2011, it placed an expectation on governments and global enterprise to address the role business plays in the promotion and protection of human rights. In 2014, the Standards were updated to reflect a new policy area of workplace and human rights. Although our Group Employment Principles already reflected the business-relevant human rights components they lacked the status of a global policy. As a result our enhanced human rights provisions are now bound into our internal compliance framework by way of Standards of Business Conduct governance. They underline the principles of workplace human rights – equality, diversity and mutual respect – and supply chain human rights, particularly with regard to our commitments to support the elimination of child labour, exploitation of labour and respect for freedom of association.

**For information on our approach to human rights see**
the sustainability section of our Strategic Report on pages 26 and 27

The Company also 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 a means of maintaining good relationships with local communities, rather than as a means of promotion. Over the last five years, the Group has invested more than £60 million in CSI activities worldwide.

## Sustainability reporting

We are a major international business in a controversial sector, so it is particularly important that we demonstrate openness and build trust.

The Company has produced independently assured reports since 2001 and believes this long history of reporting demonstrates a serious commitment to transparency, corporate responsibility and sustainability.

Our sustainability reporting aims to provide focused and integrated sustainability communications for our stakeholders across different formats. This includes an annual Sustainability Summary, regular Focus Reports and a dedicated online performance centre – all independently assured by Ernst & Young LLP.

The Sustainability Summary is published at the same time as the Company's Annual Report and covers our performance for the year across the key focus areas of our sustainability agenda. This is complemented by our online Sustainability Performance Centre covering progress against our goals, data charts and our reporting against the Global Reporting Initiative (GRI) G4 indicators.

Our Sustainability Focus Reports each cover specific topics and provide stakeholders with more in-depth information on the areas that interest them most.

**To view our Sustainability Summary and Focus Reports visit**
www.bat.com/sustainability

## External recognition

As a result of the Group's progress in embedding sustainability practices into its day-to-day business, British American Tobacco has received notable external recognition in 2014. This includes maintaining its industry leadership position in the Dow Jones Sustainability Indices (DJSI) and inclusion for the 13th consecutive year. The Company's overall score was 89%, its highest ever score. The Indices track the economic, environmental and social performance of leading sustainability-driven companies worldwide and are based on the cooperation between Dow Jones Indices and RobecoSAM, a sustainability investment specialist.

In RobecoSAM's Sustainability Yearbook we were named industry leader and placed in the highest Gold Class category. The Yearbook lists the world's most sustainable companies in each industry as determined by their score in the DJSI Assessment.

We were also listed as a component of the STOXX Global ESG Leaders indices, an innovative series of environmental, social and governance (ESG) equity indices owned by Deutsche Börse (the German Stock Exchange). This index model allows investors to understand which factors determine a company's ESG rating and why these factors are important.

In addition, we received top 10 global rankings in a number of sustainability reporting awards.

GOVERNANCE

# Appointments to the Board

Richard Burrows
Chairman of the Nominations Committee

## Nominations Committee current members

| | |
|---|---|
| Richard Burrows (Chairman) | Dr Gerry Murphy |
| Sue Farr | Dimitri Panayotopoulos |
| Ann Godbehere | Kieran Poynter |
| Savio Kwan | Karen de Segundo |
| Dr Pedro Malan | Dr Richard Tubb |
| Christine Morin-Postel | |

## Attendance at meetings in 2014

| Name | Member since | Attendance/Eligible to attend |
|---|---|---|
| Richard Burrows | 2009 | 5/5 |
| Christine Morin-Postel | 2007 | 5/5 |
| Sue Farr[1] | 2015 | n/a |
| Ann Godbehere | 2011 | 5/5 |
| Savio Kwan | 2014 | 5/5 |
| Dr Pedro Malan[1] | 2015 | n/a |
| Dr Gerry Murphy | 2009 | 5/5 |
| Dimitri Panayotopoulos[1] | 2015 | n/a |
| Kieran Poynter | 2010 | 5/5 |
| Karen de Segundo | 2007 | 5/5 |
| Dr Richard Tubb | 2013 | 5/5 |
| Anthony Ruys[2] | 2006 | 1/1 |

Notes:
1. Sue Farr, Pedro Malan and Dimitri Panayotopoulos became members of the Committee on 2 February 2015 following their appointment as Non-Executive Directors.
2. Anthony Ruys ceased to be a member upon his retirement as a Non-Executive Director at the AGM on 30 April 2014.
3. The Chief Executive and Group Human Resources Director regularly attend meetings by invitation but are not members.
4. The Committee held five meetings, two of which were convened at short notice to consider Management Board succession plans as well as Board appointments.

**For the Committee's terms of reference visit**
www.bat.com/governance

## Role

### The Nominations Committee is responsible for:

- reviewing the structure, size and composition of the Board and Management Board to ensure both have an appropriate balance of skills, expertise, knowledge and (for the Board) independence;
- reviewing the succession plans for the Executive Directors and members of the Management Board;
- ensuring that the procedure for appointing Directors is rigorous, transparent, objective, merit-based and has regard for diversity;
- making recommendations to the Board on suitable candidates for appointments to the Board and Management Board; and
- assessing the time needed to fulfil the roles of Chairman, Senior Independent Director and Non-Executive Director, and ensuring Non-Executive Directors have sufficient time to fulfil their duties.

## Key activities in 2014

- reviewing succession planning for the Executive Directors and for the Management Board;
- considering appointments to the Management Board, as proposed by the Chief Executive, and recommended to the Board;
- reviewing the creation of bespoke development plans for high potential candidates for Executive Director and Management Board roles (covering the key experience required for further progression, mentoring and education opportunities);
- agreeing the skills and experience profile for candidates including general management experience in an international FMCG company, consumer marketing experience and a background in emerging markets;
- agreeing on the appointment of external search agencies;
- discussing the impact of the remuneration policy on the succession plans for the Chief Executive; and
- the recruitment of the new Non-Executive Directors.

## Terms of appointment to the Board

Details of the Directors' terms of appointment to the Board are contained in the Remuneration Policy which is set out in full in the Annual Report 2013 on www.bat.com. 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 for one year. Their expected time commitment is 25–30 days per year. The Board takes into account the need for it to refresh its membership progressively over time. Non-Executive Directors are normally expected to serve for up to six years. They may be invited to serve for longer, but additional service beyond six years is subject to rigorous review and service beyond nine years is unlikely.

The Committee is responsible for identifying candidates for positions on the Board. This process includes an evaluation of the skills and experience to be looked for in candidates to ensure continuing Board balance and relevant experience. The selection process will generally involve interviews with several candidates, using the services of specialist external search firms to identify and shortlist appropriate candidates. A balanced list including both genders is a requirement of any shortlist. This process was followed for the recruitment of the new Non-Executive Directors. They were shortlisted and/or benchmarked by independent external consultancies, Odgers Berndtson and the Inzito Partnership, and interviewed by the Chairman, the Executive Directors and members of the Committee, which then recommended their appointment to the Board.

An explanation of the Group's diversity policy appears on page 24 of this report.

## Annual General Meeting 2015

At this year's AGM on 29 April 2015, the Company will be submitting all eligible Directors for re-election and, in the case of Pedro Malan, Sue Farr and Dimitri Panayotopoulos, election for the first time. The Chairman's letter accompanying the AGM Notice confirms that all Directors being proposed for re-election are effective and that they continue to demonstrate commitment to their roles as Non-Executive Directors. Biographical details are also provided.

REMUNERATION REPORT

# Annual Statement

Dr Gerry Murphy
Chairman of the Remuneration Committee

## Dear Shareholder

Throughout 2014 the Remuneration Committee has continued in its efforts to ensure that our Remuneration Policy represents an appropriate framework for executive remuneration at British American Tobacco, remaining true to a number of key principles:

- alignment of policy with long-term shareholder interests and delivery of the Company's strategy;
- incentive plans that are simple and transparent, i.e. a framework of a single long-term and a single short-term incentive scheme; and
- ensuring that British American Tobacco remains competitive in recruiting and retaining top talent internationally, as befitting the global nature of its business, while remaining aligned to the UK market.

Adherence to these principles prompted us to make a number of changes to our policy last year, following extensive consultation with a number of major shareholders. By way of summary, those changes and their rationale were as follows:

i) improving the alignment of our LTIP performance metrics to business strategy via the introduction of a net turnover (NTO) growth parameter;

ii) increasing alignment of interests between management and shareholders through higher minimum shareholding requirements (400% for the Chief Executive; and 250% for the Finance Director); and

iii) strengthening the link between individual performance and reward outcomes by means of a bonus adjustment factor in the short-term incentive scheme.

### Engagement with shareholders

Notwithstanding these changes, several factors arose in 2014 which have prompted further scrutiny and analysis by the Board and the Remuneration Committee, resulting in a further round of engagement with major shareholders on possible revisions to our policy.

**The key factors were, first, the impact of the relatively dramatic movements in sterling exchange rates over the last 12 months which have substantially de-linked long-term rewards for management from the underlying strong performance of the business** as manifested by consistently high single digit EPS growth when measured on a constant currency basis, and market-share growth at the expense of competitors. The principal problem has been the effect of translating the results of the Company's global operations into its reporting currency, sterling, at a time of the dramatic depreciation of a number of British American Tobacco's key trading currencies including those of Brazil, South Africa, Australia, Russia, Canada and Japan.

**Secondly, the impact of these exchange rate movements on actual LTIP outcomes has highlighted the emergence of a clear gap between British American Tobacco and its relevant peers in terms of Chief Executive's earnings potential.** As noted above, a key principle of the Company's remuneration framework is to recruit and retain top talent in a highly competitive global market while remaining aligned to UK market practice. While our Chief Executive's base salary, benefits and short-term bonus opportunity are broadly competitive, the reward opportunity from long-term incentives is not.

Accordingly, I wrote to major shareholders in late 2014 and, in early 2015, Richard Burrows and I engaged with over 30 of our largest shareholders to gauge their opinions on, inter alia, changing the measurement of EPS growth to a constant currency basis to eliminate the effect of translation anomalies and to increasing the Chief Executive's reward potential under the LTIP. Given the diversity of viewpoints and the feedback received from those consulted, and the importance attached by the Committee and the Board to reflect the views of investors in our decisions, we decided not to propose policy changes in these areas at this time.

Consequently, the only forward-looking changes will be the implementation of clawback clauses in each of our principal incentive schemes, in line with the requirements of the 2014 UK Corporate Governance Code and which are elaborated upon in the body of this Report.

### Performance in 2014

As the Chief Executive's overview highlights, the Group's performance in 2014, in a challenging market environment significantly impacted by currency movements, demonstrates that the Group is making excellent progress to increase its share of the global cigarette market and growing Global Drive Brands. In addition, pricing supported by strong brands and innovation, significant reductions in cost base and improving productivity have continued to drive improvements in operating margin. In the face of a challenging global economic environment, the robustness of the Group's performance against the four measures of its annual IEIS incentive scheme – profit, cash and the key strategic measures of market share and Global Drive Brands' growth – is evident in awards achieved for the Chief Executive and the Finance Director of 121.9% and 109.7% respectively. I set out below how, this year, the evaluation of each Director's individual performance has impacted upon this award by application of the performance adjustment factor approved by shareholders last year.

As noted earlier, the vesting level of the 2012 LTIP award at 0% is significantly impacted by foreign exchange movements, most obviously in respect of the EPS growth metric: in spite of achieving a compound annual growth rate (CAGR) of 7.3% (adjusting for UK inflation) when measured on a constant currency basis over a three-year period, currency headwinds result in an EPS CAGR of only 0.2% (above UK inflation) when measured on a current exchange basis over the same three-year period. The anomaly of a strong underlying performance of the Group and its non-recognition in the form of LTIP vesting prompted the Committee to discuss changing the basis of the EPS metric, as referred to above. While we have decided not to proceed with this change, the underlying issue – the potential anomalies caused by sterling's fluctuations on reward outcomes – remains unresolved.

REMUNERATION REPORT

# Annual Statement continued

## Individual performance adjustment factor and annual salary increases

The Committee considered this year, for the first time, the operation of the performance adjustment factor to the short-term incentive (IEIS) scheme outcome based on individual performance. The Remuneration Committee has concluded that both the Chief Executive and the Finance Director have each delivered an exceptionally strong level of personal performance, against their objectives. In our judgement, their individual contributions have been pivotal in enabling the Company to deliver a strong performance versus key strategic metrics amid a backdrop of intense economic volatility globally and political instability in important markets and in particular to outperform its principal competitors against the key operating metrics. Of particular weight in the Committee's consideration has been this strong delivery versus operational metrics while maintaining an unrelenting focus on driving the Group's long-term strategic agenda, including:

- making significant investments to nurture the growing next-generation products portfolio;
- progressing a significant global investment in an integrated Group information system; and
- making important progress with its China JV with international launches of Shaung Xi.

Moreover, both Executive Directors have strengthened discernibly the senior talent and succession pipelines in the Group, a key performance area from the Board's perspective.

Consequently, in the Committee's judgement, these outstanding personal performances merited the application of the highest performance adjustment factor i.e. an uplift of 20% on their IEIS award as derived from the Group performance formula. The impact of the performance adjustment factors are as follows:

- for the Chief Executive, an award of 121.9% of salary based upon corporate performance is adjusted upwards by a further 20%, based on our assessment of his individual performance, to 146.3% of base salary; and
- for the Finance Director, an award of 109.7% of salary based on corporate performance is adjusted upwards by a further 20%, based on our assessment of his individual performance to 131.6% of base salary.

We do not take lightly the application of this upwards adjustment factor, particularly so in the first year of its operation. However, the Board was unanimous in its judgement that both Nicandro Durante and Ben Stevens had delivered exceptional personal performances versus their previously agreed objectives. Finally, we committed last year to showing the distribution of outcomes for the senior management population to whom the performance adjustment factor has been applied. In line with this undertaking, the distribution is shown graphically in the Remuneration Report, indicating that some 23% of this managerial group of over 230 employees was evaluated as 'Outstanding', the majority delivering 'Successful' individual performances while some 12% were considered to fall below this level.

As noted in last year's Remuneration Report, annual salary increases for Executive Directors will be generally in line with those for other UK-based employees. The introduction of the individual performance adjustment factor now represents the principal manner in which outstanding individual performance can be recognised (and conversely, via a decrement, poor individual performance can be penalised). In line with this commitment, the Committee has awarded annual salary increases to both the Executive Directors that are consistent with the general increase applied to other UK employees of the Company.

Overall, in arriving at its conclusions, the Committee has tried to strike an appropriate balance between the long-term interests of the business and its shareholders such that British American Tobacco can continue to attract and retain top talent in a globally competitive marketplace. I hope we can count on our shareholders to support our approach generally, and specifically to support our Annual Report on Remuneration at the forthcoming AGM.

**Dr Gerry Murphy**
Chairman of the Remuneration Committee

The following Policy Report and Annual Report on Remuneration have been prepared in accordance with the relevant provisions of the Companies Act 2006 and as prescribed in The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (the Regulations). Where required, data has been audited by PricewaterhouseCoopers LLP and this is indicated appropriately.

REMUNERATION REPORT

# At a glance

## Our policy in 2014

| Remuneration element YE 31 December 2014 | Chief Executive (Nicandro Durante) | Finance Director (Ben Stevens) |
|---|---|---|
| Base salary from 1 April 2014 | – £1,155,000 (+5%) | – £841,500 (+3%) |
| Short-term incentives: IEIS opportunity 50% cash 50% deferred shares (DSBS) | Maximum bonus opportunity: **200%** of base salary. On-target opportunity: **100%**. | Maximum bonus opportunity: **180%** of base salary. On-target opportunity: **90%**. |
| Short-term incentives: Performance adjustment and malus | Up to **20% uplift** possible if individual performance is assessed as outstanding (up to the maximum opportunity of 200% or 180%). A **50% reduction** is possible if individual performance is assessed as poor. Malus facility in place. | |
| Short-term incentives: IEIS – performance measures and weightings (%) | – Adjusted profit from operations **(40%)**<br>– Increase in the Group's share of key markets **(20%)**<br>– Global Drive Brand and Key Strategic Brands volumes **(20%)**<br>– Cash flow from operations **(20%)** | |
| Long-term incentives: LTIP Awards 2014 opportunity | Maximum vesting: shares to a value of **400%** of base salary at time of award. Threshold vesting: 20% of maximum (80% of base salary). | Maximum vesting shares to a value of **300%** of base salary at time of award. Threshold vesting: 20% of maximum (60% of base salary). |
| Long-term incentives: Dividend equivalent payment and malus | Dividend equivalent payment on all vesting shares. Malus facility in place. | |
| Long-term incentives: LTIP Awards 2014 – performance measures and weightings (%) | **TSR** Performance versus international FMCG companies comparator group **(25%)**.<br>**EPS** Adjusted diluted EPS growth at current rates of exchange **(50%)**.<br>**NTO** CAGR of net turnover at constant rates of exchange **(25%)**. Underpin: no NTO element payable unless the corresponding three-year constant currency CAGR of underlying profit exceeds the CAGR of the threshold performance level for underlying operating profit (as defined annually in the IEIS). | |
| Pension | **UURBS (UK):** accrual of 2.5% per annum for each year of service on a basic salary in excess of £788,328 per annum from 1 April 2014. | (1) **Pension Fund (UK):** retains a scheme-specific salary cap (currently £146,400 effective 1 April 2014). Benefits in excess of the cap are accrued in the UURBS. Where accrual exceeds the UK regulated allowances, benefits are adjusted to remain within these limits and the balance is provided through the UURBS.<br>(2) **UURBS (UK):** pension accrual in the UURBS is at the same rate as in the Pension Fund (1/40 per annum). |
| Shareholding requirements | **400%** of salary | **250%** of salary |
| Changes in policy from 2013 | **IEIS:** Introduction of up to 20% IEIS uplift (within maximum opportunity) for outstanding personal performance. Global Drive Brands and Key Strategic Brands volume metric amended to include Rothmans as a GDB and the brands State Express 555 and Shuang Xi as Key Strategic Brands. Malus facility introduced into the deferred share (DSBS) element.<br>**LTIP:** TSR measure against FTSE 100 companies replaced with NTO multi-year growth with underlying profit underpin. EPS measure changed to absolute growth range of 5–10% based on current rates of foreign exchange.<br>**Shareholding requirements:** Increased to 400% (from 300%) for Chief Executive and 250% (from 200%) for Finance Director. | |

REMUNERATION REPORT

# At a glance

## Our Remuneration outcomes 2014

### KPIs and business measures performance year-end 2014

The performance measures (KPIs) for the management incentive schemes reflect the alignment of management's strategic focus areas with the interests of our shareholders.

| Measure | Strategic focus area | Strategic target or objective | Management incentive | Weighting % | Indicative outcome 2014[1] | Actual performance 2014 |
|---|---|---|---|---|---|---|
| Group share of key markets | Growth | To continue to grow market share | IEIS | 20 | Target | +0.1% |
| Global Drive Brands (GDB) and Key Strategic Brands (KSB) volumes | Growth | To increase GDB and KSB volumes faster than the rest of our portfolio | IEIS | 20 | Maximum | +6.5% |
| Adjusted profit from operations | Productivity | To grow adjusted profit from operations on average by 6% per year over the medium to long term | IEIS | 40 | Target | +4% |
| Cash flow from operations | Productivity | To generate optimal cash flow while continuing to support business requirements. The target for 2014 was exceeded | IEIS | 20 | Maximum | +8% |
| Note 1: | | Specific IEIS bonus targets are considered to be commercially sensitive and are not disclosed. | | | | |
| Adjusted earnings per share (EPS) | Growth | To grow EPS by high single figures per year, on average, over the medium to long term | LTIP (2012 Awards) | 50 | Below median | 0.2% |
| Total shareholder return (TSR) – FTSE 100 Index | Growth | To grow shareholder value relative to peers | LTIP (2012 Awards) | 25 | Below median (12.4%) | 11.4% |
| Total shareholder return (TSR) – FMCG group | Growth | To grow shareholder value relative to peers | LTIP (2012 Awards) | 25 | Below median (14.6%) | 11.4% |

| Year-end 2014 Outcomes: Executive Directors | Chief Executive (Nicandro Durante) | Finance Director (Ben Stevens) |
|---|---|---|
| Short-term incentives IEIS | **121.9%** on the corporate result plus performance uplift of 20% on the corporate result: total **146.3%** | **109.7%** on the corporate result plus performance uplift of 20% on the corporate result: total **131.6%** |
| Long-term incentives LTIP – 2012 awards | **00.0%** | **00.0%** |

| Policy implementation 2014: Non-Executive Directors | Chairman (Richard Burrows) – fees from 1 April 2014 | |
|---|---|---|
| | £632,400 (+2%) | |
| | **Non-Executive Directors – fees from 1 January 2014** | |
| Base fee | £90,000 (no change) | |
| Supplements: | | |
| Senior Independent Director | £30,000 (no change) | |
| Audit Committee | Chairman: £30,000 (no change) | Member: £6,000 (reduced from £6,250) |
| CSR Committee | Chairman: £25,000 (no change) | Member: £6,000 (reduced from £6,250) |
| Nominations Committee | Chairman: £– (no change) | Member: £6,000 (new fee introduced) |
| Remuneration Committee | Chairman : £30,000 (no change) | Member: £6,000 (reduced from £6,250) |

REMUNERATION REPORT

# Policy Report

## Introduction

The Remuneration Policy for the Executive Directors and the Non-Executive Directors, approved by shareholders at the AGM on 30 April 2014, is set out in full in the Annual Report 2013 on www.bat.com. A summary of its key elements is set out in this policy section of the Remuneration Report in the form of the Future Policy Table (Executive Directors) and the Remuneration Table (Non-Executive Directors and the Chairman).

## Principles of remuneration

The Committee's remuneration principles are to:

- conduct an annual review to ensure that the policy is both rigorously applied and remains aligned with business needs to promote the long-term success of the Company;
- reward, as an overriding objective, the delivery of the Group's strategy in a manner that is simple, straightforward and understandable;
- structure a remuneration package that is appropriately positioned relative to the market and comprises core fixed elements (base salary, pension and other benefits) designed to recognise the skills and experience of our Executive Directors and to ensure current and future market competitiveness in attracting talent;
- provide a remuneration package based on two performance-based variable elements (a single cash and share incentive annual bonus plan (IEIS), and a single long-term incentive scheme (LTIP)) which are designed to be both transparent and stretching and to motivate and reward the delivery of growth to shareholders on a long-term sustainable basis; and
- maintain an appropriate balance between both fixed and performance-related remuneration (and immediate and deferred remuneration): the performance-based elements form an approximate range of 70%–80% of the total remuneration package.

**For Annual Reports visit** www.bat.com/annualreport

## Strengthening alignment to strategy and shareholders' interests

During the year, the Company has implemented the changes approved by shareholders as part of our Remuneration Policy at the AGM in April 2014. The key changes were: (1) to improve the alignment of the Company's LTIP performance metrics to its business strategy through the introduction of the net turnover (NTO) growth parameter; (2) the alignment of interests between management and shareholders through higher minimum shareholding requirements for the Chief Executive (now 400%) and the Finance Director (now 250%); and (3) to strengthen the link between individual performance and reward outcomes for the short-term incentives by means of a bonus adjustment factor in the International Executive Incentive Scheme (IEIS).

The outcomes of these policy changes are reported in detail in the Annual Report on Remuneration.

As highlighted in the Annual Statement of the Remuneration Committee Chairman, the Committee's annual review of the remuneration framework during 2014 focused on two areas of emerging concern to the Committee as well as developments in best practice. In particular, the Committee examined:

(1) the growing and continuing impact of the appreciation of sterling on the measurement of the Company's performance; and

(2) the identification of a clear and unsustainable competitive gap between the Company and its relevant peers in terms of the earnings potential for the Chief Executive.

Proposals to address these concerns were shared with the Group's key institutional investors as part of a consultation process in early 2015. Given the mixed feedback that was received, however, the Committee has decided not to propose any changes to the Remuneration Policy for this year.

In September 2014, the UK Corporate Governance Code was revised requiring companies to put in place arrangements enabling them to recover or withhold variable pay when appropriate to do so (Provision D.1.1). The Company is therefore introducing clawback elements to awards which may be made under both the short-term and long-term incentives. These changes are identified in the Future Policy Table (Executive Directors). The introduction of clawback is not deemed to be a change requiring approval by shareholders. There are therefore no proposed changes to the approved policy which require a shareholders' vote for 2015.

REMUNERATION REPORT

# Policy Report continued

## Future Policy Table – Executive Directors

This table sets out the remuneration elements of the policy as approved by shareholders at the AGM on 30 April 2014. It identifies and includes the introduction of provisions under the rules of the schemes to enable the clawback of awards in certain circumstances under the short-term (IEIS) and long-term incentives (LTIP). The complete approved policy continues to be displayed in full on the Company's website.

| Base salary | |
|---|---|
| **How the element supports the Company's strategic objectives** | To attract and retain high-calibre individuals to deliver the Company's strategic plans by offering market competitive levels of guaranteed cash; to reflect an individual's skills, experience and role within the Company. |
| **Operation of the element** | **Base salary** is paid in 12 equal monthly instalments during the year.<br>Salaries are normally reviewed annually in February (with salary changes effective from April) or subject to an ad hoc review on a significant change of responsibilities. Salaries are reviewed against general UK pay trends and a company size and complexity model based on UK companies, as well as a **Pay Comparator Group,** the constituents of which at the date of this report are as follows:<br>AstraZeneca; GlaxoSmithKline; Reckitt Benckiser; Tesco<br>BP; Imperial Tobacco Group; Reed Elsevier; Unilever<br>BT Group; Pearson; Royal Dutch Shell; Vodafone<br>Diageo; Philip Morris International; SABMiller; WPP Group<br>Further reference is also made for discussion purposes only to published salary data of internationally listed companies of a similar size and complexity. The Committee will exercise its judgement to vary the constituents of the Pay Comparator Group over the life of this Remuneration Policy.<br>Base salary is pensionable.<br>There are no contractual provisions for clawback or malus in place for this element. |
| **Maximum potential value** | Current levels stated in the Annual Report on Remuneration will be increased following the 2015 salary review. Increases will generally be in line with increases in the base pay of other UK-based employees in the Group. The salary of a recently appointed Executive Director as he or she progresses in a role may exceed the average salary increase to reflect the accrual of experience. A change in responsibilities may also be reflected in an above average increase in salary. Promotion leading to a complete change of role would be considered in line with the Committee's approach to recruitment.<br>Year-on-year increases for Executive Directors, currently in role, will not exceed 10% per annum during the policy period. |
| **Performance metrics used, weighting and time period applicable** | None. |

| Benefits | |
|---|---|
| **How the element supports the Company's strategic objectives** | To provide market competitive benefits consistent with role which:<br>– allow the attraction and retention of high-calibre individuals to deliver the Company's strategic plans; and<br>– recognise that such talent is global in source and that the availability of certain benefits (e.g. relocation, repatriation, taxation compliance advice) will from time to time be necessary to avoid such factors being an inhibitor to accepting the role. |
| **Operation of the element** | The Company currently offers the following contractual benefits to Executive Directors: **a car or car allowance**; the **use of a driver**; **tax advice** (in instances where multi-jurisdictional tax authorities are involved); **tax equalisation payments** (where appropriate); **private medical insurance**, including **general practitioner 'walk-in' medical services**; **personal life and accident insurance**; and, where the individual is not a long-term resident of the UK, **relocation** and shipment of effects and associated expenses on appointment and at the end of tenure, and **housing** and **education** allowances or similar arrangements as appropriate to family circumstances. Other benefits not identified above may be offered if, in the Committee's view, other benefits are necessary in order to remain aligned with market practice.<br>The cost of legal fees spent in reviewing a settlement agreement on departure may also be provided where appropriate.<br>With the exception of the car or car allowance, it is also practice to pay the tax that may be due on these and any similar benefits.<br>Further, HM Revenue & Customs may classify the provision of certain services and payments as taxable benefits. These include: the installation and maintenance of home security systems; the reimbursement of travel and related expenses; and other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events. It is also the Company's practice to pay the tax that may be due on these types of benefits. |
| **Maximum potential value** | The maximum potential values are based on market practice for individuals of this level of seniority and considerations of a cost that is affordable to the business together with a range of benefits consistent with market practice. Any tax due on these benefits paid by the Company is in addition to the maximum amounts specified below.<br>The maximum annual benefit that can be offered for each element is:<br>– **car or car allowance:** £20,000 (subject to periodic inflation-related increases);<br>– **use of a company driver:** variable maxima as the actual cost is dependent on the miles driven in any year;<br>– variable maxima will apply to the cost of **private medical insurance**, which is dependent on an individual's circumstances and is provided on a family basis;<br>– **GP 'walk-in' medical services located close to the Group's headquarters in London:** £5,000 per annum;<br>– **personal life and accident insurance** designed to pay out at a multiple of four and five times base salary respectively;<br>– **international tax advice** as required, but not exceeding £30,000 (per annum); and tax equalisation payments as agreed by the Committee from time to time; and<br>– **relocation and shipment expenses** for non-UK citizens at the beginning and end of service as an Executive Director (if appropriate) up to £200,000 together with **housing and education allowances** or other similar arrangements appropriate to the individual's family circumstances.<br>There are no contractual provisions for clawback or malus. |
| **Performance metrics used, weighting and time period applicable** | None. |

REMUNERATION REPORT

# Policy Report continued

| Pensions | |
|---|---|
| **How the element supports the Company's strategic objectives** | To provide competitive post-retirement benefit arrangements recognising both the individual's length of tenure with the Group and the external environment in the context of attracting and retaining high-calibre individuals to deliver the Group's strategy. |
| **Operation of the element** | **British American Tobacco UK Pension Fund (the 'Pension Fund') – non-contributory defined benefit section**<br>The early retirement rules in the Pension Fund permit a member to draw the accrued retirement pension within five years of Fund 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. The defined benefit section closed to new members with effect from 1 April 2005.<br>The Pension Fund includes provision for spouses' and children's 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 together with, where there are dependent eligible children, a pension equal to half of the member's prospective pension at normal retirement age, shared equally between any eligible children. A spouse's pension payable in the event of death after retirement is equal to half of the member's pension, irrespective of any previous decision to exchange part of the benefit for a lump sum at retirement. Eligible children share equally a pension equal to half of the member's full pension.<br>**British American Tobacco UK Pension Fund – defined contribution section**<br>Individuals joining the organisation since April 2005 participate in a defined contribution arrangement. On the appointment of a new Executive Director an annual contribution of up to the equivalent of 35% of base salary would be made. The actual level of contribution paid to the Pension Fund is restricted to take into account the annual allowance and lifetime allowance with any balance payable as a gross cash allowance.<br>**Unfunded unapproved retirement benefit scheme (UURBS)**<br>The Pension Fund retains a scheme-specific salary cap, currently £146,400 effective 1 April 2014, which is adjusted in April each year in line with the Retail Prices Index as at September of the previous year. Where an individual is entitled to benefits calculated on a base salary that exceeds the scheme-specific cap, these are accrued in the Company's UURBS. Pension accrual in the UURBS will not exceed the accrual rate applicable to the individual in respect of their Pension Fund entitlement (maximum one-fortieth per annum). In addition, where pension accrual in the Pension Fund exceeds the UK regulated annual and lifetime allowances, subject to the individual's consent, benefits are adjusted to remain within these limits with any excess being provided through the UURBS.<br>Upon retirement, Executive Directors who have accrued benefits in the UURBS will have the opportunity to receive this element of their overall entitlement either in the form of a single lump sum or as an ongoing pension payment. Lump sums in lieu of a pension entitlement in the UURBS are subject to a decrement of between 19% and 21%, depending on age. In addition, a further reduction that recognises the Company's liability to employer's national insurance will also be made.<br>Pensionable pay covers base salary only and therefore bonus awards and the value of benefits in kind are not pensionable. |
| **Maximum potential value** | Internal appointees as Executive Directors may have existing defined benefit or defined contribution pension entitlements with the Group which may differ marginally from those outlined in the policy and these will ordinarily remain unchanged. Pension benefits and entitlements will continue to be calculated with reference to an individual's base salary.<br>Pension entitlements for external appointees as Executive Directors will be subject to negotiation taking into account the relevant annual and lifetime allowances; and in most circumstances these will be defined contribution in nature and will not exceed 35% of base salary in value. |
| **Performance metrics used, weighting and time period applicable** | There are no performance metrics.<br>Pensions in payment are paid monthly or quarterly in accordance with the rules of the relevant section of the Pension Fund. |

| Short-term incentives: International Executive Incentive Scheme (IEIS) | |
|---|---|
| **How the element supports the Company's strategic objectives** | To incentivise the attainment of corporate targets aligned to the strategic objectives of the Company on an annual basis.<br>Performance-based award in the form of cash and deferred shares, so that the latter element ensures alignment with shareholders' long-term interests.<br>Strong alignment and linkage between individual and corporate annual objectives via the application of an individual performance adjustment factor to the corporate result.<br>To ensure, overall, a market competitive package to attract and retain high-calibre individuals to deliver the Group's strategy. |
| **Operation of the element**<br><br>**Change to short-term incentives 2015:**<br>The introduction of a clawback facility which may be applied at the Committee's discretion: (1) within two years after the payment of a bonus cash amount and/or (2) within three years of the date of grant of an award of shares under the DSBS – see below for details. | IEIS comprises an annual award referenced to base salary, which is normally paid approximately three months after the end of the financial year to which it relates: **50%** is paid immediately in **cash** and **50%** of the total bonus amount is awarded in **shares** through the **Deferred Share Bonus Scheme – DSBS**.<br>The free deferred shares 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 all of the shares.<br>Deferred shares attract a cash payment equivalent to the dividend on the after-tax position of all of a participant's unvested ordinary shares held in the DSBS at the dividend record date.<br>The **corporate result** under the IEIS for the prior year is based on achievement against targets set and is reviewed by the Remuneration Committee in February each year. The Group's external auditors perform certain specified procedures to assist the Committee's assessment of the calculations used to determine the IEIS corporate bonus outcomes and future targets.<br>The total payout is determined by the Company's performance under each measure relative to that measure's performance target. The Committee may use its discretion to adjust the payout in circumstances where, it considers, the overall performance of the Company warrants a different outcome, whether higher or lower, than that determined by the application of the bonus formula.<br>An **individual performance element** for outstanding performance may be awarded (being an adjustment factor of either 10% or 20% of the annual corporate result) and is paid in cash. In cases of identified poor individual performance, the corporate result will be reduced by 50%.<br>The Remuneration Committee sets the performance targets each year and is able to vary the exact measures and the weighting of them from year to year.<br>**Clawback (from 2016 IEIS cash awards and DSBS awards for performance ending 2015):** provisions operate under which all or a part of the value of an award may be recovered if the Committee determines that there has been: (1) a material misrepresentation or misstatement in relation to the performance of the Company and/or the participant; or (2) an erroneous calculation in the assessment of the extent to which the award was made, and in either case which caused the award to be granted with a greater value than would otherwise have been the case. This provision may be applied in respect of an IEIS cash award within the two-year period from payment and in respect of a DSBS share award within the three-year period from grant. Clawback may also be applied at any time where the Committee determines that a participant committed, at any time prior to the payment/vesting, an act or omission which justified dismissal for misconduct.<br>Where the Committee determines that these provisions are to be applied, the number of shares subject to an unvested DSBS share award may be reduced or the participant can be required to repay the excess value received (and this repayment may be effected by reducing other cash or share based awards held by the participant).<br>The introduction of clawback for awards from 2016 onwards means that for IEIS participants determined by the Committee as 'good leavers': (1) a cash bonus is pro-rated to the period of service during the year subject to a clawback period of two years from the payment date; and (2) a DSBS share award will vest or transfer to a participant upon termination of their contract subject to a clawback period of up to three years referenced to the original award date. The details of the policy on payment for loss of office which includes the scope for determination of 'good leaver' status applied by the Committee is set out in the Policy Report in the Annual Report 2013 on www.bat.com.<br>**Malus (for 2014 and 2015 DSBS share awards)**: malus provisions apply so that the number of shares subject to an unvested DSBS share award may be reduced where the Committee determines that there has been a material misrepresentation or misstatement of the performance of the Company and/or the participant on the basis of which that or any prior DSBS share award was granted.<br>Awards under the annual incentive scheme are not pensionable and no element of the bonus is guaranteed. |

REMUNERATION REPORT

# Policy Report continued

| Short-term incentives: International Executive Incentive Scheme (IEIS) | |
|---|---|
| **Maximum potential value** | The **maximum annual bonus** opportunity for the Chief Executive (including any performance element) is 200% of base salary. The equivalent bonus opportunity for other Executive Directors (including any performance element) is 180% of base salary. No bonus is paid at the threshold level of performance, which must be exceeded for any element of the bonus to be paid.<br>The annual **'on-target' bonus opportunity** for the Chief Executive is 100% of base salary (increasing up to 120% if the Committee assesses individual performance as outstanding and applies the individual performance element at 20% to an 'on-target' corporate result).<br>For the other Executive Directors, the 'on-target' bonus opportunity is 90% (increasing up to 108% if the individual performance element is awarded at a 20% level, based on an 'on-target' corporate result). |
| **Performance metrics used, weighting and time period applicable** | For 2015, the IEIS contains four corporate performance measures and weightings measured over the financial year:<br>(1) **Adjusted profit from operations (40%)** – this is the profit from operations of the Group's subsidiaries at constant rates of exchange adjusted for the items shown as memorandum information in the Group Income Statement. It is the Group's medium- to long-term aim to grow adjusted profit from operations on average by 6% annually.<br>(2) **Increase in the Group's share of key markets (20%)** – this is the Group's retail market share in its key markets, which accounts for around 80% of the volumes of the Group's subsidiaries. The aim is to increase the Group's share year on year. The information used in this calculation is based on information (available on subscription) on retail audit share. The process is subject to rebasing as and when the Group's key markets change. When rebasing occurs to reflect changes in the sample or estimated market size, the Company will also restate history and provide fresh comparative data on the markets.<br>(3) **Global Drive Brands and Key Strategic Brands volumes (20%)** – this comprises: (1) the cigarette volumes of the following GDBs sold by the Group's subsidiaries: Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans, including volumes of the Fine Cut variants of the above brands sold in Western Europe; and (2) the cigarette volumes of State Express 555 and Shuang Xi, being Key Strategic Brands associated with the CNTC joint venture.<br>The aim is to improve the quality of the Group's portfolio by increasing the volume of GDBs faster than the rest of the brands in the Group's portfolio.<br>(4) **Cash flow from operations (20%)** – this is defined as the free cash flow excluding restructuring costs, dividends and other appropriations from associate undertakings measured at constant rates of exchange. The aim is to generate the optimal level cash flow while continuing to invest to support the short-medium and long-term requirements of the business. A specific target is set each year.<br>Three levels of award attainment relative to the measures are defined under the IEIS:<br>(1) **Threshold** (which must be exceeded to attract any bonus pay-out in respect of that measure);<br>(2) **Target** (which amounts to the budgeted performance); and<br>(3) **Maximum** (the level of performance exceeding budget and at which the bonus pay-out for that measure is capped).<br>An award is pro-rated in respect of attainment between the measures set out above. The specific performance targets for each measure are considered to be commercially sensitive and are not disclosed. Indicative performance against them will be disclosed in the Annual Report on Remuneration in the following year.<br>An individual performance element may also be awarded by the Remuneration Committee based on its assessment of the Executive Director's performance against specific individual KPIs set at the beginning of the year. This element is applied to the corporate result but is subject to the maximum award limit as explained above. |

## Long-term incentives: Long-Term Incentive Plan (LTIP)

### How the element supports the Company's strategic objectives

To incentivise long-term sustainable growth in **total shareholder return (TSR), adjusted diluted earnings per share (EPS) and net turnover (NTO)**, over a three-year period; to attract and retain high-calibre individuals required to deliver the Company's strategic plans; and to promote the long-term success of the Company.

To put in place a combination of measures with appropriately stretching targets around the long-term plan that provides a balance relevant to the Company's business and market conditions as well as providing alignment between Executive Directors and shareholders. In setting performance criteria and thresholds/targets, the Committee takes account of the Group's long-term plans and market expectations.

### Operation of the element for awards made in 2015

**Change to long-term incentives for 2015 awards:**

**LTIP – clawback**

To introduce a clawback facility which may be applied at the Committee's discretion at any time during the two-year period from the vesting date – see below for details.

Discretionary annual awards of shares with vesting levels based on the achievement of defined and appropriately stretching targets that for 2015 are relative TSR, EPS growth and NTO growth aligned to Group's strategic objectives over a three-year performance and vesting period.

**TSR** – performance is measured against a **peer group of international FMCG companies** using the return index calculated by Datastream and reviewed by the Company's remuneration consultants. The current constituents of the FMCG peer group as at the date of this report are as follows:

| | | |
|---|---|---|
| Anheuser-Busch InBev | Imperial Tobacco Group | PepsiCo |
| Campbell Soup | Japan Tobacco | Pernod Richard |
| Carlsberg | Johnson & Johnson | Philip Morris International |
| Coca-Cola | Kellogg | Procter & Gamble |
| Colgate-Palmolive | Kimberly-Clark | Reckitt Benckiser |
| Danone | LVMH | SABMiller |
| Diageo | Mondeléz International | Unilever |
| Heineken | Nestlé | |

TSR 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 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.

**EPS** – growth in adjusted diluted EPS for these purposes incorporates 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.

**NTO** – is defined for these purposes as growth in gross turnover less excise, duties and rebates. No vesting will occur for NTO unless the corresponding three-year constant currency compound annual growth rate (CAGR) of underlying operating profit exceeds the CAGR of the threshold performance level for underlying operating profit, as defined annually in the IEIS, as approved by the Board.

LTIP awards vest only to the extent that the performance conditions are satisfied at the end of the **three-year performance period**. The Remuneration Committee may apply its discretion to vary the outcome of the formulaic performance to ensure a fair result for both the Executive Directors and the shareholders.

Participants may receive a **dividend equivalent payment** to the value of the dividends that they would have received as shareholders on their vesting awards. Any proportion of an award that lapses does not attract the payment of the LTIP dividend equivalent payment.

**Clawback and malus (from 2015 awards):** provisions operate under which all or a part of the value of an award may be recovered if, within the two-year period from vesting, the Committee determines that there has been: (1) a material misrepresentation or misstatement in relation to the performance of the Company and/or the participant; or (2) an erroneous calculation in the assessment of the extent to which the award vested, in either case which caused the award to vest in respect of a greater number of shares than would otherwise have been the case. Clawback may also be applied at any time where the Committee determines that a participant committed, at any time prior to vesting, an act or omission which justified dismissal for misconduct.

Where the Committee determines that these provisions are to be applied, the participant may be required to repay the excess value which vested and this repayment may be effected by reducing other cash or share-based awards held by the participant.

REMUNERATION REPORT

# Policy Report continued

| Long-term incentives: Long-Term Incentive Plan (LTIP) | |
|---|---|
| **Operation of the element for awards made in 2015** continued | For LTIP participants determined by the Committee as 'good leavers', the number of shares vesting is dependent on the final performance at the end of the performance period (pro-rated for the period employed) and, for awards from 2015, shares vesting will be subject to the clawback period of two years from the end of the performance period. The detailed policy on payment for loss of office which includes the scope for determination of 'good leaver' status applied by the Committee is set out in the Policy Report in the Annual Report 2013 on www.bat.com.<br>**Malus (for 2011-2014 awards)**: malus provisions apply so that the number of shares subject to an unvested award may be reduced where the Committee determines that there has been a material misrepresentation or misstatement of the performance of the Company and/or the participant which influenced the extent to which any prior award vested.<br>The Remuneration Committee is able to vary the exact measures and the weighting of them from year to year, but will generally only seek to make amendments to them following consultation with shareholders. |
| **Maximum potential value and payment at threshold** | **Maximum award of shares** permitted is 400% of salary for the Chief Executive and 300% for other Executive Directors. Proportion of vesting is determined by reference to achievement of defined targets over a three-year performance period in respect of three measures:<br>– earnings per share (50%);<br>– total shareholder return (25%); and<br>– net turnover (25%).<br>A **maximum vesting** of 100% will result in the vesting of shares to a value equivalent to 400% of the Chief Executive's salary as at the time of award, plus the appropriate dividend equivalent payment. For other Executive Directors, a maximum vesting 100% will result in the vesting of shares to a value of 300% of salary as at the time of award, plus the applicable dividend equivalent payment.<br>If the **threshold performance** level were to be attained in respect of all three measures, 20% of the original award level in respect of the Chief Executive – shares with a value equivalent to 80% of salary – would vest, plus the appropriate dividend equivalent attaching to the shares vesting. A threshold performance outcome for the other Executive Directors would result in 20% of the original award level vesting. This amounts to shares with a value equivalent to 60% of salary, plus the appropriate dividend equivalent payment.<br>In respect of **LTIP awards made from 2014**, departing Executive Directors will receive vesting shares, conditional upon plan performance, based upon the **final vesting percentage measured over the full three-year period of the award**. There will be no application of an early vesting percentage in respect of LTIP awards made in or after 2014. |

| Long-term incentives: Long-Term Incentive Plan (LTIP) | |
|---|---|
| **Performance metrics used, weighting and time period applicable** | **Performance conditions in relation to awards made from 2014 onwards must be met over a three-year period** in respect of three measures:<br>(1) **25% of an LTIP award based on the Company's TSR performance against a peer group of international FMCG companies**. In the event of a top quartile performance by the Company relative to this comparator group, this element of the award vests in full; 6% vests for median performance and there is a pro-rata vesting between these two points. The TSR portion of an LTIP award will not vest for below median performance;<br>(2) **50% of an LTIP award is based on adjusted diluted EPS growth measured at current rates of exchange.** If the Company achieves a compound annual growth rate of 10%, this element of the award will vest in full. If 5% growth is achieved, then 8% of the award will vest. For performance between these two points, a pro-rated award will vest. If EPS growth over the period is less than 5%, none of the EPS portion of an award will vest; and<br>(3) **25% of an LTIP award is based on the compound annual growth rate of NTO measured at constant rates of exchange.** If the Company achieves a growth rate of 5%, this element of the award relating to NTO will vest in full. If the Company achieves a compound annual growth rate over the three-year period of 2%, then 6% of the award will vest in full. There is a pro rata vesting between these points. The NTO portion of the LTIP award will not vest for growth below 2%.<br>There is an **underpin to the NTO measure** whereby the corresponding three-year constant currency CAGR of underlying operating profit must exceed the CAGR of the threshold performance level for underlying operating profit (as defined annually in the IEIS and approved by the Board) in order for an LTIP vesting payment in respect of the NTO measure to become payable.<br>The Remuneration Committee will also assess the performance of the **current outstanding LTIP awards** against the performance conditions applicable to those awards as follows:<br>**Measures applying for March 2012 LTIP awards (vesting 28 March 2015) and March 2013 LTIP awards (vesting 22 March 2016)**<br>**EPS:** compound annual growth of 3% (measured at current rates of exchange) in excess of UK inflation triggers threshold performance. Growth of 8% in excess of inflation would trigger maximum vesting under this measure. Component weighting: 50%.<br>**TSR:** relative to and measured against two groups of companies: (1) a group of international FMCG companies (weighting 25%); and (2) the constituents of the London Stock Exchange's FTSE 100 Index (weighting 25%).<br>Application of an early vesting percentage can apply. |

REMUNERATION REPORT

# Policy Report continued

| All-employee share schemes | |
|---|---|
| How the element supports the Company's strategic objectives | Executive Directors are eligible to participate in the Company's all-employee share schemes, which are designed to incentivise employees by giving them an opportunity to build shareholdings in the Company. |
| Operation of the element and performance metrics used | **Sharesave Scheme** – an HM Revenue & Customs (HMRC) approved scheme where eligible employees are granted savings-related share options to subscribe for ordinary shares in the Company. Options are granted to be exercisable in conjunction with either a three-year or five-year savings contract with a monthly savings limit of £500. Options are normally granted at a discount of 20% to market price at the time of invitation.<br>Following changes in legislation, the monthly savings limit for the Sharesave Scheme was increased from £250 to £500 for invitations made from 2014 onwards.<br>**Share Incentive Plan (SIP)** – an HMRC-approved plan incorporating:<br>(1) **Partnership Scheme** – eligible employees can allocate part of their pre-tax salary to purchase shares in the Company. Shares purchased are held in a UK-based trust, normally capable of transfer to participants tax-free after a five-year holding period.<br>Following changes in legislation, the annual value of partnership shares that can be purchased was increased from £1,500 to £1,800 during 2014.<br>(2) **Share Reward Scheme** – eligible employees receive an award of shares in April of each year in which the Scheme operates in respect of performance in the previous financial year. 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. Further to recent changes in legislation, the annual value of 'free shares' that can be awarded to employees will increase to £3,600; the Company intends to apply this new limit during the lifetime of this policy from awards made in 2016 onwards. |
| Maximum potential value | **Sharesave Scheme:** the market value of the shares under option at the date of maturity of the Sharesave savings contract, less the grant price of the option at the contract start date.<br>**SIP – Partnership Scheme:** the value of the shares purchased out of the potential maximum annual purchase value of £1,800 at the end of the five-year holding period.<br>**SIP – Share Reward Scheme:** the value of the shares awarded out of the potential maximum annual award value of £3,600 at the end of the three-year holding period. |

| Shareholding guidelines | |
|---|---|
| How the element supports the Company's strategic objectives | To strengthen the alignment between the interests of the Executive Directors and those of the shareholders by requiring Executive Directors to build up a high level of personal shareholding in the Company. |
| Operation of the element and performance metrics used | Executive Directors are required to hold shares in the Company equal to the value of a multiple of salary. Arrangements apply to those Executive Directors who do not, at any point, meet the requirements of the shareholding guidelines. Individuals may sell a maximum of up to 50% of any shares vesting (after tax) under the Company's share plans until the threshold for the shareholding guidelines has been met. Shares earned but not yet vested under the Company's share incentive plans are not taken into account when assessing compliance.<br>There are no performance metrics. |
| Maximum potential value | Chief Executive: 400% of salary.<br>Other Executive Directors: 250% of salary. |

| External Board appointments | |
|---|---|
| How the element supports the Company's strategic objectives | The Company recognises the opportunities and benefits that accrue to both the Company and its Executive Directors who serve as non-executive directors on the boards of comparable companies. |
| Operation of the element and performance metrics used | Each Executive Director is limited to one external appointment, with the permission of the Board.<br>There are no performance metrics. |
| Maximum potential value | Any fees from such appointments are retained by the individual in recognition of the increased level of personal commitment required. Executive Directors may also serve as nominated Directors on the Boards of the Company's associate undertakings. In such instances, the fees will be paid to the Group and are not for the individual's account. |

### Additional notes to the Future Policy Table

(1) The Remuneration Committee reserves the right to make any remuneration payments where the terms were agreed prior to an individual being appointed an Executive Director of the Company or prior to the approval and implementation of the Remuneration Policy. This includes the achievement of the applicable performance conditions, for Executive Directors who are eligible to receive payment from any award made prior to the approval and implementation of the Remuneration Policy.

(2) This policy applies in a similar form, with appropriate eligibility criteria and gradations of salary, benefits and incentive awards to the members of the Management Board and senior management. The senior management population (below Management Board) operates within a job grading structure and its most senior members may participate in both the LTIP and IEIS incentive arrangements. Award levels vary with seniority up to the appropriate maxima expressed within the relevant scheme rules. Performance measures in both LTIP and IEIS are aligned across the Group and for the IEIS locally relevant targets are set as appropriate.

For other UK employees of the Group, remuneration will cover annual base salary, retirement plus other benefits and participation in the Company's annual short-term incentive scheme, including eligibility to participate in all-employee share plans.

For employees employed outside of the UK, remuneration policy is set in accordance with conditions in the local marketplace. Local policy is established with reference to Group guidelines concerning: annual base salary relative to the local market, the provision of retirement and other benefits (where locally relevant) and participation in short-term incentive plans where the incentive opportunity is established with reference to the local market conditions.

## Other approved policy provisions in relation to Directors' pay

The Remuneration Committee's powers of flexibility, judgement and discretion, reflected in the Remuneration Policy approved by shareholders at the AGM on 30 April 2014, are amended below to reflect the introduction of a clawback facility for both the IEIS and the LTIP awards.

## Flexibility, judgement and discretion

The Company's remuneration policy needs to be capable of operating over a three-year period. As such, the Committee has taken care to prepare and explain how the policy will operate and has built in a degree of flexibility to enable the practical implementation of the policy over that prospective lifetime.

### (1) Flexibility

Areas of the policy which include a degree of flexibility are around:

- pay and benefits, allowing the Committee to set pay either on appointment or following an annual salary review, and to review and change the pay comparator groups to ensure they remain appropriate. The degree of flexibility to operate is constrained by the policy maximum;
- the IEIS bonus plan, for example, allowing the Committee to design performance measures, agree their relative weighting and set annual targets to incentivise business outcomes aligned to the Group's short-term strategic objectives. This is to ensure that these remain relevant and aligned to the Group strategy; and
- the LTIP, allowing the Committee to make revisions to the performance measures, their respective weightings, threshold and target levels as permitted under the scheme rules.

### (2) Judgement

The Committee will be required to exercise its judgement in many ways throughout the year, specifically in those areas of the policy where there is some flexibility. This may occur, for example, when considering an individual's remuneration award or the specific benefits applying to an appointment, or in varying the measures and their weightings, as well as setting specific targets, for example, in the IEIS in any year to ensure that all elements continue to remain aligned to Group strategy and drive the right behaviours. Judgement is also applied in determining the percentage of salary (up to the maximum set out in the Policy Table) which can be earned as a bonus in excess of threshold, target and up to the maximum, or the percentage salary level (again up to the maximum in the Policy Table) in respect of an LTIP award. Judgement is also required in assessing the performance of each individual Executive Director in delivering against his or her personal performance objectives.

### (3) Discretion

The Committee may also exercise its discretion either upwards or downwards to ensure fair outcomes for both Directors and shareholders notwithstanding the application of the policy.

The Committee has reserved its ability to exercise its discretion as follows:

### Short-term incentives (IEIS):

- to assess whether an individual performance element should be applied to an Executive Director's bonus outcome and at what level (+10% or +20% for outstanding personal performance or -50% for poor personal performance), subject to the overall cap as provided in the policy;
- to assess and override a payout in circumstances where the overall performance of the Company justifies a different outcome whether higher or lower than that determined by the bonus formula;
- in relation to leavers as to whether deferred shares will be released and whether any bonus (in whole or in part) is payable during the year of departure; and
- whether circumstances have arisen that should result in the application of the clawback and/or malus provisions to deferred shares held by an Executive Director.

### Long-term incentives (LTIP):

- to assess and override the formulaic outcomes of the LTIP performance outcome to ensure that the resulting LTIP pay-out reflects fairly the underlying performance of the business and serves the interest of shareholders;
- in relation to leavers as to whether shares will vest, the terms on which such shares will vest and the percentage level of the award which vests as well as whether any LTIP (in whole or in part) is payable during the year of departure; and
- whether circumstances have arisen which should result in the application of the clawback and/or malus provisions to unvested LTIP awards.

REMUNERATION REPORT

# Policy Report continued

**Other:**

- on appointment of a new Executive Director, to agree a contract, for an initial period only, longer than the normal one-year rolling contract; and
- where the shareholding requirements are not yet met to determine and vary the terms that apply to ensure compliance and/or the retention of deferred shares or vesting LTIP shares to meet the requirement.

In each case, wherever the Committee exercises its discretion in relation to an Executive Director, it will disclose the rationale for doing so in its Annual Report on Remuneration the following year.

## Remuneration Table – Non-Executive Directors and Chairman

The following table sets out the key elements of the remuneration for the Non-Executive Directors and the Chairman as approved by the shareholders at the AGM on 30 April 2014. The complete approved policy continues to be displayed in full in the Annual Report 2013 on www.bat.com.

| Non-Executive Directors | |
|---|---|
| **Fees – process** | As a UK-listed entity, the quantum and structure of Non-Executive Directors' remuneration will primarily be assessed against the same remuneration comparator group of companies used for setting the remuneration of Executive Directors. The Board may also make reference to and take account of relevant research and analysis on Non-Executive Directors' fees in FTSE 100 companies published by remuneration consultants from time to time. The fees for the Non-Executive Directors are reviewed annually, although the review does not always result in an increase in the Board fees or Committee fees.<br><br>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. |
| **Current fees for the year ending 31 December 2015** | It is anticipated that any future aggregate increase to any of the fees will be within the salary guidelines which govern the Company's annual salary reviews for UK-based staff and will not exceed the equivalent of 10% per annum in aggregate.<br><br>**Non-Executive Directors – fee structure**<br><br>**Fees from 1 Jan 2015 to 31 Dec 2015**<br>**Base fee £92,700**<br>**Supplements:**<br>– Senior Independent Director **£30,000**<br>– Audit Committee Chairman **£30,000**<br>– CSR Committee Chairman **£25,000**<br>– Nominations Committee Chairman **£–**<br>– Remuneration Committee Chairman **£30,000**<br><br>**Committee Memberships Fees (not Chairman):**<br>– Audit Committee **£6,000**<br>– CSR Committee **£6,000**<br>– Nominations Committee **£6,000**<br>– Remuneration Committee **£6,000** |
| **Travel and related expenses** | Non-Executive Directors are generally reimbursed for the cost of travel and related expenses incurred by them as Directors of the Company in respect of attendance at Board, Committee and General meetings. In addition, it is the policy of the Board that the partners of the Executive Directors and Non-Executive Directors may, from time to time, accompany the Directors to overseas or UK-based Board meetings and otherwise at hospitality functions during the year.<br><br>In the instances where such expenses are classified by HMRC as a benefit to the Director, it is also the practice of the Company to pay the tax which may be due on any such benefits. Non-Executive Directors are also eligible for general practitioner 'walk-in' medical services based a short distance from the Company's Group headquarters in London.<br><br>They receive no other pay or benefits. |
| **Shareholding requirements** | The remuneration of Non-Executive Directors is paid in cash. There are no formal requirements or guidelines for the Non-Executive Directors to hold shares in the Company. However, Non-Executive Directors are encouraged to acquire a small interest during the initial years after their date of appointment. The Non-Executive Directors do not participate in the British American Tobacco share schemes, bonus schemes or incentive plans and are not members of any Group pension plan. |

| Chairman | |
|---|---|
| **Fees – process** | The Remuneration Committee considers annually the fee payable to the Chairman. Given that the role of a chairman can vary considerably between companies and sectors, this process (using data from the FTSE 30 companies) takes into account the breadth of that role coupled with its associated levels of personal commitment and expertise in the overall context of international reach and the 'ambassadorial' aspect of the role. The Chairman is currently expected to make an annual time commitment of about 100 days to cover the responsibilities of the role. The Chairman does not participate in any discussions on his level of remuneration. |
| **Current fees for the year ending 31 December 2015** | It is anticipated that any future aggregate increase to the Chairman's fee below will be within the salary guidelines that govern the Company's annual salary reviews for UK-based staff and will not exceed the equivalent of 10% per annum in aggregate.<br>**Fees from 1 April 2015**<br>Richard Burrows (Chairman) £645,000 |
| **Benefits, travel and related expenses** | Richard Burrows is reimbursed for the cost of travel and related expenses incurred by him in respect of attendance at Board, Committee and General meetings including the cost of return airline tickets to London from his home in Ireland in connection with his duties as Chairman. He is also entitled to the use of a Company driver; private medical insurance and personal accident insurance benefits; and general practitioner 'walk-in' medical services based a short distance from the Company's Group headquarters in London.<br>In addition, Richard Burrows' spouse may, from time to time, accompany him to overseas or UK-based Board meetings and otherwise at hospitality functions during the year. Where any such reimbursements are classified by HMRC as a benefit to the Director, it is also the practice of the Company to pay any tax due.<br>In appointing a new Chairman, the Committee will offer the components set out in respect of the current Chairman, as appropriate, and may also offer housing allowances for a limited period and other relocation benefits. |

REMUNERATION REPORT

# Annual Report on Remuneration

Gerry Murphy
Chairman of the Remuneration Committee

| Remuneration Committee current members |
|---|
| Dr Gerry Murphy (Chairman) |
| Ann Godbehere |
| Christine Morin-Postel |
| Dimitri Panayotopoulos |
| Kieran Poynter |

### Attendance at meetings in 2014

| Name | Member since | Attendance/Eligible to attend |
|---|---|---|
| Gerry Murphy (Chairman) | 2009 (Chairman from 2012) | 6/6 |
| Ann Godbehere | 2011 | 6/6 |
| Christine Morin-Postel | 2007 | 6/6 |
| Dimitri Panayotopoulos[1] | 2015 | n/a |
| Kieran Poynter | 2011 | 6/6 |

Notes:
1. **Membership:** all of the members of the Remuneration Committee are independent Non-Executive Directors of the Company; Dimitri Panayotopoulos became a member of the Committee on 2 February 2015.
2. **Other attendees:** the Chairman, the Chief Executive, the Group Human Resources Director, Group Head of Reward and other senior management may also attend by invitation; neither the Chairman nor any Executive Director plays any part in determining his own remuneration.
3. **Deloitte LLP**: as the Committee's remuneration consultants they may attend meetings of the Committee. As a member of the Remuneration Consultants Group (RCG), Deloitte agrees to the RCG Code of Conduct which seeks to clarify the scope and conduct of the role of executive remuneration consultants when advising UK-listed companies.
4. **Secretary to the Remuneration Committee:** this is the Company Secretary.
5. **Number of meetings 2014:** six meetings were held, of which four were scheduled with two further meetings convened at short notice to discuss proposals to amend the Remuneration Policy for 2015.

**For the Committee's terms of reference visit**
www.bat.com/governance

This section sets out the remuneration of the Directors for the financial year ended 31 December 2014.

## Role

The Remuneration Committee is responsible for:

- agreeing and proposing the Remuneration Policy (covering salary, benefits, performance-based variable rewards and pensions) for shareholder approval;
- determining, within the terms of the agreed Policy, the specific remuneration packages for the Chairman and the Executive Directors, both on appointment and on review and, if appropriate, any compensation payment due on termination of appointment;
- the setting of targets applicable for the Company's performance-based variable reward schemes and determining achievement against those targets, exercising discretion where appropriate and as provided by the applicable scheme rules and the Policy; and
- monitoring and advising the Board on any major changes to the policy on employee benefit structures for the British American Tobacco Group.

## Remuneration Committee – advisers

During the year the Remuneration Committee was independently advised by the following external advisers:

| Adviser | Services provided to the Committee | Fees paid | Other services provided to the Company |
|---|---|---|---|
| **Deloitte LLP** | General advice on remuneration matters including: market trends and comparator group analysis; policy review and shareholder engagement perspectives; independent measurement of TSR performance conditions. | 2014: £285,650 (2013: £214,846) | Tax, corporate finance and consulting services to Group companies worldwide |
| **Herbert Smith Freehills LLP** | Advice in respect of share plan regulations is provided to the Company and is available to the Committee. | Fees relate to advice given to Company | General corporate legal and tax advice principally in the UK |
| **Ernst & Young LLP** | Provision of personal tax advice regarding Executive Directors' international pension planning. | Fees relate to advice given to Company | Tax, corporate finance and consulting services to Group companies worldwide |
| **PricewaterhouseCoopers LLP** | Specified procedures to assist in the assessment of the calculations of the IEIS bonus outcomes. | 2014: £10,870 (2013: £10,560) | External auditor; audit and tax services and other non-audit services |

The Remuneration Committee has not expressly considered the objectivity and independence of the advice received from these professional firms, although it regularly reflects upon the quality of the advice received. The Committee is confident that none of the cross-relationships generate an unmanageable conflict of interest and that the fees paid in respect of each service do not compromise the objectivity and impartiality of the provision of the other services.

During the year ended 31 December 2014, both the Chief Executive and Chairman were consulted and invited to attend meetings of the Committee and the Group Human Resources Director and Group Head of Reward, supported by the Company Secretary, also provided advice, guidance and assistance to the Committee.

## Remuneration Committee – activities in 2014

### Regular work programme

**February**

- reviewed and set salaries for the Executive Directors from 1 April 2014 taking into account both the pay comparator group positioning and the pay and employment conditions elsewhere in the Group, particularly in the UK;
- reviewed and set the Chairman's fee from 1 April 2014;
- assessed the achievement against the targets for the 2013 IEIS award and set the IEIS targets for 2014;
- assessed the achievement against the performance conditions for the vesting of the LTIP 2011 award, determined the level of LTIP awards for March 2014 and confirmed the associated performance conditions;
- assessed the achievement against the targets for the 2013 Share Reward Scheme and set the targets for the 2014 award;
- monitored the continued application of the Company's shareholding guidelines for the Executive Directors; and
- reviewed the Annual Statement, the Policy Report, and the Annual Report on Remuneration for the year ended 2013 prior to its approval by the Board and subsequent shareholder approval at the AGM on 30 April 2014.

**July**

- analysed the AGM results on remuneration and reviewed market trends in the context of the AGM season;
- previewed the salary and incentives market data and current trends for Executive Directors; and
- reviewed achievement against the performance measures for the six months to 30 June 2014 for the IEIS 2014 and the outstanding LTIP awards.

**December**

- reviewed the report on the effectiveness of the Remuneration Committee.

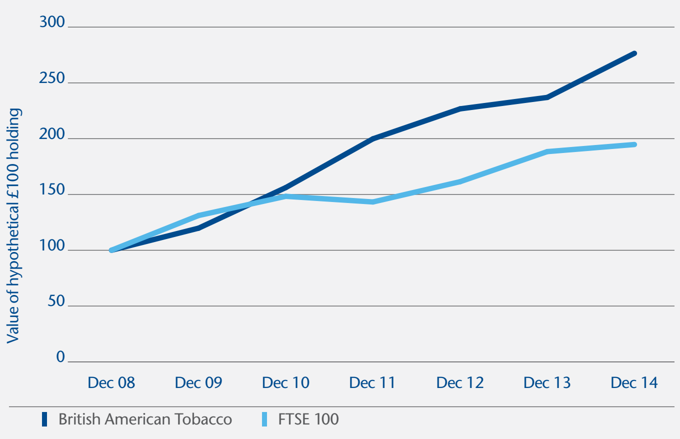
REMUNERATION REPORT

# Annual Report on Remuneration continued

| Remuneration policy matters | |
|---|---|
| **February** | – introduced a malus provision into the DSBS shares element of the IEIS for awards made on or after 1 March 2014;[1]<br>– introduced (for LTIP awards from 2014 onwards) delayed vesting of LTIP shares for departing Executive Directors; all LTIP shares vesting now conditional on plan performance measured over the full period of the award i.e. no application of an early vesting percentage in respect of LTIP awards made from 2014;[1] and<br>– increased limits in the all-employee share schemes (Share Reward Scheme; Partnership Scheme; and Sharesave Scheme) in accordance with changes in HMRC policy.[1]<br>Note:<br>1. Included in the Remuneration Policy approved by shareholders on 30 April 2014. |
| **October, November and December** | – considered the impact of exchange rates on incentive schemes and the design of the schemes for the Executive Directors relative to underlying performance;<br>– reviewed the background to the competitive gap between British American Tobacco and its relevant peers in terms of the earnings potential of the Chief Executive in respect of the long-term incentive opportunity; and<br>– considered changes to the Remuneration Policy including the early adoption of a new LTIP ahead of the expiry of the current LTIP in April 2017. |

| Other incentive matters | |
|---|---|
| **February** | – approved the final retirement arrangements for the Chief Operating Officer who retired in April 2014. |
| **December** | – reviewed reporting and disclosure best practice for the Annual Report on Remuneration including detailed consideration of retrospective disclosure of bonus targets; and<br>– approved the introduction of an unfunded unapproved retirement benefit scheme (UURBS) for members of the Management Board who participate in the defined contribution section of the UK Pension Fund and who are impacted by the UK annual allowance or lifetime allowance. |

## Performance and pay – 2009 to 2014




This chart shows the performance of a hypothetical investment of £100 in the Company's shares (as measured by the total shareholder return (TSR) for the Company) against a broad equity market index (the FTSE 100 Index) over a period of six financial years starting from 1 January 2009 through to 31 December 2014 based on 30 trading day average values.

## TSR measurement

TSR is measured according to the return index calculated by Datastream and has been reviewed by the Committee's remuneration consultants. It is measured on the basis that all the Company's dividends are reinvested in the Company's shares. The return is the percentage increase in the Company's index over the six-year period. A local currency basis is used for the purposes of the TSR calculation, making it consistent with the approach to TSR measurement for the LTIP.

## Chief Executive's pay

The pay for the Chief Executive (CEO) for each of the financial years ended 2009 to 2014 is set out below for comparative purposes:

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|
| **CEO 'single figure' of total remuneration (£'000)** | | | | | | |
| Paul Adams[1] (to 28 February 2011) | 7,713 | 8,858 | 5,961 | n/a | n/a | **n/a** |
| Nicandro Durante[2] (from 1 March 2011) | n/a | n/a | 5,589 | 6,340 | 6,674† | **3,617** |
| **Annual bonus (IEIS) paid against maximum opportunity (%)** | | | | | | |
| Paul Adams[1] (to 28 February 2011) | 67.7 | 87.0 | 100 | n/a | n/a | **n/a** |
| Nicandro Durante[2] (from 1 March 2011) | n/a | n/a | 100 | 85.0 | 81.3 | **73.2** |
| **Long-term incentive (LTIP) paid against maximum opportunity (%)** | | | | | | |
| Paul Adams[1] (to 28 February 2011) | 100 | 100 | 100 | n/a | n/a | **n/a** |
| Nicandro Durante[2] (from 1 March 2011) | n/a | n/a | 100 | 87.1 | 49.2 | **00.0** |

Notes:

1. **Paul Adams:** (a) historic data is taken from the Remuneration Reports for the relevant years, but recast (as appropriate) on the basis of the 'single figure' calculation as prescribed in the Regulations; (b) he retired as Chief Executive on 28 February 2011 which affected his short-term (annual bonus – IEIS) and long-term incentives (LTIP) as follows in accordance with the rules of those schemes: (i) his performance-related bonus (IEIS) for the year ended 31 December 2010 was paid as a 100% cash bonus instead of 50% in cash and 50% in deferred shares; (ii) the outstanding LTIP awards of shares vested immediately on his retirement either in full (2008 Award) or on a pro-rated basis (2009 Award and 2010 Award); and (iii) the LTIP dividend equivalent payments for the LTIP awards which vested at his retirement were also paid in full and/or on a pro-rated time and performance basis.
2. **Nicandro Durante:** (a) historic data is taken from the Remuneration Reports for the relevant years, but recast (as appropriate) on the basis of the 'single figure' calculation as prescribed in the Regulations; and (b) he became Chief Executive on 1 March 2011 and his 'single figure' remuneration for the year ended 31 December 2011 has accordingly been time apportioned.

## Relative importance of spend on pay

To illustrate the relative importance of the remuneration of the Directors in the context of the Group's finances overall, the Remuneration Committee makes the following disclosure:

| Item | 2014 £m | 2013 £m | % change |
|---|---|---|---|
| Remuneration of Group employees[1] | **2,194** | 2,384 | **(8)** |
| – Remuneration of Executive Directors | **7** | 15† | **(53)** |
| – Remuneration of Chairman and Non-Executive Directors | **2** | 2 | – |
| Dividends paid in the year | **2,712** | 2,611 | **4** |
| Share buy-back programme[2] | **795** | 1,500 | **(47)** |
| Adjusted profit from operations[3] | **6,075** | 5,820 | **4** |

Notes:

1. **Total remuneration of Group employees:** this has changed in the year mainly as a result of local remuneration agreements, varying employment costs across end markets and regions; and the impact of exchange rate movements.
2. **Share buy-back programme:** this was suspended with effect from 30 July 2014.
3. **Adjusted profit from operations:** this is the adjusted profit from operations of the Group's subsidiaries at constant rates of exchange for the items shown as memorandum information in the Group Income Statement. It has been chosen as a benchmark for this disclosure given its linkage to the short-term incentive element of remuneration as one of the four performance measures under the IEIS.

## Directors' remuneration for the year ended 31 December 2014

### 'Single figure' table for Executive Directors' remuneration: aggregate – audited

The following table shows a single figure of remuneration for the Executive Directors in respect of qualifying services for the year ended 31 December 2014 together with comparative figures for 2013. The aggregate Directors' emoluments are shown on page 100. Details of the fees for the Chairman and the Non-Executive Directors are set out in separate tables below.

| Single figure for Executive Directors | Salary £'000 | | Taxable benefits £'000 | | Short-term incentives £'000 | | Long-term incentives[2] £'000 | | Pension £'000 | | Other emoluments[3] £'000 | | Total remuneration £'000 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 | **2014** | 2013† | **2014** | 2013 | **2014** | 2013 | **2014** | 2013† |
| Nicandro Durante | **1,141** | 1,088 | **132** | 626[1] | **1,690** | 1,790 | **293** | 2,790 | **323** | 307 | **38** | 73 | **3,617** | 6,674 |
| Ben Stevens | **835** | 808 | **99** | 100 | **1,108** | 1,196 | **158** | 1,578 | **521** | 607 | **28** | 56 | **2,749** | 4,345 |
| John Daly (retired 6 April 2014) | **191** | 713 | **59** | 104 | **171** | 1,056 | **143** | 1,358 | **109** | 480 | **2** | 46 | **675** | 3,757 |
| **Total** | **2,167** | 2,609 | **290** | 830 | **2,969** | 4,042 | **594** | 5,726 | **953** | 1,394 | **68** | 175 | **7,041** | 14,776 |

Notes:

1. **Nicandro Durante taxable benefits 2013:** includes a single one-off gross payment of £440,000 by the Company as a tax equalisation payment in respect of the tax charge arising from the FASC (Brazil) pension accrual in excess of the UK-regulated annual allowance.
2. **Long-term incentives:** these include cash dividend equivalent payments made under the LTIP which were previously categorised for the year ended 31 December 2013 as 'other emoluments'.
3. **Other emoluments:** include: (1) life insurance; (2) cash dividend equivalent payments made under the DSBS in 2013; and (3) the value of shares received under the Share Reward Scheme during the year.

† **Long-term incentives**: in accordance with the Regulations, estimates for the values of the vesting 2011 LTIP awards were given in the Annual Report on Remuneration 2013; these amounts have been re-presented to show the actual market values on the dates of exercise in 2014.

REMUNERATION REPORT

# Annual Report on Remuneration continued

## Analysis by individual Director – audited

### Nicandro Durante

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| **Salary** | **1,141** | 1,088 |
| **Taxable benefits**[1] | | |
| **Cash:** | | |
| – car allowance | **16** | 16 |
| **Non-cash:** | | |
| – health insurance/provision of 'walk-in' health care services | **8** | 7 |
| – tax advice | **22** | 36 |
| – tax equalisation payment re tax charge for FASC pension accrual[2] | **–** | 440 |
| – the use of a company driver | **62** | 64 |
| – employee welfare and medical payments in Brazil[3] | **–** | 37 |
| – maintenance of home security systems in the UK and Brazil | **17** | 19 |
| – other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events | **7** | 7 |
| **Total taxable benefits** | **132** | 626 |
| **Short-term incentives** | | |
| **IEIS:** annual performance-related bonus – cash receivable March 2015 (YE 2014); cash received March 2014 (YE 2013) | **704** | 895 |
| **DSBS:** annual performance-related bonus – award of deferred shares at this full market value March 2015 (YE 2014) and March 2014 (YE 2013)[4] | **704** | 895 |
| **IEIS:** individual performance uplift of 20% of total annual performance-related bonus – cash receivable March 2015 (YE 2014) | **282** | |
| **Total short-term incentives** | **1,690** | 1,790 |
| **Long-term incentives** | | |
| **LTIP: award 28 March 2012** of 124,688 shares; performance period 2012/2014 with a vesting date of 28 March 2015; none of the performance conditions have been met which will result in the lapse of the full award | **–** | |
| **LTIP: award 13 May 2011** of 147,329 shares; performance period 2011/2013; award vested on 13 May 2014 at 49.2% resulting in a vesting of 72,485 shares; the award was exercised on 30 July 2014 at an execution price of 3,535.0p per share[5] | | 2,562 |
| **Cash dividend equivalent (LTIP):** a cash sum equivalent to the aggregated dividends that an LTIP participant would have received as a shareholder over the three-year period on the actual number of shares that vest under an LTIP award; 2014: (LTIP award 13 May 2011; vested 13 May 2014); 2013: (LTIP award 25 March 2010; vested 25 March 2013)[6] | **293** | 228 |
| **Total long-term incentives** | **293** | 2,790 |
| **Pension-related benefits** | | |
| Unfunded unapproved retirement benefit scheme (UURBS – UK)[7] | **323** | 307 |
| **Total pension-related benefits** | **323** | 307 |
| **Other emoluments** | | |
| Life insurance | **17** | 15 |
| Cash dividend equivalent (DSBS) | | 55 |
| **Share Reward Scheme:** value of shares received during the year | **2** | 3 |
| **Sharesave Scheme:** grant of options on 26 August 2014 over 543 shares at an option price of 2,787.0p per share; options were awarded at a discount of 20% of the market value (3,483.0p per share) in accordance with the rules of the Sharesave Scheme | **19** | – |
| **Total other emoluments** | **38** | 73 |

Notes:
1. **Benefits:** the figures shown are gross amounts as it is the normal practice of the Company to pay the tax which may be due on any benefits, with the exception of the car or car allowance.
2. **Tax equalisation payment:** this is in respect of the tax charge arising from the FASC pension accrual in excess of the UK-regulated annual allowance and was met by a single one-off gross payment by the Company.
3. **Employee welfare medical payments in Brazil:** Nicandro Durante retained certain termination or compensation rights in respect of his former employment with Souza Cruz SA until 2 April 2012; outstanding welfare payments were made in 2013.
4. **DSBS:** an award of deferred shares attracts a payment of a cash sum equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share award held by the participant at each dividend record date and paid on or after the relevant dividend payment date.
5. **Long-term incentives:** LTIP award 13 May 2011; an estimated value of £2,380,000 was disclosed in the Annual Report on Remuneration for the year ended 31 December 2013.
6. **Long-term incentives:** cash dividend equivalent (LTIP); these payments were previously categorised for the year ended 31 December 2013 as 'other emoluments'; the 2013 comparative figures have been restated accordingly.
7. **UURBS pension-related benefits:** 2014: pension-related benefits represent the net accrual for the period, being the differential between the individual's total pension entitlements as at 31 December 2013 (adjusted for inflation) and as at 31 December 2014, multiplied by 20 in accordance with the Regulations (2013 calculation basis: a gross pension accrual for the period (adjusted for inflation), multiplied by 20, was applied).
8. **External directorship:** Nicandro Durante is a non-executive director of Reckitt Benckiser Group plc (appointed 1 December 2013). He retains the fees for this appointment 2014: £91,250 (2013: £7,083).

## Ben Stevens

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| **Salary** | **835** | 808 |
| **Taxable benefits**[1] | | |
| **Cash:** | | |
| – car allowance | **14** | 14 |
| **Non-cash:** | | |
| – health insurance/provision of 'walk-in' health care services | **4** | 4 |
| – the use of a company driver | **73** | 74 |
| – maintenance of home security systems in the UK | **3** | 3 |
| – other expenses incurred in connection with individual and/or spouse accompanied attendance at certain business functions and/or corporate events | **5** | 5 |
| **Total taxable benefits** | **99** | 100 |
| **Short-term incentives** | | |
| **IEIS:** annual performance-related bonus – cash receivable March 2015 (YE 2014); cash received March 2014 (YE 2013) | **462** | 598 |
| **DSBS:** annual performance-related bonus – award of deferred shares at this full market value March 2015 (YE 2014) and March 2014 (YE 2013)[2] | **462** | 598 |
| **IEIS:** individual performance uplift of 20% of total annual performance-related bonus – cash receivable March 2015 (YE 2014) | **184** | |
| **Total short-term incentives** | **1,108** | 1,196 |
| **Long-term incentives** | | |
| **LTIP: award 28 March 2012** of 70,137 shares; performance period 2012/2014 with a vesting date of 28 March 2015; none of the performance conditions have been met which will result in the lapse of the full award | **–** | |
| **LTIP: award 13 May 2011** of 79,558 shares; performance period 2011/2013; award vested on 13 May 2014 at 49.2% resulting in a vesting of 39,142 shares; the award was exercised on 31 July 2014 at an execution price of 3,486.0p per share[3] | | 1,364 |
| **Cash dividend equivalent (LTIP):** a cash sum equivalent to the aggregated dividends that an LTIP participant would have received as a shareholder over the three-year period on the actual number of shares that vest under an LTIP award; 2014: (LTIP award 13 May 2011; vested 13 May 2014); 2013: (LTIP award 25 March 2010; vested 25 March 2013)[4] | **158** | 214 |
| **Total long-term incentives** | **158** | 1,578 |
| **Pension-related benefits**[5] | | |
| British American Tobacco UK Pension Fund | **6** | 28 |
| Unfunded unapproved retirement benefit scheme (UURBS – UK) | **515** | 579 |
| **Total pension-related benefits** | **521** | 607 |
| **Other emoluments** | | |
| Life insurance | **7** | 7 |
| Cash dividend equivalent (DSBS) | | 46 |
| **Share Reward Scheme:** value of shares received during the year | **2** | 3 |
| **Sharesave Scheme:** grant of options on 26 August 2014 over 543 shares at an option price of 2,787.0p per share; options were awarded at a discount of 20% of the market value (3,483.0p per share) in accordance with the rules of the Sharesave Scheme | **19** | – |
| **Total other emoluments** | **28** | 56 |

Notes:
1. **Benefits:** the figures shown for benefits are gross amounts as it is the normal practice of the Company to pay the tax which may be due on any benefits, with the exception of the car or car allowance.
2. **DSBS:** an award of deferred shares attracts a payment of a cash sum equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share award held by the participant at each dividend record date and paid on or after the relevant dividend payment date.
3. **Long-term incentives:** LTIP award 13 May 2011; an estimated value of £1,285,000 was disclosed in the Annual Report on Remuneration for the year ended 31 December 2013.
4. **Long-term incentives:** cash dividend equivalent (LTIP); these payments were previously categorised for the year ended 31 December 2013 as 'other emoluments'; the 2013 comparative figures have been restated accordingly.
5. **Pension-related benefits:** 2014: pension-related benefits represent the net accrual for the period, being the differential between the individual's total pension entitlements as at 31 December 2013 (adjusted for inflation) and as at 31 December 2014, multiplied by 20 in accordance with the Regulations (2013 calculation basis: a gross pension accrual for the period (adjusted for inflation), multiplied by 20, was applied).

REMUNERATION REPORT

# Annual Report on Remuneration continued

## John Daly – retired 6 April 2014

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| **Salary** | **191** | 713 |
| **Taxable benefits**[1] | | |
| **Cash:** | | |
| – car allowance | **4** | 14 |
| – outstanding holiday entitlement | **19** | – |
| **Non-cash:** | | |
| – health insurance/provision of 'walk-in' health care services | **1** | 5 |
| – the use of a company driver | **17** | 75 |
| – maintenance of home security systems in the UK | **5** | 8 |
| – retirement gift | **13** | – |
| – other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events | – | 2 |
| **Total taxable benefits** | **59** | 104 |
| **Short-term incentives** | | |
| **IEIS:** annual performance-related bonus – cash received April 2014 (YE 2014)[2]; cash received March 2014 (YE 2013) | **171** | 528 |
| **DSBS:** annual performance-related bonus – award of deferred shares at this full market value March 2014 (YE 2013)[3] | | 528 |
| **Total short-term incentives** | **171** | 1,056 |
| **Long-term incentives** | | |
| **LTIP: award 22 March 2013** of 59,058 shares; performance period 2013/2015; award vested at date of retirement (6 April 2014) as determined by performance outcomes at the quarter end (31 March 2014) prior to departure in accordance with the LTIP rules; none of the performance conditions were met which resulted in the lapse of the full award[4a] | – | |
| **LTIP: award 28 March 2012** of 60,785 shares; performance period 2012/2014; award vested at date of retirement (6 April 2014) as determined by performance outcomes at the quarter end (31 March 2014) prior to departure in accordance with the LTIP rules; none of the performance conditions were met which resulted in the lapse of the full award[4a] | – | |
| **LTIP: award 13 May 2011** of 71,823 shares; performance period 2011/2013; award vested on 13 May 2014[4a] at 49.2% resulting in a vesting of 35,336 shares; the award was exercised on 29 September 2014 at an execution price of 3,496.0p per share[4b] | | 1,235 |
| **Cash dividend equivalent (LTIP):** a cash sum equivalent to the aggregated dividends that an LTIP participant would have received as a shareholder over the three-year period on the actual number of shares that vest under an LTIP award; 2014: (LTIP award 13 May 2011; vested 13 May 2014); 2013: (LTIP award 25 March 2010; vested 25 March 2013)[5] | **143** | 123 |
| **Total long-term incentives** | **143** | 1,358 |
| **Pension-related benefits**[6] | | |
| British American Tobacco UK Pension Fund | **13** | 86 |
| Unfunded unapproved retirement benefit scheme (UURBS – UK) | **96** | 394 |
| **Total pension-related benefits** | **109** | 480 |
| **Other emoluments** | | |
| Life insurance | **–** | 8 |
| Cash dividend equivalent (DSBS) | | 35 |
| **Share Reward Scheme:** value of shares received during the year | **2** | 3 |
| **Total other emoluments** | **2** | 46 |

Notes:
1. **Benefits:** the figures shown for benefits are gross amounts as it is the normal practice of the Company to pay the tax which may be due on any benefits, with the exception of the car or car allowance.
2. **Short-term incentives:** the Remuneration Committee determined John Daly as a 'good leaver' on 26 February 2014 with reference to the IEIS rules and made a cash-only award pro-rated for the period from 1 January 2014 to 6 April 2014 made on the basis of 'on-target' performance in accordance with the rules of the IEIS.
3. **DSBS**: an award of deferred shares attracts a payment of a cash sum equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share award held by the participant at each dividend record date and paid on or after the relevant dividend payment date.
4. **Long-term incentives:** (a) the Remuneration Committee determined John Daly as a 'good leaver' on 26 February 2014 with reference to the LTIP rules; and (b) LTIP award 13 May 2011; an estimated value of £1,160,000 was disclosed in the Annual Report on Remuneration for the year ended 31 December 2013.
5. **Long-term incentives:** cash dividend equivalent (LTIP); these payments were previously categorised for the year ended 31 December 2013 as 'other emoluments'; the 2013 comparative figures have been restated accordingly.
6. **Pension-related benefits:** 2014: pension-related benefits represent the net accrual for the period, being the differential between the individual's total pension entitlements as at 31 December 2013 (adjusted for inflation) and as at 6 April 2014, multiplied by 20 in accordance with the Regulations (2013 calculation basis: a gross pension accrual for the period (adjusted for inflation), multiplied by 20, was applied). John Daly ceased accrual in the PJ Carroll Directors' Plan with effect from 31 August 2004.
7. **Reynolds American Inc. (RAI):** John Daly has been a BAT-nominated director of RAI, an associate undertaking of the Company, since 1 December 2010. In accordance with the arrangements applicable up to the date of his retirement as a Director of the Company on 6 April 2014, the Group received a fee of US$81,665 from RAI (2013: US$277,284) in respect of John Daly's service in that role for the period from 1 January to 6 April 2014. Following his retirement from the Company, John Daly remained a BAT Designee from that date and receives an annual fee direct from RAI for these services in lieu of the fee previously paid to the Group.

## Base salary

The Executive Directors' salary review in February 2014 agreed the following changes effective from 1 April 2014. UK-based employees received salary increases averaging around 3.4% and within a range of 0.5% to 6.0% with effect from 1 April 2014.

| Executive Directors – salaries | **Base salary from 1 Apr 2014 £** | Percentage change % | Base salary from 1 Apr 2013 £ |
|---|---|---|---|
| Nicandro Durante | **1,155,000** | 5.00 | 1,100,000 |
| Ben Stevens | **841,500** | 3.00 | 817,000 |
| John Daly (retired 6 April 2014) | **721,000** | – | 721,000 |

## Additional requirements in respect of the single total figure table

This section sets out: supporting information and details for the single total figure for remuneration for the Executive Directors with particular reference to the annual IEIS short-term incentive payments; the extent to which performance conditions have been satisfied for the LTIP; and more details on pension entitlements.

## Short-term incentives: International Executive Incentive Scheme (IEIS) – audited

### IEIS performance review – process

These are earned by reference to the financial year and are paid in March following the end of the financial year. These variable performance-related awards are delivered 50% in cash and 50% in shares (deferred shares through the Deferred Share Bonus Scheme – DSBS). No element of the bonus is guaranteed.

Performance is reviewed in February each year on the basis of an internal report as well as an assessment by the Group's external auditors of the relevant calculations. The total payout is determined by the actual performance for each measure, relative to that measure's performance points. The Committee retains discretion to override that payout in circumstances where, in its judgement, the overall performance of the Company justifies a different outcome whether higher or lower than that determined by the bonus formula.

### IEIS performance review – presentation of outcomes

In presenting the outcomes for the year ended 2014, the Remuneration Committee has again considered carefully the question of commercial confidentiality and the sensitivity of bonus targets and results. It remains of the view that no specific targets, including retrospective targets, should be disclosed this year. The Group operates in a highly consolidated industry and is the second largest tobacco company in the world outside China. Its two key competitors (the largest and third largest global tobacco companies) are not subject to the same regulatory disclosures. The Committee considers that these competitors would gain significant commercial insights into the Group's specific objectives and key priorities for its brands and markets if actual targets were disclosed year on year, even if such disclosure was on a retrospective basis. The Committee considers that any such disclosure would be prejudicial to the interests of the Company and its shareholders. The specific performance measures, their weightings and actual performance achieved will continue to be disclosed and an indication is also given as to whether actual performance was at threshold target or maximum. The Committee will continue to review the commercial confidentiality of specific targets on an annual basis.

The ranges of indicative performance for the year ended 31 December 2014 are set out below.

| IEIS: performance measure | Assessment 2014 | Indicative outcome |
|---|---|---|
| **Adjusted profit from operations (growth over prior year)**<br>**Weighting: 40%** | Adjusted profit from operations of the Group's subsidiaries is at constant rates of exchange adjusted for the items shown as memorandum information in the Group Income Statement.<br>The growth in 2014 was underpinned by market share gains, pricing and a continued focus on cost management which has been partially offset by volume decline due to overall market contraction. Profit was also impacted by significant transactional adverse foreign exchange rates. | see below |

| Year | Threshold | Target | Maximum | Actual performance |
|---|---|---|---|---|
| **2014** | | | | +4% |
| 2013 | | | | +7% |
| 2012 | | | | +8% |

**Strategic target or objective**
The medium- to long-term target is to grow adjusted profit from operations on average by 6% per year.

REMUNERATION REPORT

# Annual Report on Remuneration continued

| IEIS: performance measure | Assessment 2014 | Indicative outcome |
|---|---|---|
| **Increase in the Group's share of key markets (growth over prior year)**<br>**Weighting: 20%** | The Group's retail market share in its key markets accounts for around 80% of the volumes of the Group's subsidiaries. The Group's share is calculated from data supplied by retail audit service providers and is rebased as and when the Group's key markets change. When rebasing does occur, the Company will also restate history and provide fresh comparative data on the markets.<br>Global market share in key markets grew by 10 basis points, driven by the success of the GDBs which were up by 90 basis points. | Year / Threshold / Target / Maximum / Actual performance<br>**2014**: +0.1%<br>2013: +0.2%<br>2012: +0.1%<br>**Strategic target or objective**<br>To continue to grow market share. |
| **Global Drive Brands (GDB) and Key Strategic Brands (KSB) volumes (growth over prior year)**<br>**Weighting: 20%** | GDB volumes comprise the cigarette volumes of Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans and include volumes of the Fine Cut variants of those brands sold in Western Europe.<br>KSB volumes comprise the cigarette volumes of State Express 555 and Shuang Xi associated with the joint venture with CNTC in China.<br>GDB and KSB volumes (as defined above) grew by 6.5% in 2014, driven by the contributions of Rothmans, Pall Mall and Dunhill and our China JV brands. | Year / Threshold / Target / Maximum / Actual performance<br>**2014**: +6.5%<br>2013: +2.1%<br>2012: +3.0%<br>**Strategic target or objective**<br>To increase our GDB and KSB volumes faster than the rest of the portfolio. |
| **Cash flow from operations (as against budget)**<br>**Weighting: 20%** | Cash flow from operations is defined as the free cash flow excluding restructuring costs, dividends and other appropriations from associate undertakings measured at constant rates of exchange.<br>The improvement in cash flow from operations reflected the continuing programme to optimise working capital coupled with the growth of underlying operating performance and was despite a substantial increase in net capital expenditure as the Group invests in TaO and its operations (growth markets and innovations). | Year / Threshold / Target / Maximum / Actual performance<br>**2014**: +8%<br>2013: +10%<br>2012: +14%<br>**Strategic target or objective**<br>To generate optimal cash flow while continuing to support business requirements. |

## IEIS payouts – Executive Directors

In addition to the Company-based IEIS corporate performance measures, the Remuneration Committee has also reviewed each Executive Director's personal performance against a weighted set of operational and strategic measures. These were agreed as their specific individual objectives at the beginning of the year and depend on the priorities for each Director's area of responsibility in the context of the delivery of Group strategy. Personal performance rated as 'Outstanding' can result in an uplift of either 10% or 20% to the corporate IEIS result but is subject to the applicable maximum award limit. Personal performance rated as 'Requires Improvement' results in any corporate IEIS result being reduced by 50%.

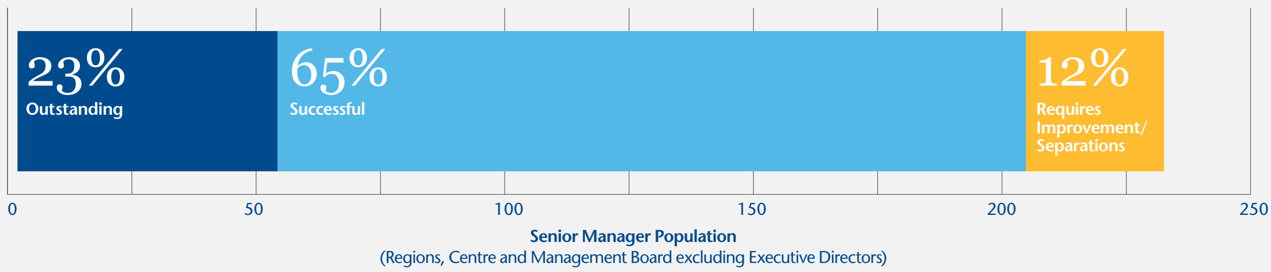
The Remuneration Committee exercised its discretion to rate the Executive Directors as follows: Nicandro Durante 'Outstanding' and Ben Stevens 'Outstanding'. These ratings resulted in the IEIS outcomes for both Executive Directors being increased by 20% to give a total short-term incentive result of 146.3% and 131.6% respectively.

The Committee concluded that Nicandro Durante has shown exceptional leadership and sound judgement in pursuing the long-term sustainability of the business while delivering results in keeping with the expectations of shareholders. This has been against a background of intense competition on price and the impact of significant foreign exchange volatility. More particularly, the Group has outperformed the sector and his personal objectives, which were all achieved or exceeded, included progressing the Group's M&A agenda, stimulating our NGP programme and developing management throughout the organisation.

In respect of Ben Stevens' personal performance, the Committee confirmed that his financial stewardship of the Group during a particularly challenging year to be worthy of special recognition. His personal objectives for the year, which were also all achieved or exceeded, included mitigating the impact of foreign exchange volatility and overseeing the implementation of the TaO programme in delivering transformational change with a global integrated management system. This, together with a focus on cost reduction, has led to a further improvement in the Group's operating margin.

A similar performance related uplift is available for all senior managers whose performance is rated as 'Outstanding'. The outcomes of the performance assessment for these senior managers in 2014 were as follows:

**Senior Managers: individual performance ratings 2014**




The total payouts for the Executive Directors (expressed as a percentage of base salary) are shown below with the actual payments shown in the individual analysis tables on pages 88–90.

The awards made under the DSBS are in the form of free ordinary shares in the Company that 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 all of the shares. Malus-only provisions apply for DSBS share awards made for 2014 and 2015 and clawback provisions operate from 2016 IEIS cash awards and DSBS share awards for performance ending 2015.

| IEIS payout: 50% in cash, 50% in deferred shares (DSBS), up to 20% performance uplift on the corporate result (cash) | Corporate result 2014 % | Performance uplift result 2014 % | Total IEIS result 2014 % | Maximum opportunity % | Corporate result 2013 % | Performance uplift result 2013 % | Total IEIS result 2013 % | Maximum opportunity % |
|---|---|---|---|---|---|---|---|---|
| Nicandro Durante | 121.9 | 20 | 146.3 | 200 | 162.7 | n/a | 162.7 | 200 |
| Ben Stevens | 109.7 | 20 | 131.6 | 180 | 146.4 | n/a | 146.4 | 180 |
| John Daly (retired 6 April 2014) | 85 | n/a | 85 | 180 | 146.4 | n/a | 146.4 | 180 |

Note:
1. **John Daly:** determined by the Remuneration Committee on 26 February 2014 as a 'good leaver'; the IEIS award for the year ended 31 December 2014 was a cash-only award receivable for the period from 1 January 2014 to 6 April 2014 made on the basis of an 'on-target' performance in accordance with the rules of the IEIS.

REMUNERATION REPORT

# Annual Report on Remuneration continued

## Long-term incentives: Long-Term Incentive Plan (LTIP) – audited

### Vesting of the 2012 LTIP awards in 2015: outcomes against performance measures

| 2012 LTIP awards<br>Performance measure | Threshold | Maximum | Actual | % maximum achieved |
|---|---|---|---|---|
| **Total shareholder return (TSR) ranking** – the constituents of the London Stock Exchange **FTSE 100 Index** at the beginning of the three-year performance period (1 January 2012 to 31 December 2014): **25% of award**. | | | | |
| The comparison is based on three months' average values and the Company achieved a below-median annualised TSR of 11.4%. Four companies in the comparator group delisted during the performance period. | Median (6% of award vests) | Upper quartile (25% of award vests) | Ranked 53/96 | 00.0 |
| **Total shareholder return (TSR) ranking** – a peer group of international **FMCG companies** at the beginning of the three-year performance period (1 January 2012 to 31 December 2014): **25% of award**. | | | | |
| The comparison is based on three months' average values and the Company achieved a below median annualised TSR of 11.4%. Two companies in the comparator group delisted during the performance period. | Median (6% of award vests) | Upper quartile (25% of award vests) | Ranked 19/24 | 00.0 |
| In the event of upper-quartile performance by the Company relative to both the comparator groups, 50% of the total award vests in full; 6% of the total award vest for median performance. There is a pro rata vesting between these two points. The TSR portions of an LTIP award do not vest for below median performance. | | | | |
| **Earnings per share (EPS)** – compound annual growth relative to UK inflation measured at current rates of exchange: **50% of award**. | | | | |
| 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 annum in excess of UK inflation. 8% of the award will vest if the EPS growth over the performance period is 3% in excess of inflation. An award will vest on a pro rata UK basis between these two points. None of the EPS portion of an award vests if EPS growth is less than 3% per annum in excess of UK inflation. | 3% | 8% | 0.2% | 00.0 |
| **Total** | | | | **00.0** |
| None of the performance conditions for the 2012 LTIP awards were met and none of the awards will vest on 28 March 2015. A nil value has been used for the purposes of the 'single figure' table. The awards held by the Executive Directors at the anniversary of the date of the award were as below. | | | | |

| 2012 LTIP awards<br>Performance period: 1 Jan 2011 – 31 Dec 2014<br>Award date: 28 March 2012<br>Vesting date: 28 March 2015 | Number of shares awarded | Number of shares vesting<br>% vesting | Number of shares lapsing<br>% lapsing | Value of shares vesting £'000 |
|---|---|---|---|---|
| **Nicandro Durante** | 124,688 | 0<br>00.0 | 124,688<br>100 | 0 |
| **Ben Stevens** | 70,137 | 0<br>00.0 | 70,137<br>100 | 0 |
| **John Daly:** determined by the Remuneration Committee on 26 February 2014 as a 'good leaver' in accordance with the rules of the LTIP; the actual vesting percentage in respect of his 2012 LTIP award was determined by the outcomes of the performance measures at the quarter end of 31 March 2014 prior to his date of retirement of 6 April which was also nil%. | | | | |

### Current position on outstanding LTIP awards

The tables below show: (1) the current position against the performance targets for the outstanding LTIP awards for 2013 and 2014 for Executive Directors as at 31 December 2014; and (2) a description of the key elements supporting the performance measures for those awards and for the vesting 2012 award referred to above.

| 2013 LTIP awards<br>Performance measure | Threshold | Maximum | Actual to<br>31 Dec 2014 | % achieved at<br>31 Dec 2014 |
|---|---|---|---|---|
| **Total shareholder return (TSR) ranking** – the constituents of the London Stock Exchange **FTSE 100 Index** at the beginning of the performance period (1 January 2013 to 31 December 2015): **25% of award**. | | | | |
| The comparison is based on three months' average values and the Company achieved a below-median annualised TSR of 9.8% for the interim testing period. Three companies in the comparator group have delisted during the performance period to date, 31 December 2014. | Median (6% of award vests) | Upper quartile (25% of award vests) | Ranked 51/97 | 00.0 |
| **Total shareholder return (TSR) ranking** – a peer group of international **FMCG companies** at the beginning of the performance period (1 January 2013 to 31 December 2015): **25% of award**. | Median (6% of award vests) | Upper quartile (25% of award vests) | Ranked 17/24 | 00.0 |
| The comparison is based on three months' average values and the Company achieved a below-median annualised TSR of 9.8% for the interim testing period. One company in the comparator group has delisted during the performance period to date, 31 December 2014. | | | | |
| In the event of upper quartile performance by the Company relative to both the comparator groups, 50% of the total award vests in full; 6% of the total award vest for median performance. There is a pro rata vesting between these two points. The TSR portions of an LTIP award do not vest for below-median performance. | | | | |
| **Earnings per share (EPS)** – compound annual growth relative to UK inflation measured at current rates of exchange: **50% of award**. | | | | |
| 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 annum in excess of UK inflation. 8% of the award will vest if the EPS growth over the performance period is 3% in excess of inflation. An award will vest on a pro rata UK basis between these two points. None of the EPS portion of an award vests if EPS growth is less than 3% per annum in excess of UK inflation. | 3% | 8% | 0.2% | 00.0 |
| **Total** | | | | **00.0** |

REMUNERATION REPORT

# Annual Report on Remuneration continued

| 2014 LTIP awards<br>Performance measure | Threshold | Maximum | Actual to 31 Dec 2014 | % achieved at 31 Dec 2014 |
|---|---|---|---|---|
| **Total shareholder return (TSR) ranking** – a peer group of international **FMCG companies** at the beginning of the performance period (1 January 2014 to 31 December 2016): **25% of award**. | | | | |
| The comparison is based on three months' average values and the Company achieved a below-median annualised TSR of 12.8% for the interim testing period. No company in the comparator group has delisted during the performance period to date, 31 December 2014. | Median (6% of award vests) | Upper quartile (25% of award vests) | Ranked 8/24 | **20.8** |
| **Earnings per share (EPS)** – compound annual growth measured at current rates of exchange: **50% of award**. | | | | |
| This element of the award will vest in full if EPS growth over the three-year performance period is an average of at least 10% per annum. 10% of the award will vest if the EPS growth over the performance period is 5%. An award will vest on a pro rata UK basis between these two points. None of the EPS portion of an award vests if EPS growth is less than 5% per annum. | 5% | 10% | 3.0% | **00.0** |
| **Net turnover (NTO)** – compound annual growth measured at constant rates of exchange: **25% of award**. | | | | |
| There is an underpin to this measure: vesting will only be triggered if (on the assumption that threshold or above is achieved in respect of the measure) the corresponding three-year constant compound annual growth rate (CAGR) of underlying operating profit exceeds the CAGR of the threshold performance level for underlying operating profit, as defined annually in the IEIS and is approved by the Board. | 2% | 5% | 3.2% | **13.6** |
| **Total** | | | | **34.4** |

## TSR: comparator group and measurement

The comparator group of FMCG companies, which is regularly reviewed to ensure that it remains both relevant and representative, is chosen to reflect the Company's financial and business trading environments. The constituents of the comparator group as at 31 December 2014 are as follows:

| FMCG peer group | | | |
|---|---|---|---|
| Anheuser-Busch InBev | Diageo | Kimberly-Clark | Philip Morris International |
| Campbell Soup | Heineken | LVMH | Procter & Gamble |
| Carlsberg | Imperial Tobacco Group | Mondeléz International | Reckitt Benckiser |
| Coca-Cola | Japan Tobacco | Nestlé | SABMiller |
| Colgate-Palmolive | Johnson & Johnson | PepsiCo | Unilever |
| Danone | Kellogg | Pernod Ricard | |

TSR is measured according to the return index calculated by Datastream and reviewed by the Committee's remuneration consultants. TSR 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 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, used historically by the Remuneration Committee for the purposes of TSR measurement, is considered to have the benefits of simplicity and directness of comparison with the performance of the comparator companies.

## EPS: calculation

Growth in EPS for these purposes is calculated on an adjusted diluted EPS basis using a formula which incorporates: (1) 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; and (2) the annualised retail price (RPI) growth between the last month of the year immediately preceding the performance period and the last month of the final financial year of the performance period. This method is considered to be a fair and reasonable measure of performance.

### LTIP – clawback and malus provisions

**Clawback (from 2015 awards):** provisions operate under which a part or a whole of an LTIP award can be recovered at any time during the two-year period from the end of the performance period or vesting date against the gross number of shares comprised in an LTIP award. The Committee may determine to apply clawback where: (1) there has been a material misrepresentation or misstatement by an LTIP participant in relation to the performance of the Company and/or the participant which has influenced the extent to which any prior award vested; or (2) where an LTIP participant leaves employment on the grounds of misconduct in relation to an act or omission committed at any time prior to and/or after the vesting date. LTIP awards may be reduced or lapsed accordingly and the value of past exercised awards may be subject to recovery by the Company.

**Malus (from 2014 awards):** provisions operate under which a part or a whole of an LTIP award can be recovered at any time during the three-year vesting period against the gross number of shares comprised in an LTIP award. The Committee may determine to apply clawback where: (1) there has been a material misrepresentation or misstatement by an LTIP participant in relation to the performance of the Company and/or the participant which has influenced the extent to which any prior award vested; or (2) where an LTIP participant leaves employment on the grounds of misconduct in relation to an act or omission committed at any time prior to and/or after the vesting date. LTIP awards may be reduced or lapsed accordingly and the value of past exercised awards may be subject to recovery by the Company.

### Vesting of past LTIP awards for the years ended 2010 to 2014

The following table shows the historical vesting of awards over the five-year period for the years ended 31 December 2010 to 31 December 2014, inclusive.

| LTIP award date | 28 Mar 2012 | 13 May 2011 | 25 Mar 2010 | 27 Mar 2009 | 15 May 2008 |
|---|---|---|---|---|---|
| Year ended | 31 Dec 2014 | 31 Dec 2013 | 31 Dec 2012 | 31 Dec 2011 | 31 Dec 2010 |
| Performance period | 2012/2014 | 2011/2013 | 2010/2012 | 2009/2011 | 2008/2010 |
| Vesting date | 28 Mar 2015 | 13 May 2014 | 25 Mar 2013 | 27 Mar 2012 | 15 May 2011 |
| **TSR – FTSE 100 group of companies:** | | | | | |
| Ranking | 53 | 34 | 15 | 21 | 12 |
| Percentage of vesting award | 00.0 | 17.9 | 25 | 25 | 25 |
| **TSR – FMCG peer group:** | | | | | |
| Ranking | 19 | 10 | 5 | 5 | 2 |
| Percentage of award vesting | 00.0 | 14.2 | 25 | 25 | 25 |
| **Earnings per share growth:** | | | | | |
| Percentage per annum above inflation | 0.2 | 4.1 | 6.5 | 10.8 | 15.9 |
| Percentage of vesting award | 00.0 | 17.1 | 37.1 | 50 | 50 |
| **Total vesting percentage** | 00.0 | 49.2 | 87.1 | 100 | 100 |

## All-employee share schemes

The Company operates the following all-employee share schemes in which the Executive Directors participate, as shown as at 31 December 2014.

| Executive Directors | Nicandro Durante | Ben Stevens |
|---|---|---|
| All-employee share schemes: | ✓ | ✓ |
| Sharesave Scheme | ✓ | ✓ |
| Share Incentive Plan (Partnership Scheme) | ✓ | ✓ |
| Share Incentive Plan (Share Reward Scheme) | ✓ | ✓ |

## Percentage change in the Chief Executive's remuneration

In the 2013 Annual Report on Remuneration, we reported the percentage change in salary, taxable benefits and short-term incentive of the Chief Executive between 2012 and 2013 and compared it with the average change, over that period, for UK Senior Management. This group was considered relevant in terms of succession planning and management reporting, being the top 80 employees who operate immediately below and principally report to members of the Management Board. These individuals, like the Executive Directors, are generally on UK contracts and are eligible to participate in the short-term incentive arrangements.

However, the Committee recognises that this small comparator group, while compliant with the Regulations, does not match with developing best practice. The Committee also noted the practical difficulties, given the global nature of the business, of making a worthwhile comparison between the Chief Executive and a comparator group including all Group employees. A presence in almost every country in the world generates wide variations in employee pay not least as a result of differing economic conditions and wide variations in GDP per capita. Nevertheless, the Committee agreed that a revised comparator group for the year ended 31 December 2014 will be used. This now comprises 1,979 employees, being the UK employee population on UK employment contracts (2013: 2,051 employees). In 2014, UK employees were awarded performance-based pay increases in the range 0.5% to 6.0% with an average of 3.4%.

The Remuneration Committee considers this broader based group will provide a more realistic comparison when considering the percentage change in the Chief Executive's remuneration.

REMUNERATION REPORT

# Annual Report on Remuneration continued

| | Base salary £'000 | | Increase % | Taxable benefits £'000 | | Increase/ (Decrease) % | Short-term incentives £'000 | | Increase/ (Decrease) % |
|---|---|---|---|---|---|---|---|---|---|
| | **2014** | 2013 | | **2014** | 2013 | | **2014** | 2013 | |
| Nicandro Durante (Chief Executive) | **1,141** | 1,088 | **4.9** | **132** | 186[2] | **(29.0)** | **1,690** | 1,790 | **(5.6)** |
| UK-based employees[1] | **67** | 65 | **3.1** | **4** | 4 | **–** | **22** | 33 | **(33.3)** |

Notes:
1. **UK-based Employees:** the data for this comparator group comprises: (1) the weighted average base salaries as at 31 December 2014 for all employees on a UK contract based in the UK; (2) the average taxable benefits per grade as at 31 December 2014; and (3) an estimated weighted average bonus based on that population as at 31 December 2014.
2. **Taxable benefits:** in order to provide a relevant comparative figure, the one-off tax equalisation payment of £440,000 for Nicandro Durante made in 2013 was excluded.

## 'Single figure' table for Non-Executives Directors' remuneration: aggregate – audited

The following table shows a single figure of remuneration for the Non-Executive Directors in respect of qualifying services for the year ended 31 December 2014 together with comparative figures for 2013. The aggregate Directors' emoluments are shown on page 100.

| Non-Executive Directors[1] | Base fee £'000 | | Other fees £'000 | | Taxable benefits[2] £'000 | | Total remuneration £'000 | |
|---|---|---|---|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 |
| **Karen de Segundo**<br>Chair of CSR Committee, Member of Nominations Committee | **90** | 90 | **31** | 26 | **–** | 1 | **121** | 117 |
| **Ann Godbehere**<br>Member of Audit, Remuneration and Nominations Committees | **90** | 90 | **18** | 13 | **1** | 1 | **109** | 104 |
| **Savio Kwan** (from 6 January 2014)<br>Member of CSR and Nominations Committees | **89** | n/a | **12** | n/a | **39** | n/a | **140** | n/a |
| **Christine Morin-Postel**<br>Senior Independent Director, Member of Audit, Remuneration and Nominations Committees | **90** | 90 | **48** | 33 | **8** | 9 | **146** | 132 |
| **Dr Gerry Murphy**<br>Chairman: Remuneration Committee, Member of Nominations Committee | **90** | 90 | **36** | 30 | **1** | 1 | **127** | 121 |
| **Kieran Poynter**<br>Chairman: Audit Committee, Member of Remuneration and Nominations Committees | **90** | 90 | **42** | 29 | **–** | – | **132** | 119 |
| **Richard Tubb** (from 28 January 2013)<br>Member of CSR and Nominations Committees | **90** | 84 | **12** | 6 | **36** | 54 | **138** | 144 |
| **Retired Non-Executive Directors** | | | | | | | | |
| **Robert Lerwill** (to 25 April 2013)<br>Chairman: Audit Committee | **n/a** | 29 | **n/a** | 11 | **n/a** | 3 | **n/a** | 43 |
| **Anthony Ruys** (to 30 April 2014)<br>Member of Audit and Nominations Committees | **30** | 90 | **4** | 7 | **5** | 14 | **39** | 111 |
| **Sir Nicholas Scheele** (to 25 April 2013)<br>Senior Independent Director and Member of CSR Committee | **n/a** | 29 | **n/a** | 13 | **n/a** | 81 | **n/a** | 123 |
| **Total** | **659** | 682 | **203** | 168 | **90** | 164 | **952** | 1,014 |

Notes:
1. **Board Committee memberships and positions:** shown as at 31 December 2014.
2. **Benefits:** the figures shown are gross amounts, as appropriate, and it is the normal practice of the Company to pay the tax that may be due on any benefits.

### Analysis of Non-Executive Directors' taxable benefits – audited

| Non-Executive Directors: taxable benefits | Taxable benefits: accompanied attendance at business functions £'000 | | Taxable benefits: travel expenses and 'walk-in' medical services £'000 | | Total taxable benefits £'000 | |
|---|---|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 |
| Karen de Segundo | **–** | – | **–** | 1 | **–** | 1 |
| Ann Godbehere | **–** | – | **1** | 1 | **1** | 1 |
| Savio Kwan (from 6 January 2014) | **–** | n/a | **39** | n/a | **39** | n/a |
| Christine Morin-Postel | **–** | – | **8** | 9 | **8** | 9 |
| Gerry Murphy | **–** | – | **1** | 1 | **1** | 1 |
| Kieran Poynter | **–** | – | **–** | – | **–** | – |
| Richard Tubb (from 28 January 2013) | **–** | 7 | **36** | 47 | **36** | 54 |
| **Retired Non-Executive Directors** | | | | | | |
| Robert Lerwill (to 25 April 2013) | **n/a** | – | **n/a** | 3 | **n/a** | 3 |
| Anthony Ruys (to 30 April 2014) | **–** | 1 | **5** | 13 | **5** | 14 |
| Sir Nicholas Scheele (to 25 April 2013) | **n/a** | 12 | **n/a** | 69 | **n/a** | 81 |
| **Total** | **–** | 20 | **90** | 144 | **90** | 164 |

Note:
1. **Benefits:** the figures shown for benefits are gross amounts, as appropriate, and it is the normal practice of the Company to pay the tax which may be due on any benefits.

## Fees

The basis for the fees is set out in the Policy Table above. The fees' structure for 2014 is set out below.

| Non-Executive Directors – fee structure | Jan–Dec 2014 £ | Jan–Dec 2014 £ |
|---|---|---|
| **Base fee** | **90,000** | |
| **Supplements:** | | **Committee membership fee** |
| – Senior Independent Director | **30,000** | **–** |
| – Audit Committee | **Chairman: 30,000** | **6,000** |
| – CSR Committee | **Chairman: 25,000** | **6,000** |
| – Nominations Committee | **Chairman: –** | **6,000** |
| – Remuneration Committee | **Chairman: 30,000** | **6,000** |

## Travel and other expenses

Non-Executive Directors are reimbursed for the cost of travel and related expenses in respect of their attendance at Board, Committee and General meetings. Where such reimbursement is classified as a benefit to the Director, it is also the practice of the Company to pay any tax due on that benefit. The Non-Executive Directors also have the benefit of GP 'walk-in' medical services located close to the Group's headquarters in London. They receive no other pay or benefits. Spouses of Non-Executive Directors may, from time to time, accompany the Directors to overseas or UK-based Board meetings and otherwise at hospitality functions during the year.

### Non-Executive Director – Anthony Ruys: ITC Ltd – audited

ITC Ltd (ITC) is an associate undertaking of the Company and is listed on stock exchanges in India. Anthony Ruys was a Non-Executive Director of the Company until his retirement on 30 April 2014 and was also a non-executive director of ITC until 24 July 2014. During the year ended 31 December 2014 from 1 January 2014 to 30 April 2014, Anthony Ruys received INR 520,000 (£5,106) in fees from ITC (2013: INR 780,000 (£7,614)). This amount was the subject of an annual supplement from a Group company so that he received a total annual fee for this appointment in 2014 of £25,000 (2013: £75,000). Anthony Ruys also had an interest in options over shares in ITC granted under the ITC Employee Stock Option Scheme 2006 which provided for the grant of options (ITC options) to its non-executive directors as permitted by the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines 1999. No ITC options were granted to Anthony Ruys in the period from 1 January 2014 to 30 April 2014.

REMUNERATION REPORT

# Annual Report on Remuneration continued

## 'Single figure' table for the Chairman's remuneration: aggregate – audited

The following table shows a single figure of remuneration for the Chairman in respect of qualifying services for the year ended 31 December 2014 together with comparative figures for 2013. The aggregate Directors' emoluments are shown below.

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| **Chairman – Richard Burrows** | | |
| **Fees** | **629** | 615 |
| **Taxable benefits**[1] | | |
| – health insurance | **14** | 13 |
| – use of a company driver | **59** | 59 |
| – installation and maintenance of home security systems in the UK and Ireland | **7** | 13 |
| – hotel accommodation and related expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events | **16** | 14 |
| **Other emoluments** | | |
| – commuting flights to London | **5** | 6 |
| **Total remuneration** | **730** | 720 |

Note:
1. **Benefits:** the figures shown for taxable benefits are gross amounts as it is the normal practice of the Company to pay any tax due on such benefits.

The Remuneration Committee is responsible for determining the terms of engagement and fees payable to the Chairman. The current terms of Richard Burrows' appointment provide for: (1) an annual fee of £632,400; (2) the use of a driver; (3) private medical insurance and personal accident insurance benefits; and (4) the reimbursement by the Company of the cost of return airline tickets to London from his home in Ireland in connection with his duties as Chairman. Richard Burrows also has the benefit of GP 'walk-in' medical services located close to Head Office. In common with the Non-Executive Directors, he 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.

## Aggregate Directors' emoluments – audited

The aggregate emoluments of the Directors of the Company were as follows:

| | Executive Directors | | Chairman | | Non-Executive Directors | | Total | |
|---|---|---|---|---|---|---|---|---|
| | 2014 £'000 | 2013 £'000 | 2014 £'000 | 2013 £'000 | 2014 £'000 | 2013 £'000 | 2014 £'000 | 2013 £'000 |
| Salary | **2,167** | 2,609 | | | | | **2,167** | 2,609 |
| Fees | | | **629** | 615 | **862** | 850 | **1,491** | 1,465 |
| Taxable benefits | **290** | 830 | **96** | 99 | **90** | 164 | **476** | 1,093 |
| Short-term incentives | **2,969** | 4,042 | | | | | **2,969** | 4,042 |
| Long-term incentives[1] | **594** | 5,726[2] | | | | | **594** | 5,726 |
| **Sub-total: fees; benefits; incentives** | **6,020** | 13,207 | **725** | 714 | **952** | 1,014 | **7,697** | 14,935 |
| Pension | **953** | 1,394 | | | | | **953** | 1,394 |
| Other emoluments[1] | **68** | 175 | **5** | 6 | | | **73** | 181 |
| **Sub-total: pension; other emoluments** | **1,021** | 1,569 | **5** | 6 | | | **1,026** | 1,575 |
| **Total emoluments** | **7,041** | 14,776 | **730** | 720 | **952** | 1,014 | **8,723** | 16,510 |

Note:
1. **Long-term incentives:** these include cash dividend equivalent payments made under the LTIP which were previously categorised for the year ended 31 December 2013 as 'other emoluments'; the 2013 comparative figures have been restated accordingly.
2. **Long-term incentives 2013:** in accordance with the Regulations, estimated values for the vesting of LTIP awards in the year were disclosed; these amounts have been re-presented to show the actual market values on the dates of exercise in 2014.

## Total pension entitlements

### Executive Directors' pension entitlements – audited

| Pension values | Normal retirement age | Accrued pension at year end 31 Dec 2014 £'000 | Additional value of pension on early retirement £'000 |
|---|---|---|---|
| **Nicandro Durante** | | | |
| UURBS (UK) | 60 | **81** | – |
| **Total** | | **81** | |
| **Ben Stevens** | | | |
| Pension Fund (UK) | 60 | **97** | – |
| UURBS (UK) | 60 | **226** | – |
| **Total** | | **323** | |
| **John Daly (retired 6 April 2014)** | | | |
| Pension Fund (UK) | 60 | **26** | – |
| UURBS (UK) | 60 | **139** | – |
| **Total** | | **165** | |

Notes:
1. **Total accrued pension:** this is the amount of pension that would be paid annually on retirement based on service to the end of the year, excluding any increase granted under the statute before retirement. The pension-related benefits disclosed for each Director in the single total figures for Directors' remuneration represent the individual's net accrual for the period, being the differential between the individual's total pension entitlements as at 31 December 2013 (adjusted for inflation) and as at 31 December 2014 (John Daly: 6 April 2014), multiplied by 20 in accordance with the Regulations.
2. **UK Pension Fund:** this 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.
3. **John Daly:** the amounts shown reflect the pensions in payment as at 31 December 2014 following his retirement and exclude the cash lump sum of £171,663 which he elected to take as commutation of part of his pension at retirement in accordance with the rules of the UK Pension Fund.

### Nicandro Durante – UURBS

Nicandro Durante's pension entitlements derived through the UURBS are as follows:

(1) Effective from 1 March 2006 (being the date of his appointment as a member of the Management Board), an accrual of 0.65% for each year of service (the UK Accrual Rate) on a basic sterling salary comparable to that of a General Manager of Souza Cruz SA; £788,328 per annum with effect from 1 April 2014. At retirement the pension will be based on a 12 months' average and will be provided through the UURBS.

(2) With effect from 1 January 2011 (being the date of his appointment as Chief Executive Designate), Nicandro Durante commenced an accrual of 2.5% for each year of service on a basic salary in excess of that stated in (1) above. At retirement the pension is based on a 12 months' average and will be provided through the UURBS.

Nicandro Durante receives a pension in payment from the Fundação Albino Souza Cruz (FASC) from Souza Cruz SA, a Brazilian registered company in which the Group has a 75% interest. This pension benefit has been in payment since April 2012 and currently amounts to approximately £361,382 per annum (after adjusting for currency exchange) reflecting Nicandro Durante's 31 years' service at Souza Cruz.

### Ben Stevens and John Daly – British American Tobacco UK Pension Fund and UURBS

Ben Stevens and John Daly each joined the British American Tobacco UK Pension Fund (the 'Pension Fund') after 1989 and before the closure of its non-contributory defined benefit section to new members in April 2005. As a result, prior to 6 April 2006, these individuals were subject to the HMRC cap on pensionable earnings (notionally £146,400 for the tax year 2014/15). 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). Further to the changes to the applicable tax regulations, the pension accrual in the Pension Fund for John Daly was restricted to the statutory annual allowance of £40,000 with the balance being provided through the UURBS. Ben Stevens has reached his lifetime allowance of £1.8 million and has therefore ceased accrual in the Pension Fund with all future benefits being provided through membership of the UURBS.

During the year, there has been no change to the overall pension entitlement of either Director. John Daly retired as an Executive Director on 6 April 2014. The amounts shown reflect the pensions in payment as at 31 December 2014 following his retirement and exclude the cash lump sum of £171,663 which he elected to take as commutation of part of his pension at retirement in accordance with the rules of the UK Pension Fund.

These commitments are included in Note 12 on the Accounts. Members of the Pension Fund are entitled to receive increases in their pensions, once in payment, in line with price inflation (as measured by the Retail Prices Index) up to 6% per annum.

### John Daly – P J Carroll Directors' Plan

John Daly was formerly a member of the P J Carroll Directors' Plan in Ireland. Under the Plan he is entitled to a deferred benefit of €110,776 per annum, as at 31 December 2013, payable from the age of 60. John Daly stepped down as Chief Operating Officer on 31 December 2013 and he transferred the value of this deferred benefit out of the P J Carroll Directors' Plan to a private arrangement in January 2014. He ceased to be an Executive Director on 6 April 2014.

REMUNERATION REPORT

# Annual Report on Remuneration continued

## Directors' shareholdings and scheme interests

### Executive Directors' shareholding guidelines

Executive Directors are encouraged to build up a high level of personal shareholding to ensure a continuing alignment of interests with shareholders. The shareholding guidelines require Executive Directors to hold shares in the Company equal to the value of a percentage of salary as set out in the table below.

| | Shareholding requirements (% of base salary) 31 Dec 2014 | No. of eligible[1] ordinary shares held at 31 Dec 2014 | Value of eligible ordinary shares held at 31 Dec 2014[2] £m | Actual percentage (%) of base salary at 31 Dec 2014 | No. of eligible[1] ordinary shares held at 24 Feb 2015 | Value of eligible ordinary shares held at 24 Feb 2015[2] £m | Actual percentage (%) of base salary at 24 Feb 2015 |
|---|---|---|---|---|---|---|---|
| **Executive Directors** | | | | | | | |
| Nicandro Durante | 400 | 171,297 | 6.0 | 519.1 | 171,297 | 6.4 | 554.2 |
| Ben Stevens | 250 | 59,349 | 2.1 | 246.8 | 60,349 | 2.3 | 268.0 |

| | Share ownership requirements (% of base salary) 6 Apr 2014 | No. of eligible ordinary shares held at 6 Apr 2014 | Value of eligible ordinary shares held at 6 Apr 2014[2] £m | Actual percentage (%) of base salary at 6 Apr 2014 |
|---|---|---|---|---|
| **Former Executive Director** | | | | |
| John Daly (retired 6 April 2014) | 250 | 59,820 | 2.0 | 277.7 |

Notes:
1. **Eligibility of shares:** shares earned but not yet vested under the Company's short-term (DSBS) and long-term (LTIP) incentive plans as well as those held in trust under the all-employee share ownership plan (SIP) are not eligible and do not count towards the shareholding requirement.
2. **Closing mid-market prices:** the following prices are applicable to the shareholding guideline tables above.

| Date | Closing mid-market price (pence) |
|---|---|
| 4 April 2014 (the nearest business day to 6 April 2014) | 3,346.5 |
| 31 December 2014 | 3,500.0 |
| 24 February 2015 (the latest practicable date prior to the approval of the Annual Report) | 3,737.0 |

Where an Executive Director does not, at any time, meet the requirements of the shareholding guidelines, the individual may, generally, only sell a maximum of up to 50% of any shares vesting (after tax) under the Company share plans until the threshold required under the shareholding guidelines has been met. There are no formal shareholding requirements for the Non-Executive Directors although they are encouraged to build a small interest in shares during the term of their appointment.

## Share interests – audited

The interests of the Directors who served during the year ended 31 December 2014 in the ordinary shares of the Company (beneficial, family and any connected persons) are as follows:

| | At 1 Jan 2014 | Awarded on 28 Mar 2014 | Released on 25 Mar 2014[1] | At 31 Dec 2014 | Changes from 31 Dec 2014 |
|---|---|---|---|---|---|
| **Executive Directors** | | | | | |
| **Nicandro Durante** | | | | | |
| **Shares held** – owned outright | 159,040 | | | **171,297** | |
| **SIP shares**[2] – held in employee benefit trust | 1,374 | | | **1,556** | **8**[4] |
| **DSBS:** deferred shares – unvested subject to continued employment | 78,706 | 27,466 | 22,056 | **84,116** | |
| **Total share interests** | 239,120 | | | **256,969** | |
| **Ben Stevens** | | | | | |
| **Shares held** – owned outright | 58,360 | | | **59,349** | **1,000**[4] |
| **SIP shares**[2] – held in employee benefit trust | 1,018 | | | **532** | |
| **DSBS:** deferred shares – unvested subject to continued employment | 61,822 | 18,356 | 23,702 | **56,476** | |
| **Total share interests** | 121,200 | | | **116,357** | |

| | At 1 Jan 2014 | Awarded on 28 Mar 2014 | Released on 25 Mar 2014[1] | At 6 April 2014 |
|---|---|---|---|---|
| **Former Executive Director** | | | | |
| **John Daly (retired 6 April 2014)**[6] | | | | |
| **Shares held** – owned outright | 44,792 | | | **59,820** |
| **SIP shares**[2] – held in employee benefit trust | 280 | | | **353**[6] |
| **DSBS:** deferred shares – unvested subject to continued employment | 51,137 | 16,199 | 17,833 | **49,503**[6] |
| **Total share interests** | 96,209 | | | **109,676** |

Notes:
1. **DSBS – deferred shares:** the closing mid-market price on the date of release (25 March 2014) was 3,250.5p.
2. **SIP shares:** these comprise vested and unvested shares in the Share Incentive Plan (Partnership Share Scheme and Share Reward Scheme/International Share Reward Scheme).
3. **Share Reward Scheme:** based on the performance for 2014, the Executive Directors will each be awarded a number of ordinary shares to the value of £1,828 on 1 April 2015.
4. **Changes from 31 December 2014:** these relate to: (1) the purchase by **Nicandro Durante** of a total of eight ordinary shares under the Partnership Share Scheme on 7 January and 4 February 2015; and (2) the exercise by **Ben Stevens** of 1,000 options held under the Sharesave Scheme on 28 January 2015.
5. **BATGET:** on 31 December 2014, the Group's employee share ownership trust, referred to later in this Remuneration Report, held a total of 6,357,513 ordinary shares in the Company. All participating employees, including the Executive Directors, are deemed to have a beneficial interest in these shares.
6. **John Daly: SIP shares** – released in accordance with the terms of relevant plan on 14 April 2014; **DSBS shares** – the Remuneration Committee determined on 26 February 2014 that he was a 'good leaver' and he received full and immediate vesting of the 49,503 shares which were sold at a price of 3,404.0p per share on 10 April 2014.

| | At 1 Jan 2014 | At 31 Dec 2014 |
|---|---|---|
| **Chairman**<br>Shares held – owned outright | | |
| Richard Burrows | 10,000 | **15,000** |
| **Non-Executive Directors**<br>Shares held – owned outright | | |
| Karen de Segundo | 2,000 | **2,000** |
| Ann Godbehere[1] | 2,907 | **3,100** |
| Savio Kwan | – | **–** |
| Christine Morin-Postel | 3,000 | **3,000** |
| Gerry Murphy | 3,000 | **5,000** |
| Kieran Poynter | 5,000 | **5,000** |
| Richard Tubb | – | **–** |

Notes:
1. **Ann Godbehere**: these share interests consist of 1,550 American Depositary Receipts, each of which represents two ordinary shares in the Company.
2. **Changes from 31 December 2014**: there were no changes in the share interests of the Chairman and the Non-Executive Directors.

REMUNERATION REPORT

# Annual Report on Remuneration continued

| | At 1 Jan 2014 | At 30 Apr 2014 |
|---|---|---|
| **Former Non-Executive Director** | | |
| Shares held – owned outright | | |
| Anthony Ruys (to 30 April 2014) | 3,000 | **3,000** |

## Scheme interests – share incentive awards – audited

The scheme interests of the Executive Directors who served during the year ended 31 December 2014 in the shares of the Company under the Long-Term Incentive Plan (LTIP) are as follows:

| | LTIP shares balance 1 Jan 2014 | LTIP shares awarded in 2014 | Award date | LTIP shares vested at 49.2% in 2014 (13 May) | LTIP shares lapsed in 2014 | LTIP shares exercised in 2014 | **LTIP shares balance 31 Dec 2014** | Performance period |
|---|---|---|---|---|---|---|---|---|
| **Executive Director** | | | | | | | | |
| **Nicandro Durante** | 147,329 | | 13 May 2011 | 72,485 | 74,844 | 72,485 | – | 2011/2013 |
| | 124,688 | | 28 Mar 2012 | | | | **124,688** | 2012/2014 |
| | 119,828 | | 22 Mar 2013 | | | | **119,828** | 2013/2015 |
| | | 135,052 | 28 Mar 2014 | | | | **135,052** | 2014/2016 |
| **Total** | **391,845** | **135,052** | | **72,485** | **74,844** | **72,485** | **379,568** | |
| **Ben Stevens** | 79,558 | | 13 May 2011 | 39,142 | 40,416 | 39,142 | – | 2011/2013 |
| | 70,137 | | 28 Mar 2012 | | | | **70,137** | 2012/2014 |
| | 66,932 | | 22 Mar 2013 | | | | **66,932** | 2013/2015 |
| | | 75,230 | 28 Mar 2014 | | | | **75,230** | 2014/2016 |
| **Total** | **216,627** | **75,230** | | **39,142** | **40,416** | **39,142** | **212,299** | |

| | LTIP shares balance 1 Jan 2014 | Award date | LTIP shares vested in 2014 (13 May) | LTIP shares lapsed in 2014 | LTIP shares exercised in 2014 | LTIP shares balance 31 Dec 2014 | Performance period | Vesting notes |
|---|---|---|---|---|---|---|---|---|
| **Former Executive Director** | | | | | | | | |
| **John Daly[4] (retired 6 April 2014)** | 71,823 | 13 May 2011 | 35,336 | 36,487 | 35,336 | – | 2011/2013 | Award vested at 49.2%. |
| | 60,785 | 28 Mar 2012 | 0 | 60,785 | | – | 2012/2014 | Award vested at date of retirement as determined by performance outcomes at the quarter end (31 March 2014) prior to departure in accordance with the LTIP rules; the award vested at nil% resulting in the lapse of the full award. |
| | 59,058 | 22 Mar 2013 | 0 | 59,058 | | – | 2013/2015 | Award vested at date of retirement as determined by performance outcomes at the quarter end (31 March 2014) prior to departure in accordance with the LTIP rules; the award vested at nil% resulting in the lapse of the full award. |
| **Total** | **191,666** | | **35,336** | **156,330** | **35,336** | **–** | | |

Notes:
1. **Non-Executive Directors:** they do not participate in the LTIP.
2. **LTIP interests:** (a) awards of shares made under the LTIP are for nil consideration; (b) the changes to the performance conditions for the LTIP awards made from 2014 onwards are described above; there have been no other variations in the terms and conditions of the LTIP interests during the year.
3. **Aggregate gains of LTIP shares exercised in year (£'000):** (a) **Nicandro Durante** £2,562 at 3,535.0p on 30 July 2014; (b) **Ben Stevens** £1,364 at 3,486.0p on 31 July 2014; and (c) **John Daly** £1,235 at 3,496.0p on 29 September 2014.
4. **John Daly:** no awards were made in 2014; the Remuneration Committee determined John Daly as a 'good leaver' on 26 February 2014 with reference to the LTIP rules.

## Scheme interests – share options – audited

The scheme interests of the Executive Directors who served during the year ended 31 December 2014 in the shares of the Company under the Sharesave Scheme are as follows:

| | At 1 Jan 2014 Number of shares | Grant date | Grant price pence | Granted in 2014 | Exercised in 2014 | Lapsed in 2014 | At 31 Dec 2014 Number of shares | Date from which exercisable | Latest expiry date |
|---|---|---|---|---|---|---|---|---|---|
| **Nicandro Durante** | 591 | 28 Mar 2012 | 2,536.0 | | | | **591** | May 2017 | Oct 2017 |
| | | 26 Aug 2014 | 2,787.0 | 543 | | | **543** | Oct 2019 | Mar 2020 |
| **Total** | 591 | | | 543 | | | **1,134** | | |
| **Ben Stevens** | 1,000 | 25 Nov 2009 | 1,555.0 | | | | **1,000**[2] | Jan 2015 | Jun 2015 |
| | | 26 Aug 2014 | 2,787.0 | 543 | | | **543** | Oct 2019 | Mar 2020 |
| **Total** | 1,000 | | | 543 | | | **1,543** | | |
| **John Daly (retired 6 April 2014)** | 457 | 25 Mar 2011 | 1,974.0 | | | 457 | – | May 2014 | Oct 2014 |
| **Total** | 457 | | | | | 457[3] | – | | |

Notes:
1. **Sharesave:** there have been no variations in the terms and conditions of these interests in share options during the year; the aggregate gain on the exercise of Sharesave options was £nil (2013: £nil); 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; (d) options are normally granted at a discount of 20% to the market price at the time of the invitation, as permitted under the rules of the Sharesave Scheme (2009: 1,943.0p; 2011: 2,466.5p; 2012: 3,170.0p; and 2014: 3,483.0p).
2. **Ben Stevens:** exercised 1,000 options on 28 January 2015 giving an aggregate gain of £22,235 on the basis of a closing mid-market price of 3,778.5p; he retained the shares.
3. **John Daly:** the options were exercisable upon his departure in accordance with the rules of Sharesave Scheme; the options lapsed on 7 October 2014.
4. **Non-Executive Directors:** they do not participate in the Sharesave Scheme.

## Scheme interests awarded during the year ended 31 December 2014 – audited

| | Scheme | Date of award | Basis of award – multiple of base salary % | Face value £'000 | Percentage vesting at threshold performance | Number of shares | Performance period end date | Awards exercisable |
|---|---|---|---|---|---|---|---|---|
| **Executive Directors**[3] | | | | | | | | |
| **Nicandro Durante** | LTIP | 28 Mar 2014 | 400 | 4,399 | 20 | 135,052 | 31 Dec 2016 | 28 Mar 2017–27 Mar 2024 |
| **Ben Stevens** | LTIP | 28 Mar 2014 | 300 | 2,450 | 20 | 75,230 | 31 Dec 2016 | 28 Mar 2017–27 Mar 2024 |

Notes:
1. **Face value of awards 2014:** is calculated by reference to the closing mid-market price of the Company's ordinary shares being an average over three dealing days preceding the date of grant of the award: 3,258.0p.
2. **John Daly:** no LTIP awards were made during the year ended 31 December 2014.
3. **Threshold performance:** the percentage vesting is broken down as follows:

| | |
|---|---|
| **TSR – FMCG peer group** | |
| Ranking – median | |
| Percentage of vesting award | 6 |
| **Earnings per share growth** | |
| Compound annual growth measured at current rates of exchange | |
| Percentage of vesting award | 8 |
| **Net turnover** | |
| Compound annual growth at constant rates of exchange | |
| Percentage of vesting award | 6 |
| **Total** | **20** |

## Shareholder dilution – options and awards outstanding

In accordance with The Investment Association's Principles of Remuneration, the Company can satisfy awards under all its share plans with new issue shares or shares issued from treasury only up to a maximum of 10% of its issued share capital in a rolling 10-year period. Within this 10% limit, the Company can only issue (as newly issued shares or from treasury) 5% of its issued share capital to satisfy awards under discretionary or executive plans. The Company's former executive share option plan (the 'Share Option Scheme') closed to further grants in March 2004 and the remaining outstanding options lapsed during the year ended 31 December 2014. The rules of the Company's Deferred Share Bonus Scheme (DSBS) do not allow for the satisfaction of awards by the issue of new shares.

During the year, new ordinary shares were issued by the Company in relation to the Sharesave Scheme. Under the Sharesave Scheme, a total of 911,260 options over ordinary shares in the Company were outstanding at 31 December 2014, representing 0.05% of the Company's issued share capital (excluding shares held in treasury). The options outstanding under the Sharesave Scheme are exercisable until end March 2019 at option prices ranging from 1,555.0p to 2,807.0p.

REMUNERATION REPORT

# Annual Report on Remuneration continued

## 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 DSBS and the LTIP and was used to satisfy the exercise of options under the closed Share Option Scheme before it expired. The number of shares held in BATGET to satisfy outstanding awards is consistently monitored by a committee of senior management that reports to the Board's Employee Share Schemes Committee.

## Funding of the BATGET

BATGET is funded by interest-free loan facilities from the Company totalling £1 billion, 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 £272 million at 31 December 2014 (2013: £603 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.

## Ordinary shares held in the BATGET

Details of the ordinary shares in the Company held by BATGET are set out below:

| | 1 January 2014 | 31 December 2014 |
|---|---|---|
| Number of ordinary shares | 8,929,075 | **6,357,513** |
| Market value of ordinary shares | £289.1m | **£222.5m** |
| Percentage of the issued share capital of the Company % | 0.44 | **0.31** |

BATGET currently waives dividends on the ordinary shares held by it. BATGET waived payment of the final dividend for 2013 of £8.4 million in May 2014 and the interim dividend for 2014 of £3.3 million in September 2014. The trustee does not exercise any voting rights while shares are held by BATGET. 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 on the accounts.

## Other required disclosures

### Payments to former Directors and payments for loss of office – audited

The Company did not make: (1) any payment of money or other assets to former Directors; or (2) any payments to Directors for loss of office during the year ended 31 December 2014 other than in respect of certain elements of remuneration referenced in the following table:

| Director | Date of retirement | Disclosure |
|---|---|---|
| John Daly (Executive Director) | 6 April 2014 | John Daly did not receive any payment for loss of office or any other payments in relation to the cessation of his employment with the Company. Certain elements of John Daly's remuneration, which were consequent upon his retirement and which were paid at or following the date of his retirement, are disclosed in this Report. |
| Anthony Ruys (Non-Executive Director) | 30 April 2014 | Anthony Ruys did not receive any payment for loss of office or any other payments in relation to the cessation of his term of appointment with the Company. He received pro-rated Board fees and Audit Committee fees to the date of his retirement and these are disclosed in this Report. |

## Voting on the Remuneration Report at the 2014 AGM

At the AGM on 30 April 2014, the shareholders considered and voted on the Directors' Remuneration Report as set out on the table below. No other resolutions in respect of Directors' remuneration and incentives were considered at the AGM.

| | Approval of Directors' Remuneration Policy | | Approval of Directors' Remuneration Report (other than the part containing the Remuneration Policy) – advisory vote only | |
|---|---|---|---|---|
| | AGM 2014 | AGM 2013 | AGM 2014 | AGM 2013 |
| Percentage for | **90.54** | n/a | **95.30** | 91.36 |
| Votes for including discretionary votes | **1,251,092,549** | n/a | **1,316,656,333** | 1,257,995,534 |
| Percentage against | **9.46** | n/a | **4.70** | 5.72 |
| Votes against | **130,764,082** | n/a | **64,934,172** | 78,807,245 |
| **Total votes cast excluding votes withheld** | **1,381,856,631** | n/a | **1,381,590,505** | 1,336,802,779 |
| Votes withheld[1] | **4,014,169** | n/a | **4,280,179** | 40,209,042 |
| **Total votes cast including votes withheld** | **1,385,870,800** | n/a | **1,385,870,684** | 1,377,011,821 |

Note:

1. **Votes withheld:** these are not included in the final proxy figures as they are not recognised as a vote in law.

In early 2014 the Company continued its discussions with shareholders on the Remuneration Policy that had started in the autumn of 2013. In addition, the Chairman undertook his regular programme of engagement in the run-up to the 2014 AGM. The Committee considered the broad range of views and opinions in relation to the proposed changes to the policy: (1) the introduction of the individual performance element in IEIS; (2) the introduction of NTO as a metric in the LTIP; (3) the reduction of the TSR component in the LTIP; and (4) an adjustment to the EPS metric also in the LTIP. These changes were considered to be largely positive.

## Directors' remuneration in the year ending 31 December 2015

### Proposed implementation of Remuneration Policy in 2015

The Remuneration Policy for the Executive Directors and the Non-Executive Directors, which was approved by shareholders at the AGM on 30 April 2014, is set out in full as the Policy Report in the Annual Report 2013 which is available on the Company's website in the Investor Relations section. A summary of this approved policy, which is binding on the Company and is expected to apply for three years, is set out from page 72 in the form of the Future Policy Table (Executive Directors) and the Remuneration Table (Non-Executive Directors and the Chairman).

The basic elements to note for 2015 are set out below:

| Remuneration element<br>YE 31 December 2015 | Chief Executive<br>(Nicandro Durante) | Finance Director<br>(Ben Stevens) |
|---|---|---|
| Base salary from 1 April 2015 | £1,190,000 (+3%) | £867,000 (+3%) |
| Short-term incentives:<br>IEIS opportunity<br>50% cash<br>50% deferred shares (DSBS) | Maximum bonus opportunity:<br>**200%** of base salary<br>On-target opportunity: **100%** | Maximum bonus opportunity:<br>**180%** of base salary<br>On-target opportunity: **90%** |
| | Up to **20% uplift** possible if individual performance is assessed as outstanding (up to the maximum opportunity of 200% or 180%). Up to **50% reduction** possible if individual performance is assessed as poor. | |
| Short-term incentives<br>IEIS – performance measures and weightings (%) | – Adjusted profit from operations **(40%)**<br>– Increase in the Group's share of key markets **(20%)**<br>– Global Drive Brands and Key Strategic Brands volumes **(20%)**<br>– Cash flow from operations **(20%)**<br>Specific IEIS bonus targets are considered to be commercially sensitive and are not disclosed. | |
| Long-term incentives<br>LTIP awards 2015 opportunity | Maximum vesting: shares to a value of **400%** of base salary at time of award.<br>Threshold vesting: **20%** of maximum (**80%** of base salary). | Maximum vesting shares to a value of **300%** of base salary at time of award.<br>Threshold vesting: **20%** of maximum (**60%** of base salary). |
| Long-term incentives<br>LTIP awards 2015 – performance measures and weightings (%) | **TSR** Performance versus international FMCG companies comparator group **(25%)**;<br>**EPS** Adjusted diluted EPS growth at constant rates of exchange **(50%)**; and<br>**NTO** CAGR of net turnover at constant rates of exchange **(25%)**. Underpin: no NTO element payable unless the corresponding three-year constant currency CAGR of underlying profit exceeds the CAGR of the threshold performance level for underlying operating profit (as defined annually in the IEIS). | |

| Remuneration element<br>YE 31 December 2015 | Chairman (Richard Burrows) – Fee from 1 April 2015<br>£645,000 (+2%) | |
|---|---|---|
| | Non-Executive Directors – Fees from 1 January 2015 | |
| Base fee | £92,700 (+3%) | |
| Supplements: | Senior Independent Director: £30,000 (no change) | |
| Committee Membership Fees: | | |
| Audit Committee | Chairman: £30,000 (no change) | £6,000 (no change) |
| CSR Committee | Chairman: £25,000 (no change) | £6,000 (no change) |
| Nominations Committee | Chairman: £– (no change) | £6,000 (no change) |
| Remuneration Committee | Chairman: £30,000 (no change) | £6,000 (no change) |

On behalf of the Board

**Gerry Murphy**
Chairman of the Remuneration Committee
25 February 2015

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# Other corporate disclosures

## Strategic report disclosures

Section 414C(11) of the Companies Act 2006 allows the Board to include in the Strategic Report information that it considers to be of strategic importance that would otherwise need to be disclosed in the Directors' Report. The Board has chosen to take advantage of this provision and accordingly, the information set out below, which would otherwise be required to be contained in the Directors' Report, has been included in the Strategic Report.

| Information required in the Directors' Report | Section in the Strategic Report |
|---|---|
| Certain risk information about the use of financial instruments | Financial Review |
| An indication of likely future developments in the business of the Group | Delivering our strategy |
| An indication of the activities of the Group in the field of research and development | Delivering our strategy: Sustainability |
| A statement describing the Group's policy regarding the hiring, continuing employment and training, career development and promotion of disabled persons | Delivering our strategy: Winning organisation |
| Details of employee engagement: information, consultation, share scheme participation and the achievement of a common awareness of the financial and economic factors affecting the performance of the Group | Delivering our strategy: Winning organisation |
| Disclosures concerning greenhouse gas emissions | Delivering our strategy: Sustainability |

## Listing Rules (LRs) disclosures

For the purpose of LR 9.8.4C R, the applicable information required to be disclosed in accordance with LR 9.8.4 R can be found in the sections set out below.

| Applicable information required by LR 9.8.4 R | Section in this Annual Report |
|---|---|
| Section (12) – Shareholder waivers of dividends | Remuneration Report, page 106 and Other Corporate Disclosures, page 109 |
| Section (13) – Shareholder waivers of future dividends | Remuneration Report, page 106 and Other Corporate Disclosures, page 109 |

## Dividends

### Final dividend – recommendation

The Board recommends to shareholders for approval at the Annual General Meeting on 29 April 2015, a final dividend of 100.6p per ordinary share of 25p for the year ended 31 December 2014.

### Final dividend – key dates and South Africa branch register

In compliance with the requirements of the London Stock Exchange (LSE) and Strate, the electronic settlement and custody system used by the JSE Limited (JSE), the following are the salient dates for the payment of the final dividend:

| Event | Date 2015 |
|---|---|
| Last day to trade (LDT) cum-dividend (JSE) | 13 March |
| Shares commence trading ex-dividend (JSE) | 16 March |
| Shares commence trading ex-dividend (LSE) | 19 March |
| Record date (JSE and LSE) | 20 March |
| Payment date | 7 May |

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 = 17.76480 as at 24 February 2015 (the closing rate for that date as quoted on Bloomberg), results in an equivalent final dividend of 1,787.13888 SA cents per ordinary share. From the commencement of trading on 26 February 2015 (the date of the preliminary announcement) until the close of business on 20 March 2015, no removal requests between the UK main register and the South Africa branch register (in either direction) are permitted. Further, from the close of business on 13 March 2015 until the close of business on 20 March 2015, no transfers between the UK main register and the South Africa branch register are permitted and no shares may be dematerialised or rematerialised between 16 and 20 March 2015, both days inclusive.

### South Africa branch register: Dividends Tax information

South Africa Dividends Tax of 268.07083 SA cents per ordinary share will be withheld from the gross final dividend paid to shareholders on the South Africa branch register at the rate of 15% unless a shareholder qualifies for an exemption. After Dividends Tax has been withheld, the net dividend will be 1,519.06805 SA cents per ordinary share.

The Company, as a South Africa non-resident, was not subject to the secondary tax on companies (STC) regime which used to operate before the introduction of Dividends Tax. No STC credits are available for set-off against the Dividends Tax liability on the final dividend which is regarded as a 'foreign dividend' for the purposes of the South Africa Dividends Tax. British American Tobacco p.l.c. is registered with the South African Revenue Service (SARS) with tax reference number 9378193172.

Dividends Tax and the information provided above is only of direct application to shareholders on the South Africa branch register. Shareholders on the South Africa branch register should refer to 'Shareholder and contact information' for the contact details of Computershare Investor Services Proprietary Limited, the Company's registrar for the branch register.

### Dividend information

Further details of the total amounts of dividends paid in 2014 (with 2013 comparatives) are given in note 8 on the accounts.

## Annual General Meeting (AGM)

The AGM will be held at Milton Court Concert Hall, Silk Street, London EC2Y 9BH at 11.30am on 29 April 2015. Details of the business to be proposed at the meeting are contained in the Notice of AGM, which is sent to all shareholders and published on www.bat.com

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 voting results are announced on the same day through the Regulatory News Service and on www.bat.com

## Share capital

As at 31 December 2014, the Company had an allotted and fully paid share capital of 2,026,693,029 ordinary shares of 25p each with an aggregate nominal value of £506.7 million (including treasury shares and shares owned by the employee share trusts).

At the close of business on 24 February 2015 (the latest practicable date prior to the recommendation of the final dividend for the year ended 31 December 2014), the Company had a total of 1,864,117,591 ordinary shares in issue (excluding treasury shares). The Company held 162,645,590 ordinary shares in treasury giving a total issued share capital of 2,026,763,181 ordinary shares.

## Significant shareholders

At 31 December 2014, the following substantial interests (3% or more) in the Company's ordinary share capital (voting securities) had been notified to the Company in accordance with Section 5.1.2 of the Disclosure Rules and Transparency Rules. As at 25 February 2015, the Company had not received notification either of any change in the interests below or that any other person holds 3% or more of its ordinary shares.

| Name | Number of ordinary shares | % of issued share capital |
|---|---|---|
| BlackRock, Inc. | 132,891,526 | 7.13 |
| Reinet Investments S.C.A. | 76,518,264 | 4.10 |
| The Capital Group Companies, Inc. | 67,664,399 | 3.63 |

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

## Stock market listings

### Premium listing

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). This is classified as a premium listing. The share registrar is Computershare Investor Services plc.

### Secondary listing

The Company's ordinary shares have 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 2014, 313,088,347 ordinary shares of the Company (being 16.80% of the Company's issued ordinary share capital – excluding treasury shares) were on its South Africa branch register for which Computershare Investor Services Proprietary Limited are share registrars.

### American Depositary Receipts

The Company's ordinary shares are also traded on NYSE MKT 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 2014, 39,375,710 ADRs were outstanding, represented by 78,751,420 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 MKT 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 and those that would be required if the Company were subject to those rules. The statement is available at www.bat.com/governance.

## Purchase of own shares

### Share buy-back programme 2014

The Board reinstated its on-market share buy-back programme on 28 February 2014 following the Company's Preliminary Announcement on 27 February 2014 and under the authority granted by shareholders in 2013. At the 2014 AGM, the Company was given authority to purchase up to 188,400,000 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% 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.

During the year ended 31 December 2014, the Company made on-market repurchases totalling 23,129,245 of its own ordinary shares, representing 1.24% of the issued share capital (excluding treasury shares) as at 31 December 2014 and at a value of £795.2 million, excluding transaction costs. These share repurchases were made on the basis of effectively managing the Company's capital base thereby generating an increase in the Company's earnings per share and being in the interest of its shareholders generally. In accordance with the Company's policy, all of these repurchased shares are held as treasury shares and as at 31 December 2014 the number of treasury shares was 162,645,590. 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.

The share buy-back programme was suspended with effect from 30 July 2014 following the Company's announcement on 15 July 2014 that the Group planned to invest US$4.7 billion as part of Reynolds American's proposed acquisition of Lorillard.

### Renewal of authority to purchase shares

The present authority for the Company to purchase its own shares will expire at the 2015 AGM. The Directors are seeking a fresh authority for the Company to purchase its ordinary shares in order that the appropriate mechanisms are 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 interest of its shareholders generally. Further details 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 agreement contains certain termination and other rights for our counterparties upon a change of control of the Company.

On 29 May 2014, the Company, B.A.T. International Finance p.l.c., British American Tobacco Holdings (The Netherlands) B.V. and B.A.T. Netherlands Finance 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 £3 billion for general corporate

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# Other corporate disclosures continued

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 12 September 2014, the Company (as guarantor) and B.A.T. International Finance p.l.c. (as borrower) entered into a term loan 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 borrower US$4.7 billion for the Company's planned investment in Reynolds American in connection with that company's proposed acquisition of Lorillard (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 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.

### LTIP – change of control

The rules of the 2007 LTIP 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 that 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.

## Directors' interests and indemnities

Further details of Directors' contracts and letters of appointment, remuneration and emoluments, and their interests in the Company's shares (including share options and deferred shares) as at 31 December 2014 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.

The Company has arranged appropriate insurance to provide cover in the event of legal action against its Directors and also provides indemnities to 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 that 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 them on behalf of the Company or any such associated company.

## Information and advice

The Board and its Committees receive papers for review in good time ahead of each meeting. The Company Secretary ensures good information flow within the Board and its Committees, and between the Non-Executive Directors and senior management. She also advises the Board on all governance matters.

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 if required. Each of the four principal Committees of the Board may obtain independent legal or other professional advice, at the Company's expense, and secure attendance at meetings of outsiders if needed.

## Articles of Association

The following description summarises certain provisions of the Company's current Articles of Association (as adopted by special resolution at the AGM on 28 April 2010), 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, available on www.bat.com

### 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, and not subject to any maximum.

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 AGM and will put himself/herself forward to be reappointed by the shareholders. Such a Director shall not be taken into account in determining the number or identity of the Directors to retire by rotation at that next AGM.

At each AGM, all Directors shall retire from office by rotation who: (1) held office at the time of each of the two preceding AGMs and who did not retire at either of them; and (2) if the number of Directors retiring in (1) above 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, is less than the number which is nearest to but does not exceed one-third of the Directors), such additional number of Directors as shall, together with the Directors retiring under (1) above, equal one-third of the Directors (or, if their number is not three or a multiple of three, the number which is nearest to but does not exceed one-third of the Directors).

Subject to the provisions of the Companies Act and the Articles of Association, the Directors to retire at an AGM under (2) above will be those who have been in office the longest since their appointment or last reappointment.

Notwithstanding these provisions contained in the Articles of Association, the Company is not restricted to the number of Directors who may retire and seek re-election each year. The Articles of Association merely set a minimum number of Directors who must be subject to retirement by rotation each year. As a result, since the introduction of the provision in the UK Corporate Governance Code in 2011 that all Directors of FTSE 350 companies should be subject to annual re-election by shareholders, all of the Directors of the Company will be subject to either election (i.e. those Directors appointed by the Board of Directors during the year) or re-election at the forthcoming AGM to be held on 29 April 2015.

A Director who retires at an AGM 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 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 comprises 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 that 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 1% 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 1% 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 a 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 anybody 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.

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# Other corporate disclosures continued

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.

An interest of which a Director has no knowledge and of which it is unreasonable to expect him to have knowledge is not treated as an interest; an interest which consists of a Director being a Director or other officer of, or employed by any subsidiary of the Company is not deemed to be a material interest; a Director need not disclose an interest if it cannot be reasonably regarded as likely to give rise to a conflict of interest; and a Director need not disclose an interest if, or to the extent that, the other Directors are already aware of it.

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); and
2. a Director to accept or continue in any office, employment or position in addition to his office as a Director of the Company and may authorise the manner in 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: (a) 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 (b) 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 think fit to impose, and subject 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 such matter, 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 it became due for payment shall, if the Directors so resolve, be forfeited and 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.

The Directors may elect to pay dividends to shareholders by bank or electronic transfer only. Amounts due to shareholders who provide no, or invalid, account details may be held in an account in the Company's name until such shareholders nominate a valid account. The Company shall not be a trustee of any such monies, shall be deemed to have discharged its payment obligations by paying the relevant monies into such account and interest will not accrue for shareholders on any such monies pending payment to such persons.

## 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 has one vote regardless of the number of shares held by the shareholder.

Every proxy appointed by a shareholder and present at a general meeting has one vote, except that if the proxy has been duly appointed by more than one shareholder entitled to vote on the resolution and is instructed by one or more of those shareholders to vote for the resolution and by one or more others to vote against it, or is instructed by one or more of those shareholders to vote in one way and is given discretion as to how to vote by one or more others (and wishes to use that discretion to vote in the other way) he has one vote for and one vote against the resolution.

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 the 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.

When convening a meeting the Company may specify a time not more than 48 hours before the time of the meeting (excluding any part of a day that is not a working day) by which a person must be entered on the register of members in order to have the right to attend or vote at the meeting.

## 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.

For 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 share transfer, 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 registering a transfer.

## 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 a 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.

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# Other corporate disclosures continued

## 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 Rules and the Transparency Rules made by the Financial Conduct Authority imposes a statutory obligation on a person to notify the Company and the Financial Conduct 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% 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.

The Disclosure Rules and the 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 Rules and the 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 AGM and all other general meetings of the Company must be called by at least 21 clear days' written notice. However, the Companies Act allows for this period of notice for meetings other than AGMs 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 AGM every year approving that shortening of the notice period to 14 days. A special resolution enabling the Company to hold general meetings (other than AGMs) on 14 days' notice will be proposed at the AGM to be held on 29 April 2015.

Subject to the resolution being passed, the approval of the shortening of the notice period will be effective until the Company's next AGM, when it is intended that the approval be renewed. The shorter notice period would not be used as a matter of routine. Rather the Directors will consider on a case-by-case basis whether the use of the flexibility offered by the shorter notice period is merited, taking into account the circumstances, including whether the business of the meeting is time sensitive, and is thought to be to the advantage of shareholders as a whole. Further, the shorter notice period would not be used unless both of the conditions as stated above are met.

## 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. There is no longer a requirement for public companies to have specific authorisations in their articles of association to undertake these actions.

The Strategic Report and the Directors' Report comprised in this Annual Report have been approved and are signed by order of the Board by:

**Nicola Snook**
Secretary
25 February 2015

British American Tobacco p.l.c.
Registered in England and Wales No. 3407696

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# Responsibility of Directors

## Statement of the Directors in relation to the Annual Report and financial statements

The Board confirms that it considers that this Annual Report, taken as a whole, is fair, balanced and understandable and provides information necessary for shareholders to assess the Company's performance, business model and strategy.

When making this assessment, the Board was supported by a recommendation from the Audit Committee, who oversaw well established and effective processes in relation to its preparation.

## 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 that 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 judgements 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 the applicable accounting standards identified above, 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 and the Strategic Report include 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 25 February 2015 and signed on its behalf by:

**Richard Burrows**
Chairman

**Ben Stevens**
Finance Director

FINANCIAL STATEMENTS

# Independent auditors' report

## To the members of British American Tobacco p.l.c.

## Report on the Group financial statements

### Our opinion

In our opinion, British American Tobacco p.l.c.'s Group financial statements (the 'financial statements'):

- give a true and fair view of the state of the Group's affairs as at 31 December 2014 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards ('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.

### What we have audited

British American Tobacco p.l.c.'s financial statements comprise:

- the Group Balance Sheet as at 31 December 2014;
- the Group Income Statement and Group Statement of Comprehensive Income for the year then ended;
- the Group Cash Flow Statement for the year then ended;
- the Group Statement of Changes in Equity for the year then ended; and
- the Notes on the Accounts, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the Notes on the Accounts. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and IFRSs as adopted by the European Union.

### Our audit approach

| | |
|---|---|
| **Materiality** | – Overall Group materiality is £260 million (2013: £290 million). |
| **Audit Scope** | – Out of over 400 reporting units, we identified 51 which, in our view, required an audit of their complete financial information.<br>– Specific audit procedures on certain balances and transactions were performed on a further 65 reporting units, one of which represents the results of an associate.<br>– Together these accounted for 79% of Group reported profit before taxation. |
| **Areas of Focus** | – Corporate tax exposures, including the uncertain tax positions in Brazil and South Africa.<br>– Litigation principally in relation to claims and class actions and the recent settlement in respect of Flintkote and the Funding Agreement reached in respect of Fox River.<br>– Restructuring and integration costs arising from the Group's continued implementation of its revised operating model.<br>– Defined benefit pension plan assets and liabilities.<br>– Goodwill impairment assessments. |

#### The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ('ISAs (UK & Ireland)').

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as 'areas of focus' in the following table. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole. Each of the areas of focus below is referred to in the Audit and accountability section of the Directors' Report on page 58 and in the Accounting Policies on pages 127 to 132. This is not a complete list of all risks identified by our audit.

| Area of focus | How our audit addressed the area of focus |
| --- | --- |
| **Corporate Tax Exposures** | |
| Refer also to notes 6 and 30.<br>The Group operates in many different markets and is therefore subject to varying tax regimes across the world.<br><br>Where the amount of tax payable or recoverable is uncertain, management is required to apply judgement when determining whether, and how much, to provide in respect of material tax assessments leading to uncertain tax positions in a number of jurisdictions.<br><br>These principally relate to Brazil, in respect of a reassessment of the profits of overseas subsidiaries to corporate income tax and social contribution tax and South Africa relating to the treatment of debt financing arrangements.<br><br>We focused on this area due to the significant quantum of gross risk and exposure across the Group, and the inherent complexity and judgement in estimating the amount of provision required. | We held a programme of meetings with the Group's Corporate tax team and local management to assess the Group's process for identifying uncertain tax positions potentially requiring provisions, and the related accounting policy of provisioning for tax exposures.<br><br>We gained an understanding of the current status of tax investigations and litigation, and monitored changes in circumstance in ongoing disputes through examining recent rulings and correspondence with local tax authorities.<br><br>We used our specialist tax knowledge and obtained written responses from the Group's external advisers, containing their views on material tax exposures and any related litigation.<br><br>These procedures assisted in our corroboration of management's position in respect of significant tax exposures, and with our assessment that the disclosures and provisions recorded in the financial statements, including whether any provisions sufficiently addressed probable penalties and interest, were appropriate and reflected the latest developments. |
| **Litigation** | |
| Refer also to notes 22 and 30.<br>There are claims and class actions which could have a significant impact on the results of the Group if the potential exposures were to materialise. Management applies significant judgement when determining whether, and how much, to provide for matters of litigation.<br><br>We focused on this area due to the number and magnitude of potential exposures across the Group, and the inherent complexity and judgement in whether to provide for or disclose certain exposures.<br><br>Specific consideration was given to the Fox River and Flintkote matters in light of the Fox River Funding Agreement and Flintkote settlement. | We understood, evaluated and tested management's controls in respect of litigation, both tobacco and non-tobacco related, at the Group, regional and local levels.<br><br>We discussed the nature and status of exposures with in-house and external legal counsel and obtained letters from the Group's external legal counsel which corroborated management's position for significant litigation matters.<br><br>We also read publicly available information containing recent updates in respect of court hearings and judgements impacting the Group which also corroborated management's position.<br><br>We assessed the appropriateness of provisions recorded in the financial statements, or the rationale for not recording a provision, and the completeness of disclosures in respect of contingent liabilities in light of the procedures above.<br><br>Specifically for the Flintkote and Fox River matters, we corroborated management's position with the terms of the Flintkote Settlement Agreement and the Fox River Funding Agreement. We checked that the classification of the related charges and releases was consistent with the Group's accounting policy on adjusting items. |
| **Restructuring and Integration Costs** | |
| Refer also to note 3.<br>During the year the Group has continued with the implementation of its revised Operating Model and single IT operating system in a number of markets.<br><br>Accounting judgement is required regarding whether costs incurred meet the criteria to be capitalised as part of the global SAP system within intangible assets, or whether they should be expensed immediately.<br><br>In addition, judgement is also required when determining whether costs are directly attributable to the programme, and hence presented within adjusting items. | We challenged the appropriateness of the Group's policies in respect of project costs, including the nature of costs to be capitalised, and the timing of commencing depreciation. We did this by confirming that the project costs eligible for capitalisation set out within the policies were directly attributable to the development of the software assets, including the global single instance of SAP, associated with the Group's new operating model.<br><br>We tested a sample of costs incurred during the period in order to test the appropriateness of £115 million costs capitalised versus £176 million that were expensed. We also assessed the appropriateness of the classification of the related costs as adjusting items and checked that they were consistent with the Group's accounting policy set out on page 131. |

FINANCIAL STATEMENTS

# Independent auditors' report continued

| Area of focus | How our audit addressed the area of focus |
|---|---|
| **Defined benefit pension plan assets and liabilities** | |
| Refer also to note 12.<br>The Group has defined benefit pension plans with net post-retirement liabilities of £741 million and net post-retirement assets of £40 million, which are significant in the context of the overall Balance Sheet of the Group.<br><br>The valuation of the pension liabilities requires judgement and technical expertise in choosing appropriate assumptions. Changes in a number of the key assumptions (including salary increases, inflation, discount rates and mortality) can have a material impact on the calculation of the liability. The Group uses external actuaries to assist in assessing these assumptions.<br><br>There is also some judgement in the measurement of fair value of certain pension assets. | We used our specialist actuarial knowledge to obtain evidence that the assumptions used in calculating the pension plan liabilities, including salary increases and mortality rate assumptions, were consistent with relevant national and industry benchmarks.<br><br>We also verified that the discount and inflation rates used in the valuation of the pension liabilities were consistent with our internally developed benchmarks, and, where available to us, with other companies' reporting as at 31 December 2014.<br><br>For pension plan assets, we obtained third-party confirmations of ownership and valuations of pension assets. |
| **Goodwill and intangible asset impairment assessments** | |
| Refer also to note 9.<br>The goodwill balance of £9.8 billion, which principally relates to the acquisitions of Rothmans, Imperial Tobacco Canada, ETI (Italy), ST (Scandinavia) and Indonesia, is supported by an annual impairment review. No impairment charge has been recorded by management against these balances in the current financial year. The risk is that the goodwill balance may be overstated and that an impairment charge may be required. The value-in-use assessment for these assets involves subjective judgements about future business performance.<br><br>Certain assumptions made by management in the impairment review are key judgements, including cash flows, the overall long-term growth rates and discount rates used.<br><br>As described in note 9, management concluded that even if discounted cash flows for Cash Generating Units ('CGUs') should fall by 10%, or the discount rate was increased at a post-tax rate of 1%, there would be no impairment to goodwill. | We evaluated the future cash flow forecasts and the process by which they were drawn up, including confirming the accuracy and the underlying calculations and checking the forecasts were consistent with the latest Board approved budgets.<br><br>We obtained corroborating evidence regarding the carrying value of goodwill, and the related disclosures, through challenging:<br>– the key business drivers of the cash flow forecasts supporting their impairment assessment, including tobacco pricing, raw material costs and market share by examining reported results for each CGU and third-party data;<br>– key assumptions for long-term growth rates in the forecasts by comparing them to historical results, and economic forecasts; and<br>– the discount rates by assessing the cost of capital for the Group and country risk adjustments.<br><br>We examined the results of management's sensitivity analysis around the long-term growth rates and discount rates to ascertain the extent of change in those assumptions that would be required for the goodwill in individual CGUs to be impaired. |

## How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

The Group is primarily structured across four geographic regions, being Asia-Pacific; Americas; Western Europe; and Eastern Europe, Middle East and Africa. The Group financial statements are a consolidation of over 400 reporting units, comprising the Group's operating businesses and sales offices (often legal entities), centralised functions, and supply chain entities.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed at the reporting units by us, as the Group engagement team, component auditors from PwC network firms and component auditors from other firms operating under our instruction. Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole.

The Group's operating reporting units vary significantly in size and we identified 51 which, in our view, required an audit of their complete financial information, due to their size or risk characteristics. Audits of these reporting units were performed using materiality levels lower than the materiality level for the Group as a whole, ranging from £15 million to £60 million, and established by reference to the size of, and risks associated with, the business concerned. Specific audit procedures on certain balances and transactions were performed at a further 65 reporting units, one of which represents the results of an associate. Together these accounted for 79% of Group reported profit before taxation. We performed work centrally in the areas of IT general controls, taxation, pensions, earnings per share and treasury-related procedures.

Our Group engagement team's involvement included various site visits and component auditor working paper reviews across each of the Group's four regions, together with conference calls with the component audit teams and attendance at certain component audit clearance meetings.

### Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

| | |
|---|---|
| **Overall Group materiality** | £260 million (2013: £290 million). |
| **How we determined it** | We used Group reported profit before taxation (£4,848 million) and allowed for the one-off impact of the Flintkote settlement (£374 million). Overall materiality represents approximately 5% of Group reported profit before taxation. |
| **Rationale for benchmark applied** | We have allowed for the Flintkote charge as it is non-recurring and represents the settlement of a historical item that does not impact continuing business performance. |
| **Misstatements to be reported to the Audit Committee** | We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £15 million (2013: £15 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons. |

### Going concern

Under the Listing Rules we are required to review the Directors' statement, set out on page 44, in relation to going concern. We have nothing to report having performed our review.

As noted in the Directors' statement, the Directors have concluded that it is appropriate to prepare the financial statements using the going concern basis of accounting. The going concern basis presumes that the Group has adequate resources to remain in operation, and that the Directors intend it to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the Directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's ability to continue as a going concern.

## Other required reporting

### Consistency of other information

#### Companies Act 2006 opinion

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

#### ISAs (UK & Ireland) reporting

| Under ISAs (UK & Ireland) we are required to report to you if, in our opinion: | |
|---|---|
| – information in the Annual Report is:<br>– materially inconsistent with the information in the audited financial statements; or<br>– apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or<br>– otherwise misleading; or | We have no exceptions to report arising from this responsibility. |
| – the statement given by the Directors on page 115, in accordance with provision C.1.1 of the UK Corporate Governance Code ('the Code'), that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's performance, business model and strategy is materially inconsistent with our knowledge of the Group acquired in the course of performing our audit; or | We have no exceptions to report arising from this responsibility. |
| – the section of the Annual Report on page 58, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee. | We have no exceptions to report arising from this responsibility. |

### Adequacy of information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion, we have not received all the information and explanations we require for our audit. We have no exceptions to report arising from this responsibility.

### Directors' remuneration

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. We have no exceptions to report arising from this responsibility.

### Corporate governance statement

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to the parent company's compliance with 10 provisions of the UK Corporate Governance Code. We have nothing to report having performed our review.

FINANCIAL STATEMENTS

# Independent auditors' report continued

## Responsibilities for the financial statements and the audit

### Our responsibilities and those of the Directors

As explained more fully in the Responsibility of Directors set out on page 115, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & 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.

### What an audit of financial statements involves

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.

We primarily focus our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## 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 2014 and on the information in the Directors' Remuneration Report that is described as having been audited.

**Paul Cragg (Senior Statutory Auditor)**
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
25 February 2015

FINANCIAL STATEMENTS

# Group Income Statement

## For the year ended 31 December

| | Notes | 2014 £m | 2013 £m |
|---|---|---|---|
| Gross turnover (including duty, excise and other taxes of £28,535 million (2013: £30,925 million)) | | **42,506** | 46,185 |
| **Revenue** | 2 | **13,971** | 15,260 |
| Raw materials and consumables used | | **(3,088)** | (3,348) |
| Changes in inventories of finished goods and work in progress | | **58** | 105 |
| Employee benefit costs | 3(a) | **(2,194)** | (2,384) |
| Depreciation, amortisation and impairment costs | 3(b) | **(523)** | (477) |
| Other operating income | 3(c) | **178** | 302 |
| Other operating expenses | 3(d) | **(3,856)** | (3,932) |
| Profit from operations | 2 | **4,546** | 5,526 |
| Analysed as: | | | |
| – adjusted profit from operations | 2 | **5,403** | 5,820 |
| – restructuring and integration costs | 3(e) | **(452)** | (246) |
| – amortisation of trademarks and similar intangibles | 3(f) | **(58)** | (74) |
| – gain on deemed partial disposal of a trademark | 3(g) | **–** | 26 |
| – Fox River | 3(h) | **27** | – |
| – Flintkote | 3(i) | **(374)** | – |
| | | **4,546** | 5,526 |
| Net finance costs | 4 | **(417)** | (466) |
| Finance income | | **67** | 66 |
| Finance costs | | **(484)** | (532) |
| Share of post-tax results of associates and joint ventures | 5 | **719** | 739 |
| Analysed as: | | | |
| – adjusted share of post-tax results of associates and joint ventures | 2 | **712** | 723 |
| – issue of shares and change in shareholding | 5 | **14** | 22 |
| – restructuring and integration costs | 5 | **4** | (4) |
| – MSA receipts | 5 | **5** | 33 |
| – other | 5 | **(16)** | (35) |
| | | **719** | 739 |
| **Profit before taxation** | | **4,848** | 5,799 |
| Taxation on ordinary activities | 6 | **(1,455)** | (1,600) |
| **Profit for the year** | | **3,393** | 4,199 |
| Attributable to: | | | |
| Owners of the parent | | **3,115** | 3,904 |
| Non-controlling interests | | **278** | 295 |
| | | **3,393** | 4,199 |
| **Earnings per share** | | | |
| Basic | 7 | **167.1p** | 205.4p |
| Diluted | 7 | **166.6p** | 204.6p |

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.

FINANCIAL STATEMENTS

# Group Statement of Comprehensive Income

## For the year ended 31 December

| | Notes | 2014 £m | 2013 £m |
|---|---|---|---|
| **Profit for the year (page 121)** | | **3,393** | 4,199 |
| **Other comprehensive income** | | | |
| **Items that may be reclassified subsequently to profit or loss:** | | **(327)** | (1,025) |
| Differences on exchange | | | |
| – subsidiaries | | **(539)** | (972) |
| – associates | | **113** | (141) |
| Cash flow hedges | | | |
| – net fair value gains | | **57** | 94 |
| – reclassified and reported in profit for the year | | **(67)** | (49) |
| – reclassified and reported in net assets | | **8** | (1) |
| Available-for-sale investments of associates | | | |
| – net fair value gains/(losses) | | **15** | (7) |
| Net investment hedges | | | |
| – net fair value gains | | **2** | 89 |
| – differences on exchange on borrowings | | **60** | (25) |
| Tax on items that may be reclassified | 6(e) | **24** | (13) |
| **Items that will not be reclassified subsequently to profit or loss:** | | **(458)** | 355 |
| Retirement benefit schemes | | | |
| – net actuarial (losses)/gains in respect of subsidiaries | 12 | **(428)** | 308 |
| – surplus recognition and minimum funding obligations in respect of subsidiaries | 12 | **7** | (5) |
| – actuarial (losses)/gains in respect of associates net of tax | 5 | **(124)** | 90 |
| Tax on items that will not be reclassified | 6(e) | **87** | (38) |
| Total other comprehensive income for the year, net of tax | | **(785)** | (670) |
| **Total comprehensive income for the year, net of tax** | | **2,608** | 3,529 |
| Attributable to: | | | |
| Owners of the parent | | **2,349** | 3,272 |
| Non-controlling interests | | **259** | 257 |
| | | **2,608** | 3,529 |

The accompanying notes are an integral part of the Group financial statements.

FINANCIAL STATEMENTS

# Group Statement of Changes in Equity

## At 31 December

| | Notes | Share capital £m | Share premium, capital redemption and merger reserves £m | Other reserves £m | Retained earnings £m | Total attributable to owners of parent £m | Non-controlling interests £m | Total equity £m |
|---|---|---|---|---|---|---|---|---|
| | | Attributable to owners of the parent | | | | | | |
| **Balance at 1 January 2014** | | 507 | 3,919 | (190) | 2,398 | 6,634 | 301 | 6,935 |
| Total comprehensive income for the year (page 122) | | – | – | (308) | 2,657 | 2,349 | 259 | 2,608 |
| Profit for the year | | – | – | – | 3,115 | 3,115 | 278 | 3,393 |
| Other comprehensive income for the year | | – | – | (308) | (458) | (766) | (19) | (785) |
| Employee share options | | | | | | | | |
| – value of employee services | | – | – | – | 66 | 66 | – | 66 |
| – proceeds from shares issued | | – | 4 | – | 1 | 5 | – | 5 |
| Dividends and other appropriations | | | | | | | | |
| – ordinary shares | | – | – | – | (2,712) | (2,712) | – | (2,712) |
| – to non-controlling interests | | – | – | – | – | – | (260) | (260) |
| Purchase of own shares | | | | | | | | |
| – held in employee share ownership trusts | | – | – | – | (49) | (49) | – | (49) |
| – share buy-back programme | | – | – | – | (800) | (800) | – | (800) |
| Non-controlling interests – acquisitions | 29 | – | – | – | (4) | (4) | – | (4) |
| Non-controlling interests – capital injection | 26(c) | – | – | – | – | – | 4 | 4 |
| Other movements | | – | – | – | 21 | 21 | – | 21 |
| **Balance at 31 December 2014** | | 507 | 3,923 | (498) | 1,578 | 5,510 | 304 | 5,814 |

| | Notes | Share capital £m | Share premium, capital redemption and merger reserves £m | Other reserves £m | Retained earnings £m | Total attributable to owners of parent £m | Non-controlling interests £m | Total equity £m |
|---|---|---|---|---|---|---|---|---|
| | | Attributable to owners of the parent | | | | | | |
| **Balance at 1 January 2013** | | 507 | 3,916 | 796 | 2,253 | 7,472 | 307 | 7,779 |
| Total comprehensive income for the year (page 122) | | – | – | (986) | 4,258 | 3,272 | 257 | 3,529 |
| Profit for the year | | – | – | – | 3,904 | 3,904 | 295 | 4,199 |
| Other comprehensive income for the year | | – | – | (986) | 354 | (632) | (38) | (670) |
| Employee share options | | | | | | | | |
| – value of employee services | | – | – | – | 61 | 61 | – | 61 |
| – proceeds from shares issued | | – | 3 | – | 1 | 4 | – | 4 |
| Dividends and other appropriations | | | | | | | | |
| – ordinary shares | | – | – | – | (2,611) | (2,611) | – | (2,611) |
| – to non-controlling interests | | – | – | – | – | – | (271) | (271) |
| Purchase of own shares | | | | | | | | |
| – held in employee share ownership trusts | | – | – | – | (74) | (74) | – | (74) |
| – share buy-back programme | | – | – | – | (1,509) | (1,509) | – | (1,509) |
| Non-controlling interests – capital injection | 26(b) | – | – | – | – | – | 8 | 8 |
| Other movements | | – | – | – | 19 | 19 | – | 19 |
| **Balance at 31 December 2013** | | 507 | 3,919 | (190) | 2,398 | 6,634 | 301 | 6,935 |

The accompanying notes are an integral part of the Group financial statements.

FINANCIAL STATEMENTS

# Group Balance Sheet

## At 31 December

| | Notes | 2014 £m | 2013 £m |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Intangible assets | 9 | **10,804** | 11,205 |
| Property, plant and equipment | 10 | **3,004** | 3,156 |
| Investments in associates and joint ventures | 11 | **2,400** | 2,299 |
| Retirement benefit assets | 12 | **40** | 135 |
| Deferred tax assets | 13 | **311** | 248 |
| Trade and other receivables | 14 | **153** | 171 |
| Available-for-sale investments | 15 | **36** | 36 |
| Derivative financial instruments | 16 | **287** | 113 |
| **Total non-current assets** | | **17,035** | 17,363 |
| **Current assets** | | | |
| Inventories | 17 | **4,133** | 4,042 |
| Income tax receivable | 18 | **57** | 95 |
| Trade and other receivables | 14 | **2,768** | 2,876 |
| Available-for-sale investments | 15 | **50** | 54 |
| Derivative financial instruments | 16 | **274** | 312 |
| Cash and cash equivalents | 19 | **1,818** | 2,106 |
| | | **9,100** | 9,485 |
| Assets classified as held-for-sale | 26(d) | **32** | 33 |
| **Total current assets** | | **9,132** | 9,518 |
| **Total assets** | | **26,167** | 26,881 |

| | Notes | 2014 £m | 2013 £m |
|---|---|---|---|
| **Equity** | | | |
| **Capital and reserves** | | | |
| Share capital | | **507** | 507 |
| Share premium, capital redemption and merger reserves | | **3,923** | 3,919 |
| Other reserves | | **(498)** | (190) |
| Retained earnings | | **1,578** | 2,398 |
| Owners of the parent | | **5,510** | 6,634 |
| after deducting | | | |
| – cost of treasury shares | | **(5,073)** | (4,325) |
| Non-controlling interests | | **304** | 301 |
| **Total equity** | 20 | **5,814** | 6,935 |
| **Liabilities** | | | |
| **Non-current liabilities** | | | |
| Borrowings | 21 | **9,779** | 9,716 |
| Retirement benefit liabilities | 12 | **781** | 632 |
| Deferred tax liabilities | 13 | **495** | 514 |
| Other provisions for liabilities and charges | 22 | **278** | 387 |
| Trade and other payables | 23 | **128** | 131 |
| Derivative financial instruments | 16 | **123** | 130 |
| **Total non-current liabilities** | | **11,584** | 11,510 |
| **Current liabilities** | | | |
| Borrowings | 21 | **2,479** | 1,980 |
| Income tax payable | 18 | **430** | 487 |
| Other provisions for liabilities and charges | 22 | **210** | 194 |
| Trade and other payables | 23 | **5,524** | 5,741 |
| Derivative financial instruments | 16 | **126** | 34 |
| **Total current liabilities** | | **8,769** | 8,436 |
| **Total equity and liabilities** | | **26,167** | 26,881 |

The accompanying notes are an integral part of the Group financial statements.

On behalf of the Board

**Richard Burrows**
Chairman
25 February 2015

FINANCIAL STATEMENTS

# Group Cash Flow Statement

## For the year ended 31 December

| | Notes | 2014 £m | 2013 £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Cash generated from operations | 25 | **4,634** | 5,366 |
| Dividends received from associates | | **515** | 510 |
| Tax paid | | **(1,433)** | (1,440) |
| **Net cash generated from operating activities** | | **3,716** | 4,436 |
| **Cash flows from investing activities** | | | |
| Interest received | | **61** | 70 |
| Dividends received from investments | | **2** | 2 |
| Purchases of property, plant and equipment | | **(529)** | (574) |
| Proceeds on disposal of property, plant and equipment | 25 | **62** | 173 |
| Purchases of intangibles | | **(163)** | (147) |
| Purchases of investments | 25 | **(31)** | (47) |
| Proceeds on disposals of investments | 25 | **34** | 15 |
| Proceeds from associates' share buy-backs | 25 | **94** | 189 |
| Purchase of subsidiaries | 25 | **–** | (16) |
| **Net cash used in investing activities** | | **(470)** | (335) |
| **Cash flows from financing activities** | | | |
| Interest paid | | **(571)** | (570) |
| Interest element of finance lease rental payments | | **–** | (1) |
| Capital element of finance lease rental payments | | **(2)** | (2) |
| Proceeds from issue of shares to owners of the parent | | **4** | 3 |
| Proceeds from the exercise of options over own shares held in employee share ownership trusts | | **1** | 1 |
| Proceeds from increases in and new borrowings | 25 | **1,967** | 2,428 |
| Movements relating to derivative financial instruments | 25 | **244** | 54 |
| Purchases of own shares | | **(800)** | (1,509) |
| Purchases of own shares held in employee share ownership trusts | | **(49)** | (74) |
| Reductions in and repayments of borrowings | 25 | **(1,300)** | (1,421) |
| Dividends paid to owners of the parent | 8 | **(2,712)** | (2,611) |
| Purchases of non-controlling interests | 25 | **(4)** | – |
| Non-controlling interests – capital injection | 25 | **4** | – |
| Dividends paid to non-controlling interests | | **(249)** | (265) |
| **Net cash used in financing activities** | | **(3,467)** | (3,967) |
| **Net cash flows (used in)/generated from operating, investing and financing activities** | | **(221)** | 134 |
| Differences on exchange | | **(63)** | (197) |
| **Decrease in net cash and cash equivalents in the year** | | **(284)** | (63) |
| Net cash and cash equivalents at 1 January | | **1,776** | 1,839 |
| **Net cash and cash equivalents at 31 December** | 19 | **1,492** | 1,776 |

The accompanying notes are an integral part of the Group financial statements.

The net cash outflows relating to adjusting items included in the above are £750 million (2013: £175 million).

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 early adopted IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities* with effect from 1 January 2013 along with the revised versions of IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*. These standards form a single package of proposals with mandatory application in the EU from 1 January 2014. The aim of these standards is to improve the quality of reporting in relation to the consolidation of subsidiaries, special purpose vehicles and accounting for joint arrangements.

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 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 budgeted cash flows of these 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 judgements 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, 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;
- 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. The recognised deferred tax assets and liabilities, together with a note of unrecognised amounts, are shown in note 13, and a contingent tax asset is explained in note 6(b). 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 application of these accounting policies to the payments made and credits recognised under the Master Settlement Agreement by Reynolds American Inc. is described in note 5;
- 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;
- the estimation of the fair values of acquired net assets arising in a business combination 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 2013 are described in note 26;
- the determination as to whether control (subsidiaries), joint control (joint arrangements), or significant influence (associates) exists in relation to the investments held by the Group. This is assessed after taking into account the Group's ability to appoint directors to the entity's board, its relative shareholding compared with other shareholders, any significant contracts or arrangements with the entity or its other shareholders and other relevant facts and circumstances. The application of this judgement in respect of the Group's investment in Reynolds American Inc. is explained in note 11;
- the review of applicable exchange rates for transactions with and translation of entities in territories where there are restrictions on the free access to foreign currency, or multiple exchange rates; and
- 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.

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 judgement 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 arrangements.

A subsidiary is an entity controlled by the Group. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

Associates comprise investments in undertakings, which are not subsidiary undertakings or joint arrangements, 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. They are accounted for using the equity method.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 1 Accounting policies continued

Joint arrangements comprise contractual arrangements where two or more parties have joint control and where decisions regarding the relevant activities of the entity require unanimous consent. Joint operations are jointly-controlled arrangements where the parties to the arrangement have rights to the underlying assets and obligations for the underlying liabilities relating to the arrangement. The Group accounts for its share of the assets, liabilities, income and expenses of any such arrangement. Joint ventures comprise arrangements where the parties to the arrangement have rights to the net assets of the arrangement. They are accounted for using the equity method.

The results of subsidiary 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. Acquisition-related costs are expensed as incurred. Similarly, the results of associates and joint arrangements are included from the date of acquiring significant influence or joint control respectively.

The results of subsidiary undertakings, associates and joint arrangements 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.

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 using exchange rates applicable to the dates of the underlying transactions. Average rates of exchange in each year are used where the average rate approximates the relevant exchange rate at the date of the underlying transactions. Assets and liabilities of Group undertakings are translated at the applicable rates of exchange at the end of each year. In territories where there are restrictions on the free access to foreign currency or multiple exchange rates, the applicable rates of exchange are regularly reviewed.

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 undertakings, associates and joint arrangements 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 *First-time Adoption of International Financial Reporting Standards*, any differences prior to that date are not included in this separate component of equity.

Where a disposal of an investment in a Group undertaking results in a loss of control of a subsidiary undertaking, the loss of significant influence over an associated company or the loss of joint control over a joint arrangement, the cumulative amount of the related foreign exchange differences deferred in the separate component of equity are recognised in the income statement when the gain or loss on disposal is recognised. These related exchange differences comprise the exchange differences on all amounts deemed to be part of the net investment in the undertaking, which are recycled to the income statement when a disposal occurs. For partial disposals of subsidiary undertakings the related exchange differences are reclassified within equity. For all other partial disposals the proportional share of the related exchange differences is recycled to the income statement.

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 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 *Employee Benefits*, 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 any surplus restrictions or the effect 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 or credits resulting from amendments to benefits are recognised immediately.

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, net interest on the net defined benefit liability or asset, past service cost and the impact of any settlements.

Some benefits are provided through defined contribution schemes and payments to these are charged as an expense as they fall due.

## 1 Accounting policies continued

### 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 arrangements 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 *Income Taxes*, 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 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 net of accumulated impairment losses and recognised 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 *First-time Adoption of International Financial Reporting Standards*, 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, associate or joint venture to which it relates.

Goodwill in respect of subsidiaries is included in intangible assets. In respect of associates and joint ventures, goodwill is included in the carrying value of the investment in the associated company or joint venture. On disposal of a subsidiary, associate or joint venture, 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 and similar intangibles, including certain intellectual property, acquired by the Group's subsidiary undertakings and computer software.

Acquired trademarks and similar assets 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 and similar assets 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, with the exception of global software solutions, is amortised on a straight-line basis over periods ranging from three years to five years. Global software solutions are software assets designed to be implemented on a global basis and used as a standard solution by all of the operating companies in the Group. These assets are amortised on a straight-line basis over periods not exceeding 10 years.

The investments in associates and joint ventures 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.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 1 Accounting policies continued

### Property, plant and equipment

Property, plant and equipment are 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 leasehold property are depreciated at rates between 2.5% and 4% per annum, and plant and equipment at rates between 7% and 25% 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 was on or after 1 January 2009, are capitalised as part of the cost of the asset, in accordance with IAS 23 *Borrowing Costs*. The Group's previous policy was to expense such borrowing costs as they were incurred.

### Leased assets

Assets where the Group has substantially all the risks and rewards of ownership of the leased asset 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 weighted 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.

#### 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 other comprehensive income. When such investments are derecognised (e.g. through disposal) or become impaired, the accumulated gains and losses, previously recognised in other comprehensive income, are reclassified to 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.

## 1 Accounting policies continued

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 other comprehensive income, 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 other comprehensive income, 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 reclassified to 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 other comprehensive income, to the extent that they are effective, with the ineffective 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 reclassified to 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 reclassified to the Income Statement 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 other comprehensive income, are immediately reclassified to 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's 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.

### Segmental analysis

The Group is organised and managed on the basis of its 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 chief operating decision maker, identified as the Management Board, for assessing performance and allocating resources.

The Group is primarily 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 results of next-generation products are not currently material to the Group.

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, net finance costs, taxation 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. While the disclosure of adjusting items is not required by IFRS, 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.

The Group believes that these items are useful to users of the Group financial statements in helping them to understand the underlying business performance and are used to derive the Group's principal non-GAAP measures of adjusted profit from operations and adjusted diluted earnings per share.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 1 Accounting policies continued

### 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 and contingent assets

Subsidiaries and associates companies are defendants in tobacco-related and other litigation. Provision for this litigation (including legal costs) 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.

Where a provision has not been recognised, 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 be most relevant to the Group.

IFRS 9 *Financial Instruments*. This standard was finalised and published in July 2014 as the replacement for IAS 39 *Financial Instruments: Recognition and Measurement*. Further due diligence will be carried out before implementation, but the anticipated impact from restatement on the Group's reported profit and equity for 2014 and 2013 is not expected to be material. The Standard is largely retrospective in application. Subject to EU endorsement, the expected mandatory effective date of implementation is 1 January 2018.

IFRS 15 *Revenue from Contracts with Customers*. This standard was finalised and published in May 2014 and harmonises IFRS and US GAAP with a single revenue recognition standard. Further due diligence will be carried out before implementation, but the anticipated impact from restatement on the Group's operating profit for 2014 and 2013 is not expected to be material. However, this standard may require changes to the allocation of costs between operating expenses and deductions from revenue, for example, payments to customers currently classed as expenses. The Standard is retrospective in application. Subject to EU endorsement, the expected mandatory effective date of implementation is 1 January 2017.

In addition, a number of other interpretations and revisions to existing standards have been issued which will be applicable to the Group's financial statements in future years, but will not have a 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 to the overall business. The results of next-generation products as a separate segment are currently not material to the Group and are included within the Western Europe region. 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 four geographic regions 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 for assessing performance and allocating resources.

The Management Board reviews current and prior year segmental revenue, adjusted profit from operations of subsidiaries and joint operations, and adjusted post-tax results of associates and joint ventures at constant rates of exchange. 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, including inter-company royalties payable in foreign currency to UK entities. Other than in exceptional circumstances, which will be fully disclosed, it does not adjust for the normal transactional gains and losses in operations which are generated by movements in exchange rates. As a result, the 2014 segmental results were translated using the 2013 rates of exchange. The 2013 figures are stated at the 2013 rates of exchange and are, therefore, unadjusted from those published for 2013.

The analyses of revenue for the 12 months to 31 December 2014 and 31 December 2013, based on location of sales, are as follows:

| | 2014 | | | 2013 |
|---|---|---|---|---|
| | **Revenue Constant rates £m** | **Translation exchange £m** | **Revenue Current rates £m** | Revenue £m |
| Asia-Pacific | **4,253** | **(380)** | **3,873** | 4,203 |
| Americas | **3,506** | **(516)** | **2,990** | 3,317 |
| Western Europe | **3,546** | **(187)** | **3,359** | 3,635 |
| EEMEA | **4,377** | **(628)** | **3,749** | 4,105 |
| **Revenue** | **15,682** | **(1,711)** | **13,971** | 15,260 |

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:

| | 2014 | | | | | 2013 | | |
|---|---|---|---|---|---|---|---|---|
| | **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 | **1,713** | **(165)** | **1,548** | **(188)** | **1,360** | 1,693 | (21) | 1,672 |
| Americas | **1,475** | **(189)** | **1,286** | **(89)** | **1,197** | 1,364 | (61) | 1,303 |
| Western Europe | **1,262** | **(73)** | **1,189** | **(171)** | **1,018** | 1,273 | (140) | 1,133 |
| EEMEA | **1,625** | **(245)** | **1,380** | **(62)** | **1,318** | 1,490 | (72) | 1,418 |
| | **6,075** | **(672)** | **5,403** | **(510)** | **4,893** | 5,820 | (294) | 5,526 |
| Fox River** | | | | **27** | **27** | | – | – |
| Flintkote** | | | | **(374)** | **(374)** | | – | – |
| Profit from operations | **6,075** | **(672)** | **5,403** | **(857)** | **4,546** | 5,820 | (294) | 5,526 |
| Net finance costs | **(456)** | **39** | **(417)** | **–** | **(417)** | (466) | – | (466) |
| Asia-Pacific | **304** | **(27)** | **277** | **14** | **291** | 272 | 22 | 294 |
| Americas | **453** | **(22)** | **431** | **(7)** | **424** | 445 | (6) | 439 |
| EEMEA | **5** | **(1)** | **4** | **–** | **4** | 6 | – | 6 |
| Share of post-tax results of associates and joint ventures | **762** | **(50)** | **712** | **7** | **719** | 723 | 16 | 739 |
| Profit before taxation | **6,381** | **(683)** | **5,698** | **(850)** | **4,848** | 6,077 | (278) | 5,799 |

*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(i) and in note 5, respectively.

** The Fox River credit in 2014 (see note 3(h) and note 30) and the Flintkote charge in 2014 (see note 3(i) and note 30) have not been allocated to any segment as they neither relate to current operations nor the tobacco business. They are presented separately from the segmental reporting which is used to evaluate segment performance and to allocate resources, and is reported to the chief operating decision maker on this basis.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 2 Segmental analyses continued

Adjusted profit from operations at constant rates of £6,075 million (2013: £5,820 million) excludes certain depreciation, amortisation and impairment charges as explained in notes 3(b), 3(e) and 3(f). These are excluded from segmental profit from operations at constant rates as follows:

| | 2014 | | | | | 2013 | | |
|---|---|---|---|---|---|---|---|---|
| | 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 | **102** | **(6)** | **96** | **52** | **148** | 90 | 17 | 107 |
| Americas | **119** | **(13)** | **106** | **17** | **123** | 96 | 17 | 113 |
| Western Europe | **100** | **(4)** | **96** | **50** | **146** | 102 | 37 | 139 |
| EEMEA | **112** | **(14)** | **98** | **8** | **106** | 104 | 14 | 118 |
| | **433** | **(37)** | **396** | **127** | **523** | 392 | 85 | 477 |

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 | 2014 £m | 2013 £m | 2014 £m | 2013 £m | 2014 £m | 2013 £m |
| **External revenue** | **143** | 155 | **13,828** | 15,105 | **13,971** | 15,260 |

| | United Kingdom | | All foreign countries | | Group | |
|---|---|---|---|---|---|---|
| | 2014 £m | 2013 £m | 2014 £m | 2013 £m | 2014 £m | 2013 £m |
| Intangible assets | **499** | 417 | **10,305** | 10,788 | **10,804** | 11,205 |
| Property, plant and equipment | **343** | 357 | **2,661** | 2,799 | **3,004** | 3,156 |
| Investments in associates and joint ventures | **–** | – | **2,400** | 2,299 | **2,400** | 2,299 |

The only foreign operation requiring separate disclosure under the requirements of IFRS 8 *Operating Segments* is Souza Cruz operating in Brazil. The results of Souza Cruz are not disclosed separately in this Segmental analysis as they are disclosed in note 31 due to the materiality of the non-controlling interests. The main acquisitions comprising the goodwill balance of £9,842 million (2013: £10,249 million), included in intangible assets, are provided in note 9. Included in investments in associates and joint ventures are amounts of £1,361 million (2013: £1,447 million) attributable to the investment in Reynolds American Inc. and £991 million (2013: £808 million) attributable to the investment in ITC Ltd. Further information is provided in note 11.

## 3 Profit from operations

### (a) Employee benefit costs

| | 2014 £m | 2013 £m |
|---|---|---|
| Wages and salaries | **1,776** | 1,914 |
| Social security costs | **212** | 234 |
| Other pension and retirement benefit costs (note 12) | **132** | 162 |
| Share-based payments – equity-settled (note 27) | **66** | 61 |
| Share-based payments – cash-settled (note 27) | **8** | 13 |
| | **2,194** | 2,384 |

### (b) Depreciation, amortisation and impairment costs

| | | 2014 £m | 2013 £m |
|---|---|---|---|
| Intangibles | – amortisation of trademarks and similar intangibles (note 3(f)) | **58** | 74 |
| | – amortisation of other intangibles | **58** | 48 |
| | – impairment | **11** | – |
| Property, plant and equipment | – depreciation | **307** | 321 |
| | – impairment | **89** | 34 |
| | | **523** | 477 |

Impairment in respect of certain property, plant and equipment is included in restructuring costs (see note 3(e)).

### (c) Other operating income

This represents operating income arising from the Group's activities which falls outside the definition of revenue and includes gains as a result of property disposals, service fees and other shared costs charged to third parties, manufacturing fees and trademark income.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 3 Profit from operations continued

### (d) Other operating expenses include:

| | 2014 £m | 2013 £m |
|---|---|---|
| Research and development expenses (excluding employee benefit costs and depreciation) | **74** | 91 |
| Exchange differences | **7** | 11 |
| Rent of plant and equipment (operating leases) | | |
| – minimum lease payments | **28** | 38 |
| Rent of property (operating leases) | | |
| – minimum lease payments | **69** | 81 |
| Fees payable for audit services pursuant to legislation: | | |
| – fees payable to PricewaterhouseCoopers LLP for Parent Company and Group audit | **2.0** | 1.8 |
| – fees payable to other PricewaterhouseCoopers firms and associates for local statutory and Group reporting audits | **7.3** | 7.6 |
| Audit fees payable to PricewaterhouseCoopers firms and associates | **9.3** | 9.4 |
| Audit fees payable to other firms | **0.4** | 0.5 |
| **Total audit fees payable** | **9.7** | 9.9 |
| Fees payable to PricewaterhouseCoopers firms and associates for other services: | | |
| – audit-related assurance services | **0.3** | 0.3 |
| – other assurance services | **0.1** | 0.1 |
| – tax advisory services | **3.8** | 2.9 |
| – tax compliance | **0.8** | 1.0 |
| – other non-audit services | **0.2** | 0.6 |
| | **5.2** | 4.9 |

The total fees payable to PricewaterhouseCoopers firms and associates included above are £14.5 million (2013: £14.3 million).

Total research and development costs including employee benefit costs and depreciation are £154 million (2013: £161 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, including the relevant operating costs of implementing the new operating model. These costs represent additional expenses incurred which are not related to the normal business and day-to-day activities. The new operating model includes revised organisation structures, standardised processes and shared back office services underpinned by a global single instance of SAP. The new organisation structures and processes are currently being implemented and the deployment of the new SAP system started in the third quarter of 2012 and will take around a total of four years to fully roll-out. These initiatives also include a review of the Group's manufacturing operations, supply chain, 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, including acquisition costs, are included in profit from operations under the following headings:

| | 2014 £m | 2013 £m |
|---|---|---|
| Employee benefit costs | **223** | 140 |
| Depreciation and impairment costs | **69** | 11 |
| Other operating expenses | **180** | 161 |
| Other operating income | **(20)** | (66) |
| | **452** | 246 |

## 3 Profit from operations continued

Restructuring and integration costs in 2014 principally relate to the restructuring initiatives directly related to implementation of a new operating model and the cost of packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group. The costs also cover factory closure and downsizing activities in Australia, Colombia and the Democratic Republic of Congo, and restructurings in Argentina, Indonesia, Canada, Switzerland and Germany.

Restructuring and integration costs in 2013 principally related to restructuring initiatives directly related to implementation of a new operating model and the continuation of the factory closure and downsizing activities in Australia and Russia, and restructuring of factories in the Democratic Republic of Congo, Switzerland and Germany. The costs also covered packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group.

Other operating income in 2014 includes gains from the sale of land and buildings in Turkey, Uganda and the Democratic Republic of Congo. In 2013, other operating income includes gains from the sale of land and buildings in Australia, Denmark and Russia.

### (f) Amortisation of trademarks and similar intangibles

The acquisitions of Protabaco, Bentoel, Tekel, ST, CN Creative Limited and the creation of CTBAT International Limited (see note 26(a)) resulted in the capitalisation of trademarks and similar intangibles which are amortised over their expected useful lives, which do not exceed 20 years. The amortisation charge of £58 million (2013: £74 million) is included in depreciation, amortisation and impairment costs in profit from operations.

### (g) Gain on deemed partial disposal of a trademark

The contribution of the State Express 555 brand to CTBAT International Limited in 2013 (see note 26(a)) is accounted for at fair value in the arrangement. This resulted in a £26 million gain on a deemed partial disposal of a trademark which is included in other operating income but has been treated as an adjusting item.

### (h) Fox River

As explained in note 30, a Group subsidiary has certain liabilities in respect of indemnities given on the purchase and disposal of former businesses in the United States and in 2011, the Group provided £274 million in respect of claims in relation to environmental clean-up costs of the Fox River.

On 30 September 2014, a Group subsidiary, NCR, Appvion and Windward Prospects entered into the Funding Agreement with regard to the costs for Fox River. Based on this Funding Agreement, £56 million has been paid with legal costs incurred of £7 million. The Fox River provision has been reviewed and £27 million has been released in 2014 (see note 22 and note 30).

### (i) Flintkote

As explained in note 30, in December 2014, a Group subsidiary entered into a settlement agreement in connection with various legal cases related to a former non-tobacco business in Canada. Under the terms of the settlement, the subsidiary will obtain protection from current and potential future Flintkote-related asbestos liability claims in the US. The settlement is contingent upon further documentation and approval of certain courts in the US. This agreement has led to a charge of £374 million in 2014.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 4 Net finance costs

| | 2014 £m | 2013 £m |
|---|---|---|
| **Finance costs** | | |
| – interest payable | | |
| – bonds and notes | 501 | 518 |
| – other loans and commercial paper | 22 | 18 |
| – bank loans and overdrafts | 56 | 70 |
| – finance leases | – | 1 |
| – facility fees | 9 | 7 |
| | 588 | 614 |
| – fair value changes on derivative financial instruments | (154) | (103) |
| – exchange differences on financial liabilities | 50 | 21 |
| | 484 | 532 |
| **Finance income** | | |
| – interest and dividend income | | |
| – dividend income in respect of available-for-sale investments | (2) | (2) |
| – other interest income | (65) | (62) |
| | (67) | (64) |
| – exchange differences on financial assets | – | (2) |
| | (67) | (66) |
| Net finance costs | 417 | 466 |

The Group manages foreign exchange gains and losses and fair value changes on a net basis, as shown below. The derivatives that generate the fair value changes are detailed in note 16.

| | 2014 £m | 2013 £m |
|---|---|---|
| **Fair value changes** | | |
| – cash flow hedges transferred from equity | (31) | (6) |
| – fair value hedging instruments – exchange-related movements | 12 | (4) |
| – fair value hedging instruments – net interest income | (83) | (90) |
| – fair value hedging instruments – interest-related movements (*note (i)*) | (174) | 146 |
| – fair value changes on hedged items – interest-related movements (*note (i)*) | 158 | (151) |
| – instruments held-for-trading (*note (ii)*) | (36) | 2 |
| | (154) | (103) |
| Finance costs – exchange differences on financial liabilities | 50 | 21 |
| Finance income – exchange differences on financial assets | – | (2) |
| | (104) | (84) |

Notes:
(i) Hedge ineffectiveness in respect of fair value hedges is a £16 million gain (2013: £5 million gain) being the difference between the two items above.
(ii) IFRS requires derivatives which do not meet the tests for hedge accounting under IAS 39 to be classified as instruments held-for-trading with fair value changes included in the Income Statement. These derivatives principally consist of forward foreign currency contracts which have not been designated as hedges due to their fair value changes offsetting with other components of net finance costs relating to financial assets and liabilities.

Facility fees principally relate to the Group's central undrawn banking facilities of £3 billion and US$150 million (2013: £2 billion and US$150 million).

Exchange differences in respect of hedged items subject to fair value hedges and cash flow hedges were a gain of £12 million (2013: £4 million loss) and a loss of £36 million (2013: £14 million loss) respectively and are included in 'Finance costs – exchange differences' in the table above.

## 5 Associates and joint ventures

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Total £m | Group's share £m | Total £m | Group's share £m |
| Gross turnover (including duty, excise and other taxes) | **12,219** | **4,576** | 13,095 | 4,891 |
| Duty, excise and other taxes | **(3,018)** | **(1,174)** | (3,961) | (1,485) |
| Revenue | **9,201** | **3,402** | 9,134 | 3,406 |
| Profit from operations | **3,166** | **1,163** | 3,247 | 1,203 |
| Net finance costs | **(169)** | **(70)** | (174) | (73) |
| Profit on ordinary activities before taxation | **2,997** | **1,093** | 3,073 | 1,130 |
| Taxation on ordinary activities | **(1,006)** | **(370)** | (1,037) | (387) |
| Profit on ordinary activities after taxation | **1,991** | **723** | 2,036 | 743 |
| Non-controlling interests | **(11)** | **(4)** | (11) | (4) |
| Post-tax results of associates and joint ventures | **1,980** | **719** | 2,025 | 739 |
| Analysed as: | | | | |
| – adjusted share of post-tax results of associates and joint ventures | **1,951** | **712** | 1,966 | 723 |
| – issue of shares and change in shareholding | **46** | **14** | 73 | 22 |
| – restructuring and integration costs | **9** | **4** | (10) | (4) |
| – MSA receipts | **13** | **5** | 79 | 33 |
| – other | **(39)** | **(16)** | (83) | (35) |
| | **1,980** | **719** | 2,025 | 739 |

### (a) Adjusting items

The share of post-tax results of associates and joint ventures is after the following adjusting items which are excluded from the calculation of adjusted earnings per share as set out in note 7:

In 2014, the Group's interest in ITC Ltd. (ITC) decreased from 30.47% to 30.26% as a result of ITC issuing ordinary shares under the company's Employee Share Option Scheme. The issue of these shares and change in the Group's share of ITC resulted in a gain of £14 million, which is treated as a deemed partial disposal and included in the Income Statement.

Reynolds American Inc. (RAI) recognised a net gain from discontinued activities of US$25 million, reduced by restructuring activities of US$16 million, resulting in a net gain of US$9 million. The Group's share of this net gain amounted to £4 million (net of tax).

As explained in note 5(b), under the Master Settlement Agreement (MSA) in the US, in June 2014, a further two states entered into a settlement agreement in relation to disputed NPM Adjustment Claims for the years 2003 to 2012. Under the settlement, RAI expects to receive more than US$170 million in MSA credits to be applied over five years. During 2014, RAI recognised income of US$34 million related to the 2013 liability as an adjusting item. The Group's share of this income amounted to £5 million (net of tax). Credits in respect of the 2014 liability and future years would be accounted for in the applicable year and will not be treated as adjusting items.

RAI has also recognised amounts which have been combined in the table of adjusting items in the Group Income Statement and are shown as 'other'. These are costs in respect of a number of Engle progeny lawsuits and other tobacco litigation charges that amount to US$102 million, the Group's share of which is £16 million (net of tax).

In 2013, the Group's interest in ITC decreased from 30.72% to 30.47% as a result of ITC issuing ordinary shares under the company's Employee Share Option Scheme. This resulted in a gain of £22 million, which was treated as a deemed partial disposal and included in the Income Statement.

During 2013, RAI recognised restructuring charges of US$24 million and the Group's share of these charges amounted to £4 million (net of tax).

During 2013, RAI recognised income of US$219 million related to its 2012 MSA liability as an adjusting item, the Group's share of which amounted to £33 million (net of tax). Credits in respect of the 2013 liability and future years would be accounted for in the applicable year and will not be treated as adjusting items.

In the year ended 31 December 2013, RAI recognised amounts which have been combined in the table of adjusting items and reported in 'other'. These consist of a charge of US$18 million in respect of a number of Engle progeny lawsuits, the Group's share of which amounted to £3 million (net of tax); costs of US$34 million relating to other tobacco-related litigation charges, the Group's share of which amounted to £6 million (net of tax); trademark amortisation and impairment of US$27 million, the Group's share of which amounted to £4 million (net of tax); and costs of US$124 million relating to losses on extinguishment of debt, the Group's share of which amounted to £22 million (net of tax).

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 5 Associates and joint ventures continued

### (b) Master Settlement Agreement

In 1998, the major US cigarette manufacturers (including R J Reynolds and Brown & Williamson) entered into the Master Settlement Agreement (MSA) with attorney generals representing most US states and territories. The MSA imposes a perpetual stream of future payment obligations on the major US cigarette manufacturers. The amounts of money that the participating manufacturers are required to annually contribute are based upon, amongst other things, the volume of cigarettes sold and market share (based on cigarette shipments in that year). Given these facts, the Group's accounting for the MSA payments is to accrue for them in the cost of products sold as the products are shipped and no provision is made in respect of potential payments relating to future years. The event which gives rise to the obligation is the actual sales of products shipped and the MSA payments are therefore recognised as part of the costs of those business operations.

During 2013, RAI, various other tobacco manufacturers, 19 states, the District of Columbia and Puerto Rico reached a final agreement related to RAI's 2003 Master Settlement Agreement (MSA) activities. Under this agreement RAI will receive credits, currently estimated to be more than US$1 billion, in respect of its Non-Participating Manufacturer (NPM) Adjustment claims related to the period from 2003 to 2012. These credits will be applied against the company's MSA payments over a period of five years from 2013, subject to, and dependent upon, meeting the various ongoing performance obligations.

During 2014, two additional states agreed to settle NPM disputes related to claims for the period 2003 to 2012. It is estimated that RAI will receive US$170 million in credits, which will be applied over a five-year period from 2014.

### (c) Other financial information

| | 2014 Group's share £m | 2013 Group's share £m |
|---|---|---|
| Profit on ordinary activities after taxation | | |
| – attributable to owners of the parent | **719** | 739 |
| Other comprehensive income: | | |
| Differences on exchange | **113** | (141) |
| Net fair value gains/(losses) on available-for-sale investments | **15** | (7) |
| Actuarial (losses)/gains relating to pensions and other post-retirement benefits (note 20) | **(124)** | 90 |
| **Total comprehensive income (note 11)** | **723** | 681 |

| | 2014 Group's share £m | 2013 Group's share £m |
|---|---|---|
| Dividends received | | |
| – listed investments | **510** | 504 |
| – unlisted investments | **8** | 8 |
| **Total dividends received from associates** | **518** | 512 |

Summarised financial information of the Group's associates and joint ventures:

| | 2014 RAI £m | 2014 ITC £m | 2014 Others £m | 2014 Total £m | 2013 RAI £m | 2013 ITC £m | 2013 Others £m | 2013 Total £m |
|---|---|---|---|---|---|---|---|---|
| Revenue | **5,132** | **3,777** | **292** | **9,201** | 5,268 | 3,557 | 309 | 9,134 |
| Profit on ordinary activities before taxation | **1,551** | **1,389** | **57** | **2,997** | 1,648 | 1,358 | 67 | 3,073 |
| Post-tax results of associates and joint ventures | **1,000** | **938** | **42** | **1,980** | 1,035 | 942 | 48 | 2,025 |
| Other comprehensive income | **(166)** | **184** | **(29)** | **(11)** | 130 | (454) | 34 | (290) |
| **Total comprehensive income** | **834** | **1,122** | **13** | **1,969** | 1,165 | 488 | 82 | 1,735 |

## 6 Taxation on ordinary activities

### (a) Summary of taxation on ordinary activities

| | 2014 £m | 2013 £m |
|---|---|---|
| UK corporation tax | – | – |
| Overseas tax | 1,450 | 1,567 |
| Comprising: | | |
| – current year tax expense | 1,439 | 1,581 |
| – adjustments in respect of prior periods | 11 | (14) |
| **Total current tax** | 1,450 | 1,567 |
| Deferred tax | 5 | 33 |
| Comprising: | | |
| – deferred tax relating to origination and reversal of temporary differences | 7 | 33 |
| – deferred tax relating to changes in tax rates | (2) | – |
| | 1,455 | 1,600 |

### (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 25 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 judgement in November 2008 concluded, amongst other things, that the corporation tax provisions relating to dividend income from EU subsidiaries breached EU law. 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 creditable against advance corporation tax (ACT) liabilities with the consequence that ACT need not have been paid. Claims for the repayment of UK tax incurred where the dividends were from the EU were allowed back to 1973.

The case was heard by the Court of Appeal in October 2009 and the judgement handed down on 23 February 2010. The Court of Appeal determined that various questions, including which companies in the corporate tree can be included in a claim, should be referred back to the ECJ 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.

The issue of time limits was heard by the Supreme Court in February 2012 and in May 2012 the Supreme Court decided in British American Tobacco Group's favour, that claims submitted before 8 September 2003 can go back to 1973. A hearing took place in February 2012 at the ECJ on the questions referred from the Court of Appeal.

The ECJ judgement of 13 November 2012 confirms that the UK treatment of EU dividends was discriminatory and produces the same outcome for third country dividends from 1994 in certain circumstances. The judgement also confirms that the claim can cover dividends from all indirect as well as direct EU subsidiaries and also ACT paid by a superior holding company.

The detailed technical issues of the quantification mechanics of the claim were heard by the High Court during May and June 2014 and the judgement handed down on 18 December 2014. The High Court determined that in respect of issues concerning the calculation of unlawfully charged corporation tax and advanced corporation tax, the law of restitution including the defence on change of position and questions concerning the calculation of overpaid interest, the approach of the British American Tobacco Group was broadly preferred. The conclusion reached by the High Court would, if upheld, produce an estimated receivable of £1.2 billion for British American Tobacco. Appeals on a majority of the issues have been made to the Court of Appeal, which is likely to hear the case in 2016.

No potential receipt has been recognised in the current period or the prior year, in the results of the Group, due to the uncertainty of the amounts and eventual outcome.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 6 Taxation on ordinary activities continued

### (c) Factors affecting the taxation charge

The taxation charge differs from the standard 21% (2013: 23%) rate of corporation tax in the UK. The major causes of this difference are listed below:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | £m | % | £m | % |
| Profit before tax | **4,848** | | 5,799 | |
| Less: share of post-tax results of associates and joint ventures | **(719)** | | (739) | |
| | **4,129** | | 5,060 | |
| Tax at 21% (2013: 23%) on the above | **867** | **21.0** | 1,164 | 23.0 |
| Factors affecting the tax rate: | | | | |
| Tax at standard rates other than UK corporation tax rate | **236** | **5.7** | 158 | 3.1 |
| Other national tax charges | **69** | **1.7** | 51 | 1.0 |
| Permanent differences | **29** | **0.7** | 6 | 0.1 |
| Overseas withholding taxes | **157** | **3.8** | 138 | 2.7 |
| Double taxation relief on UK profits | **(9)** | **(0.2)** | (11) | (0.2) |
| Unutilised tax losses | **45** | **1.1** | 62 | 1.2 |
| Adjustments in respect of prior periods | **11** | **0.2** | (14) | (0.2) |
| Net deferred tax debits at other tax rates | **50** | **1.2** | 46 | 0.9 |
| | **1,455** | **35.2** | 1,600 | 31.6 |

### (d) Tax on adjusting items

The tax on adjusting items, separated between the different categories, as per note 7 to the accounts, amounted to £69 million (2013: £46 million), excluding outside shareholders' interests of £5 million (2013: £3 million).

### (e) Tax on items recognised directly in other comprehensive income

| | 2014 £m | 2013 £m |
|---|---|---|
| Current tax | **17** | 2 |
| Deferred tax | **94** | (53) |
| **Credited/(charged) to other comprehensive income** | **111** | (51) |

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 £3,115 million (2013: £3,904 million) and 1,864 million (2013: 1,901 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 1,870 million (2013: 1,908 million) to reflect the potential dilutive effect of employee share schemes.

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | 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 | 3,115 | 1,864 | 167.1 | 3,904 | 1,901 | 205.4 |
| Share options | – | 6 | (0.5) | – | 7 | (0.8) |
| **Diluted earnings per share** | 3,115 | 1,870 | 166.6 | 3,904 | 1,908 | 204.6 |

Earnings have been affected by a number of adjusting items, which are described in notes 3 and 5. To illustrate the impact of these items, an adjusted earnings per share calculation is shown below.

### Adjusted earnings per share calculation

| | | Diluted | | | | Basic | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | 2014 | | 2013 | | 2014 | | 2013 | |
| | 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 | | 3,115 | 166.6 | 3,904 | 204.6 | 3,115 | 167.1 | 3,904 | 205.4 |
| Effect of restructuring and integration costs | 3(e) | 452 | 24.2 | 246 | 12.9 | 452 | 24.2 | 246 | 12.9 |
| Tax and non-controlling interests on restructuring and integration costs | | (67) | (3.6) | (35) | (1.9) | (67) | (3.6) | (35) | (1.9) |
| Effect of amortisation of trademarks and similar intangibles | 3(f) | 58 | 3.1 | 74 | 3.9 | 58 | 3.1 | 74 | 3.9 |
| Tax on amortisation of trademarks and similar intangibles | | (7) | (0.4) | (14) | (0.7) | (7) | (0.4) | (14) | (0.7) |
| Gain on deemed partial disposal of a trademark | 3(g) | – | – | (26) | (1.4) | – | – | (26) | (1.4) |
| Effect of Fox River | 3(h) | (27) | (1.4) | – | – | (27) | (1.4) | – | – |
| Effect of Flintkote | 3(i) | 374 | 20.0 | – | – | 374 | 20.1 | – | – |
| Effect of associates' adjusting items net of tax | 5 | (7) | (0.4) | (16) | (0.8) | (7) | (0.4) | (16) | (0.8) |
| **Adjusted earnings per share** | | 3,891 | 208.1 | 4,133 | 216.6 | 3,891 | 208.7 | 4,133 | 217.4 |

FINANCIAL STATEMENTS

# 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 2/2013 'Headline Earnings', as issued by the South African Institute of Chartered Accountants.

| | Diluted | | | | Basic | | | |
|---|---|---|---|---|---|---|---|---|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| | **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 | **3,115** | **166.6** | 3,904 | 204.6 | **3,115** | **167.1** | 3,904 | 205.4 |
| Effect of impairment of intangibles, property, plant and equipment, and assets held-for-sale | **107** | **5.7** | 34 | 1.8 | **107** | **5.7** | 34 | 1.8 |
| Tax and non-controlling interests on impairment of intangibles, and property, plant and equipment | **(20)** | **(1.0)** | (2) | (0.1) | **(20)** | **(1.0)** | (2) | (0.1) |
| Effect of gains on disposal of property, plant and equipment and held-for-sale assets | **(34)** | **(1.9)** | (92) | (4.8) | **(34)** | **(1.8)** | (92) | (4.8) |
| Tax and non-controlling interests on disposal of property, plant and equipment and held-for-sale assets | **9** | **0.5** | 25 | 1.3 | **9** | **0.5** | 25 | 1.3 |
| Effect of disposal of businesses and trademarks | **–** | **–** | (26) | (1.4) | **–** | **–** | (26) | (1.4) |
| Effect of gains reclassified from the available-for-sale reserve | **–** | **–** | (2) | (0.1) | **–** | **–** | (2) | (0.1) |
| Share of associates' trademark and other asset impairments net of tax | **–** | **–** | 4 | 0.2 | **–** | **–** | 4 | 0.2 |
| Issue of shares and change in shareholding in associate | **(14)** | **(0.8)** | (22) | (1.1) | **(14)** | **(0.8)** | (22) | (1.2) |
| **Headline earnings per share** | **3,163** | **169.1** | 3,823 | 200.4 | **3,163** | **169.7** | 3,823 | 201.1 |

An alternative measure of headline earnings per share has been presented below to take account of the effects of Fox River (note 3(h)) and Flintkote (note (3(i)); this measure is in addition to and not mandated by the JSE Listing Requirements:

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Headline earnings per share amended for Fox River and Flintkote** | **3,510** | **187.7** | 3,823 | 200.4 | **3,510** | **188.4** | 3,823 | 201.1 |

## 8 Dividends and other appropriations

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | **Pence per share** | **£m** | Pence per share | £m |
| **Ordinary shares** | | | | |
| Interim | | | | |
| 2014 paid 30 September 2014 | **47.5** | **881** | | |
| 2013 paid 30 September 2013 | | | 45.0 | 846 |
| Final | | | | |
| 2013 paid 8 May 2014 | **97.4** | **1,831** | | |
| 2012 paid 8 May 2013 | | | 92.7 | 1,765 |
| | **144.9** | **2,712** | 137.7 | 2,611 |

The Directors have recommended to shareholders a final dividend of 100.6p per share for the year ended 31 December 2014. If approved, this dividend will be paid to shareholders on 7 May 2015. This dividend is subject to approval by shareholders at the Annual General Meeting and therefore, in accordance with IAS 10 *Events After the Reporting Period*, it has not been included as a liability in these financial statements. The total estimated dividend to be paid is £1,866 million, which takes the total dividends declared in respect of 2014 to £2,747 million (2013: £2,677 million) representing 148.1p per share (2013: 142.4p per share).

## 9 Intangible assets

| | Goodwill* £m | Computer software £m | Trademarks and similar intangibles £m | Assets in the course of development £m | Total £m |
|---|---|---|---|---|---|
| **1 January 2014** | | | | | |
| Cost | **10,249** | **631** | **891** | **283** | **12,054** |
| Accumulated amortisation and impairment | | **(496)** | **(353)** | | **(849)** |
| **Net book value at 1 January 2014** | **10,249** | **135** | **538** | **283** | **11,205** |
| Differences on exchange | **(407)** | **(3)** | **(31)** | **–** | **(441)** |
| Additions | | | | | |
| – internal development | **–** | **16** | **–** | **143** | **159** |
| – separately acquired | **–** | **4** | **3** | **–** | **7** |
| Reallocations | **–** | **121** | **–** | **(121)** | **–** |
| Amortisation charge | **–** | **(56)** | **(58)** | **–** | **(114)** |
| Impairment | **–** | **(12)** | **–** | **–** | **(12)** |
| **31 December 2014** | | | | | |
| Cost | **9,842** | **735** | **844** | **305** | **11,726** |
| Accumulated amortisation and impairment | | **(530)** | **(392)** | | **(922)** |
| **Net book value at 31 December 2014** | **9,842** | **205** | **452** | **305** | **10,804** |
| **1 January 2013** | | | | | |
| Cost | 10,793 | 659 | 904 | 173 | 12,529 |
| Accumulated amortisation and impairment | | (509) | (310) | | (819) |
| **Net book value at 1 January 2013** | 10,793 | 150 | 594 | 173 | 11,710 |
| Differences on exchange | (545) | (1) | (21) | (4) | (571) |
| Additions | | | | | |
| – internal development | – | 14 | – | 133 | 147 |
| – acquisitions (note 26(b)) | 1 | – | 25 | – | 26 |
| – separately acquired | – | 3 | 10 | – | 13 |
| Reallocations | – | 19 | – | (19) | – |
| Amortisation charge | – | (50) | (70) | – | (120) |
| **31 December 2013** | | | | | |
| Cost | 10,249 | 631 | 891 | 283 | 12,054 |
| Accumulated amortisation and impairment | | (496) | (353) | | (849) |
| **Net book value at 31 December 2013** | 10,249 | 135 | 538 | 283 | 11,205 |

* The cost of Goodwill is shown net of impairment charges made in prior years.

Included in computer software and assets in the course of development are internally developed assets with a carrying value of £493 million (2013: £398 million). The costs of internally developed assets include capitalised expenses of employees working full time on software development projects, third-party consultants, as well as software licence fees from third-party suppliers.

Acquisitions in 2013 related to the creation of CTBAT International Limited and the acquisition of British American Tobacco Myanmar Limited as explained in note 26.

Included in the net book value of trademarks and similar intangibles are trademarks relating to the acquisition of Skandinavisk Tobakskompagni (ST) £262 million (2013: £301 million), Tekel £25 million (2013: £30 million), Bentoel £30 million (2013: £38 million) and Protabaco £72 million (2013: £91 million) and intellectual property of £13 million (2013: £26 million) relating to the acquisition of CN Creative Limited in 2012.

The Group has future contractual commitments of £10 million (2013: £11 million) related to intangible assets.

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# Notes on the Accounts continued

## 9 Intangible assets continued

### Impairment testing for intangible assets with indefinite lives including goodwill

Goodwill of £9,842 million (2013: £10,249 million) is included in intangible assets in the balance sheet of which the following are the significant acquisitions: Rothmans Group £4,384 million (2013: £4,542 million); Imperial Tobacco Canada £2,223 million (2013: £2,281 million); ETI (Italy) £1,280 million (2013: £1,371 million) and ST (principally Scandinavia) £963 million (2013: £1,030 million). The principal allocations of goodwill in the Rothmans' acquisition are to the cash-generating units of Eastern Europe, Western Europe and South Africa, with the remainder mainly relating to operations in the domestic and export markets in the United Kingdom and operations in Asia-Pacific.

In 2014 and 2013, goodwill was allocated for impairment testing purposes to 14 individual cash-generating units – five in Asia-Pacific, five in the Americas, two in Western Europe and two in EEMEA.

The carrying amounts of goodwill allocated to the cash-generating units of Canada £2,223 million (2013: £2,281 million), Western Europe (includes Rothmans and other acquisitions) £3,388 million (2013: £3,624 million), Eastern Europe (includes Rothmans and other acquisitions) £851 million (2013: £908 million), South Africa £614 million (2013: £639 million), Australia (includes Rothmans and other acquisitions) £703 million (2013: £724 million), Singapore £517 million (2013: £511 million) and Malaysia £432 million (2013: £434 million) are considered significant in comparison with the total carrying amount of goodwill.

The recoverable amounts of all cash-generating units have been determined on a value-in-use basis. The key assumptions for the recoverable amounts of all units are the budgeted volumes, operating margins and long-term growth rates, which directly impact the cash flows, and the discount rates used in the calculation. 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 adjustments are derived from external sources and are based on the spread between bonds (or credit default swaps, or similar indicators) issued by the US or comparable governments and by the local government, adjusted for the Group's own credit market risk. For ease of use and consistency in application, these results are periodically calibrated into bands based on internationally recognised credit ratings. The long-term growth rates and discount rates have been applied to the budgeted cash flows of each cash-generating unit. These cash flows have been determined by local management based on experience, specific market and brand trends, pricing expectations and costs, and have been endorsed by Group management as part of the consolidated Group budget.

The valuations use cash flows based on detailed financial budgets prepared by management covering a one-year period, with growth in year 2 of 5% (2013: 6%). Cash flows for the years 3 to 10 are extrapolated from year 2 cash flows of each relevant operating unit at 4% (2013: 5%) per annum, including 1% (2013: 2%) inflation, where after a total growth rate of 2% (2013: 2%) per annum (including 2% (2013: 2%) inflation) has been assumed. The extrapolated growth rates are considered conservative given the Group's history of profit and cash 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 the country or market management, spanning five years or beyond.

Pre-tax discount rates of between 7.2% and 15.0% (2013: 7.2% to 14.1%) 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 8.5% for Canada (2013: 8.5%), 8.6% for Western Europe (2013: 9.3%), 8.5% for Eastern Europe (2013: 8.6%), 9.6% for South Africa (2013: 9.3%), 8.6% for Australia (2013: 8.6%), 7.2% for Singapore (2013: 7.2%) and 8.7% for Malaysia (2013: 8.7%).

If discounted cash flows for cash-generating units should fall by 10%, or the discount rate was increased at a post-tax rate of 1%, 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 2014** | | | | | |
| Cost | 1,034 | 258 | 4,257 | 527 | 6,076 |
| Accumulated depreciation and impairment | (325) | (123) | (2,460) | (12) | (2,920) |
| **Net book value at 1 January 2014** | 709 | 135 | 1,797 | 515 | 3,156 |
| Differences on exchange | (45) | (1) | (138) | (33) | (217) |
| Additions | 9 | 1 | 74 | 414 | 498 |
| Reallocations | 55 | 12 | 274 | (341) | – |
| Depreciation | (20) | (9) | (278) | – | (307) |
| Impairment | (40) | (8) | (36) | (3) | (87) |
| Disposals | (13) | (2) | (12) | (1) | (28) |
| Net reclassifications as held-for-sale | – | – | (11) | – | (11) |
| **31 December 2014** | | | | | |
| Cost | 998 | 260 | 4,109 | 570 | 5,937 |
| Accumulated depreciation and impairment | (343) | (132) | (2,439) | (19) | (2,933) |
| **Net book value at 31 December 2014** | 655 | 128 | 1,670 | 551 | 3,004 |
| **1 January 2013** | | | | | |
| Cost | 1,138 | 261 | 4,453 | 483 | 6,335 |
| Accumulated depreciation and impairment | (362) | (123) | (2,649) | | (3,134) |
| **Net book value at 1 January 2013** | 776 | 138 | 1,804 | 483 | 3,201 |
| Differences on exchange | (47) | (6) | (137) | (37) | (227) |
| Additions* | 12 | 16 | 117 | 420 | 565 |
| Reallocations | 24 | (4) | 314 | (334) | – |
| Depreciation | (22) | (9) | (270) | – | (301) |
| Impairment | (2) | – | (14) | (17) | (33) |
| Disposals | (32) | – | (17) | – | (49) |
| **31 December 2013** | | | | | |
| Cost | 1,034 | 258 | 4,257 | 527 | 6,076 |
| Accumulated depreciation and impairment | (325) | (123) | (2,460) | (12) | (2,920) |
| **Net book value at 31 December 2013** | 709 | 135 | 1,797 | 515 | 3,156 |
| Assets held under finance leases | | | | | |
| **31 December 2014** | | | | | |
| Cost | | | 17 | | 17 |
| Accumulated depreciation and impairment | | | (8) | | (8) |
| **Net book value at 31 December 2014** | | | 9 | | 9 |
| **31 December 2013** | | | | | |
| Cost | | | 13 | | 13 |
| Accumulated depreciation and impairment | | | (8) | | (8) |
| **Net book value at 31 December 2013** | | | 5 | | 5 |

* Additions in 2013 include amounts contributed by the non-controlling interest in Myanmar (note 26).

The Group's finance lease arrangements relate principally to the lease of vehicles and tobacco vending machines by the Group's subsidiaries in Pakistan and Japan respectively. Assets held under finance leases are secured under finance lease obligations included in note 21.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 10 Property, plant and equipment continued

As explained in note 12, contributions to the British American Tobacco UK Pension Fund are secured by a charge over the Group's Head Office (Globe House). Globe House is included in freehold property above with a carrying value of £191 million (2013: £192 million).

| | 2014 £m | 2013 £m |
|---|---|---|
| **Cost of freehold land within freehold property on which no depreciation is provided** | **200** | 203 |
| Leasehold property comprises | | |
| – net book value of long leasehold | **113** | 111 |
| – net book value of short leasehold | **15** | 24 |
| | **128** | 135 |
| **Contracts placed for future expenditure** | **121** | 82 |

## 11 Investments in associates and joint ventures

| | 2014 £m | 2013 £m |
|---|---|---|
| **1 January** | **2,299** | 2,330 |
| Total comprehensive income (note 5) | **723** | 681 |
| Dividends (note 5) | **(518)** | (512) |
| Share buy-backs (note 25(d)) | **(94)** | (189) |
| Other equity movements | **(10)** | (11) |
| **31 December** | **2,400** | 2,299 |
| | | |
| Non-current assets | **4,070** | 3,741 |
| Current assets | **1,798** | 1,667 |
| Non-current liabilities | **(2,099)** | (1,983) |
| Current liabilities | **(1,369)** | (1,126) |
| | **2,400** | 2,299 |
| | | |
| Reynolds American Inc. (Group's share of the market value is £9,205 million (2013: £6,828 million)) | **1,361** | 1,447 |
| ITC Ltd. (Group's share of the market value is £9,001 million (2013: £7,587 million)) | **991** | 808 |
| Other listed associates (Group's share of the market value is £98 million (2013: £83 million)) | **13** | 11 |
| Unlisted associates | **35** | 33 |
| | **2,400** | 2,299 |

## 11 Investments in associates and joint ventures continued

The principal associate undertakings of the Group are Reynolds American Inc (RAI) and ITC Ltd. (ITC) as shown under principal associate undertakings.

### Reynolds American Inc.

| | 2014 £m | 2013 £m |
|---|---|---|
| Non-current assets | **4,481** | 4,146 |
| Current assets | **2,193** | 2,257 |
| Non-current liabilities | **(4,838)** | (4,576) |
| Current liabilities | **(2,162)** | (1,739) |
| | **(326)** | 88 |
| Group's share of Reynolds American Inc. (42.0%) | **(137)** | 37 |
| Goodwill | **1,498** | 1,410 |
| **Total Group's share of Reynolds American Inc.** | **1,361** | 1,447 |

On 30 July 2004, the Group completed the agreement to combine the US domestic business of Brown and Williamson (B&W), one of its subsidiaries, with RJ Reynolds. This combination resulted in the formation of RAI, which is 58% owned by RJ Reynolds' shareholders and 42% owned by the Group. The Group has concluded that it does not have de facto control of RAI because of the operation of the governance agreement between the Group and RAI which ensures that the Group does not have the practical ability to direct the relevant activities of RAI; in particular, the Group cannot nominate more than five of the Directors (out of 13 or proportionally less if there are less than 13 Directors) unless it owns 100% of RAI or some other party owns more than 50%. In addition, there are no other contractual arrangements which would give the Group the ability to direct RAI's operations. Manufacturing and cooperation agreements between RAI and the Group have been agreed on an arm's length basis (see note 29).

The Group's share of RAI includes £472 million (2013: £446 million) of trademarks arising from the RAI transaction in 2004. In addition, the Group's share of non-current assets includes £667 million (2013: £628 million) of goodwill and £308 million (2013: £291 million) of trademarks arising from the acquisition of Conwood by RAI 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, 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.

The Group's share of the RAI results for the year to 31 December 2014 includes £46 million (2013: £43 million) in respect of external legal fees and other external product liability defence costs.

On 15 July 2014, the Group announced that it has agreed to invest US$4.7 billion as part of RAI's proposed acquisition of Lorillard enabling the Group to maintain its 42% equity position in the enlarged business. The investment is contingent upon the completion of RAI's acquisition of Lorillard, which has been approved by the shareholders of RAI and Lorillard, and the proposed acquisition, while subject to a number of regulatory approvals in the US, is anticipated to be completed in the first half of 2015.

### ITC Ltd

ITC prepares accounts on a quarterly basis with a 31 March year-end. As permitted by IAS 28 *Investments in Associates and Joint Ventures*, results up to 30 September 2014 have been used in applying the equity method. This is driven by the availability of information at the half year, to be consistent with the treatment in the Group's interim accounts. Any further information available after the date used for reporting purposes is reviewed and any material items adjusted for in the final results. The latest published information available is at 31 December 2014.

| | 2014 £m | 2013 £m |
|---|---|---|
| Non-current assets | **2,201** | 1,858 |
| Current assets | **2,713** | 2,202 |
| Non-current liabilities | **(212)** | (194) |
| Current liabilities | **(1,428)** | (1,214) |
| | **3,274** | 2,652 |
| **Group's share of ITC Ltd (2014: 30.26% (2013: 30.47%))** | **991** | 808 |

Additional information on associates is provided in the principal associate undertaking sections to the Annual Report.

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# Notes on the Accounts continued

## 12 Retirement benefit schemes

The Group's subsidiary undertakings operate around 170 retirement benefit arrangements worldwide. The majority of scheme members belong to defined benefit schemes, most of which are funded externally and many of which are closed to new entrants. 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 schemes are in the UK, Germany, Canada, the Netherlands and Switzerland. Together schemes in these territories account for over 85% of the total obligations of the Group's defined benefit schemes. These obligations consist mainly of final salary pension schemes which provide benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits provided depends on members' length of service and their salary in the final years leading up to retirement. As a result of regulatory changes, with effect from 1 January 2015, the schemes in the Netherlands now accrue benefits based on lifetime average salaries.

In addition, the Group operates several health care benefit schemes, of which the most significant are in Canada. The liabilities in respect of healthcare benefits are also assessed by qualified independent actuaries, applying the projected unit credit method.

All of these arrangements, including funded schemes where formal trusts or equivalents are required, have been developed and are operated in accordance with local practices and regulations where applicable in the countries concerned. For example, in the UK, the main pension scheme is the British American Tobacco UK Pension Fund, which is established under trust law and has a corporate trustee that is required to run the scheme in accordance with the Scheme's Trust Deed and Rules and to comply with the Pension Scheme Act 1993, Pensions Act 1995, Pension Act 2004 and all the relevant legislation.

Responsibility for the governance of the schemes, including investment decisions and contribution schedules, lies with the trustees. The trustees for each arrangement will usually consist of representatives appointed by both the sponsoring company and the beneficiaries.

The majority of schemes are subject to local regulation regarding funding deficits. Contributions to defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes and after taking into account regulatory requirements.

Contributions to the British American Tobacco UK Pension Fund have been agreed with the trustee as part of a recovery plan to include £30 million a year to cover ongoing service costs and additional contributions to eliminate a funding shortfall. Additional contributions were £140 million in 2014 and £190 million in 2013 and are planned to be £148 million in 2015, and £78 million in each of 2016, 2017 and 2018. These contributions will be used to achieve the statutory funding objective and thereafter to support attaining a lower risk investment strategy (noted below) and may be subject to renegotiation, dependent on funding levels. Total contributions payable are secured by a charge over the Group's Head Office (Globe House) up to a maximum of £150 million. The charge would be triggered in the event that the Group defaults on agreed contributions due to the Fund or if an insolvency event occurs with respect to the UK entity responsible for making the payments. The charge is due to be released in 2039 but may be released earlier by negotiation or if the assets of the Fund are sufficient to achieve certain funding levels. Under the rules of the scheme, any future surplus would be returnable to the Group by refund at the end of the life of the scheme. The funding commitment is therefore not considered onerous and in accordance with IFRIC 14 no additional liabilities have been recognised in respect of this commitment.

Payments made to pensioners by the operating companies in Germany, net of income on scheme assets, are deemed to be company contributions to the Contractual Trust Arrangements and are anticipated to be around £27 million per annum for the next five years. Contributions to pension schemes in Canada, the Netherlands and Switzerland in total are anticipated to be around £22 million per annum for the next five years. Group contributions to pension schemes in 2015 are expected to be £243 million in total compared to £241 million in 2014.

The majority of benefit payments are from trustee administered funds; however, there are also a number of unfunded schemes where the sponsoring company meets the benefit payment obligation as it falls due. For unfunded schemes in the UK and Canada, 32% of the liabilities reported at year-end are expected to be settled by the Group within 10 years, 29% between 10 and 20 years, 20% between 20 and 30 years, and 19% thereafter.

The funded arrangements in the Group have policies on investment management, including strategies over a preferred long-term investment profile, and schemes in certain territories including Canada and the Netherlands manage their bond portfolios to match the weighted average duration of scheme liabilities. In addition, the main scheme in the UK has a target investment strategy such that, by 31 December 2018, the scheme will have moved to 20% return-seeking assets and 80% risk-reducing assets. Investments are diversified by type of investment, by investment sector, and where appropriate by country.

## 12 Retirement benefit schemes continued

Through its defined benefit pension schemes and health care schemes, the Group is exposed to a number of risks, including:

### Asset volatility

The plan liabilities are calculated using discount rates set by reference to bond yields; if plan assets underperform this yield e.g. due to stock market volatility, this will create a deficit. However, most schemes hold a proportion of assets which are expected to outperform bonds in the long term, and the majority of schemes by value are subject to local regulation regarding funding deficits.

### Changes in bond yields

A decrease in corporate bond yields will increase scheme liabilities, although this will be partially offset by an increase in the value of the schemes' bond holdings or other hedging instruments.

### Inflation risk

Some of the Group's pension obligations are linked to inflation and higher inflation will lead to higher liabilities, although, in most cases, caps on the level of inflationary increases are in place in the scheme rules, while some assets and derivatives provide specific inflation protection.

### Life expectancy

The majority of the schemes' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the plans' liabilities. Assumptions regarding mortality and mortality improvements are regularly reviewed in line with actuarial tables and scheme specific experience.

The amounts recognised in the Balance Sheet are determined as follows:

| | Pension schemes | | Health care schemes | | Total | |
|---|---|---|---|---|---|---|
| | **2014 £m** | 2013 £m | **2014 £m** | 2013 £m | **2014 £m** | 2013 £m |
| Present value of funded scheme liabilities | **(6,594)** | (5,905) | **(15)** | (16) | **(6,609)** | (5,921) |
| Fair value of funded scheme assets | **6,253** | 5,767 | **13** | 13 | **6,266** | 5,780 |
| | **(341)** | (138) | **(2)** | (3) | **(343)** | (141) |
| Unrecognised funded scheme surpluses | **(13)** | (19) | **–** | – | **(13)** | (19) |
| | **(354)** | (157) | **(2)** | (3) | **(356)** | (160) |
| Present value of unfunded scheme liabilities | **(287)** | (239) | **(98)** | (98) | **(385)** | (337) |
| | **(641)** | (396) | **(100)** | (101) | **(741)** | (497) |
| The above net liability is recognised in the Balance Sheet as follows: | | | | | | |
| – retirement benefit scheme liabilities | **(681)** | (531) | **(100)** | (101) | **(781)** | (632) |
| – retirement benefit scheme assets | **40** | 135 | **–** | – | **40** | 135 |
| | **(641)** | (396) | **(100)** | (101) | **(741)** | (497) |

The net liabilities of funded pension schemes by territory are as follows:

| | Liabilities | | Assets | | Total | |
|---|---|---|---|---|---|---|
| | **2014 £m** | 2013 £m | **2014 £m** | 2013 £m | **2014 £m** | 2013 £m |
| – UK | **(3,217)** | (2,863) | **3,198** | 2,771 | **(19)** | (92) |
| – Germany | **(929)** | (831) | **733** | 762 | **(196)** | (69) |
| – Canada | **(753)** | (704) | **762** | 745 | **9** | 41 |
| – Netherlands | **(704)** | (560) | **685** | 633 | **(19)** | 73 |
| – Switzerland | **(349)** | (348) | **272** | 286 | **(77)** | (62) |
| – Rest of Group | **(642)** | (599) | **603** | 570 | **(39)** | (29) |
| Funded schemes | **(6,594)** | (5,905) | **6,253** | 5,767 | **(341)** | (138) |

Of the Group's unfunded pension schemes 57% (2013: 53%) relate to arrangements in the UK, while 81% (2013: 82%) of the Group's unfunded health care arrangements relate to arrangements in Canada.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 12 Retirement benefit schemes continued

The amounts recognised in the Income Statement are as follows:

| | Pension schemes | | Health care schemes | | Total | |
|---|---|---|---|---|---|---|
| | 2014 £m | 2013 £m | 2014 £m | 2013 £m | 2014 £m | 2013 £m |
| **Defined benefit schemes** | | | | | | |
| Service cost | | | | | | |
| – current service cost | 81 | 92 | 1 | 1 | 82 | 93 |
| – past service cost | (2) | 5 | (3) | (5) | (5) | – |
| Net interest on the net defined benefit liability | | | | | | |
| – interest on scheme liabilities | 261 | 253 | 6 | 7 | 267 | 260 |
| – interest on scheme assets | (252) | (227) | (1) | (1) | (253) | (228) |
| – interest on unrecognised funded scheme surpluses | 1 | 1 | – | – | 1 | 1 |
| | 89 | 124 | 3 | 2 | 92 | 126 |
| **Defined contribution schemes** | 40 | 36 | – | – | 40 | 36 |
| **Total amount recognised in the Income Statement (note 3(a))** | 129 | 160 | 3 | 2 | 132 | 162 |

The above charges are recognised within employee benefit costs in note 3(a) and include a charge of £4 million in 2014 (2013: £7 million charge) in respect of settlements, past service costs and defined contribution costs reported as part of the restructuring costs charged in arriving at profit from operations (see note 3(e)).

The amounts recognised in other comprehensive income in respect of actuarial gains and losses of subsidiaries are as follows:

| | Pension schemes | | Healthcare schemes | | Total | |
|---|---|---|---|---|---|---|
| | 2014 £m | 2013 £m | 2014 £m | 2013 £m | 2014 £m | 2013 £m |
| Actuarial (losses)/gains on scheme liabilities | (878) | 139 | (6) | 42 | (884) | 181 |
| Actuarial gains on scheme assets | 456 | 127 | – | – | 456 | 127 |
| **Net actuarial (losses)/gains in other comprehensive income (note 20)** | (422) | 266 | (6) | 42 | (428) | 308 |

The amounts recognised in other comprehensive income in respect of surplus restrictions of subsidiaries are as follows:

| | Pension schemes | | Healthcare schemes | | Total | |
|---|---|---|---|---|---|---|
| | 2014 £m | 2013 £m | 2014 £m | 2013 £m | 2014 £m | 2013 £m |
| **Movements in the year (note 20)** | 7 | (5) | – | – | 7 | (5) |

## 12 Retirement benefit schemes continued

The movements in scheme liabilities are as follows:

| | Pension schemes | | Health care schemes | | Total | |
|---|---|---|---|---|---|---|
| | **2014 £m** | 2013 £m | **2014 £m** | 2013 £m | **2014 £m** | 2013 £m |
| **Present value at 1 January** | **6,144** | 6,420 | **114** | 175 | **6,258** | 6,595 |
| Differences on exchange | **(142)** | (106) | **(4)** | (15) | **(146)** | (121) |
| Current service cost | **80** | 91 | **1** | 1 | **81** | 92 |
| Past service cost | **(2)** | 5 | **(3)** | (5) | **(5)** | – |
| Settlements | **–** | (46) | **–** | – | **–** | (46) |
| Interest on scheme liabilities | **258** | 244 | **6** | 7 | **264** | 251 |
| Contributions by scheme members | **4** | 2 | **–** | – | **4** | 2 |
| Benefits paid | **(339)** | (327) | **(7)** | (7) | **(346)** | (334) |
| Actuarial losses/(gains) | **878** | (139) | **6** | (42) | **884** | (181) |
| **Present value at 31 December** | **6,881** | 6,144 | **113** | 114 | **6,994** | 6,258 |
| Scheme liabilities by scheme membership: | | | | | | |
| Active members | **1,354** | 1,279 | **23** | 20 | **1,377** | 1,299 |
| Deferred members | **1,080** | 912 | **8** | 11 | **1,088** | 923 |
| Retired members | **4,447** | 3,953 | **82** | 83 | **4,529** | 4,036 |
| **Present value at 31 December** | **6,881** | 6,144 | **113** | 114 | **6,994** | 6,258 |

Approximately 95% of scheme liabilities in both years relate to guaranteed benefits.

Actuarial losses/(gains) shown above can be analysed as follows:

| | Pension schemes | | Health care schemes | | Total | |
|---|---|---|---|---|---|---|
| | **2014 £m** | 2013 £m | **2014 £m** | 2013 £m | **2014 £m** | 2013 £m |
| Actuarial losses/(gains): | | | | | | |
| – arising from changes in demographic assumptions | **120** | 26 | **3** | (1) | **123** | 25 |
| – arising from changes in financial assumptions | **766** | (143) | **6** | (40) | **772** | (183) |
| Experience gains | **(8)** | (22) | **(3)** | (1) | **(11)** | (23) |
| **Total** | **878** | (139) | **6** | (42) | **884** | (181) |

Changes in financial assumptions principally relate to discount rate and inflation rate movements.

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# Notes on the Accounts continued

## 12 Retirement benefit schemes continued

The movements in funded scheme assets are as follows:

| | Pension schemes | | Health care schemes | | Total | |
|---|---|---|---|---|---|---|
| | 2014 £m | 2013 £m | 2014 £m | 2013 £m | 2014 £m | 2013 £m |
| **Fair value of scheme assets at 1 January** | **5,767** | 5,547 | **13** | 16 | **5,780** | 5,563 |
| Differences on exchange | **(141)** | (93) | **(1)** | (3) | **(142)** | (96) |
| Settlements | **–** | (46) | **–** | – | **–** | (46) |
| Interest on scheme assets | **249** | 219 | **1** | 1 | **250** | 220 |
| Company contributions net of reimbursements | **241** | 320 | **–** | – | **241** | 320 |
| Contributions by scheme members | **4** | 4 | **–** | – | **4** | 4 |
| Benefits paid | **(323)** | (311) | **–** | (1) | **(323)** | (312) |
| Actuarial gains | **456** | 127 | **–** | – | **456** | 127 |
| **Fair value of scheme assets at 31 December** | **6,253** | 5,767 | **13** | 13 | **6,266** | 5,780 |

Company contributions for 2014 in the table above are shown net of a reimbursement of £1 million from a Jamaican pension scheme in the course of being wound up (2013: £7 million).

Fair value of scheme assets by category:

| | Pension schemes | | Health care schemes | | Total | |
|---|---|---|---|---|---|---|
| | 2014 £m | 2013 £m | 2014 £m | 2013 £m | 2014 £m | 2013 £m |
| Equities – listed | **1,759** | 1,908 | **5** | 5 | **1,764** | 1,913 |
| Equities – unlisted | **533** | 513 | **–** | – | **533** | 513 |
| Bonds – listed | **2,812** | 2,647 | **4** | 8 | **2,816** | 2,655 |
| Bonds – unlisted | **34** | 151 | **–** | – | **34** | 151 |
| Other assets – listed | **84** | 137 | **4** | – | **88** | 137 |
| Other assets – unlisted | **1,031** | 411 | **–** | – | **1,031** | 411 |
| **Fair value of scheme assets at 31 December** | **6,253** | 5,767 | **13** | 13 | **6,266** | 5,780 |

Scheme assets have been diversified into equities, bonds and other assets and are typically invested via fund investment managers into both pooled and segregated mandates of listed and unlisted equities and bonds. In addition certain scheme assets, including a portion of the assets held in the main UK pension scheme, are further diversified by investing in equities listed on foreign stock exchanges via investment funds. In the above analysis investments via equity-based investment funds are shown under listed equities, and investments via bond-based investment funds are shown under listed bonds.

In Jamaica, a pension scheme holds shares in Carreras Group Ltd. (a Group subsidiary) with a fair value of £1 million (2013: £1 million). The shares are listed on the Jamaica Stock Exchange.

Other assets include cash and other deposits, derivatives and other hedges (including liability driven investments funds and inflation opportunity funds), recoverable taxes, reinsurance contracts, infrastructure investments and investment property.

The actuarial gains and losses in both years principally relate to movements in the fair values of scheme assets and actual returns are stated net of applicable taxes and fund management fees.

| | Pension schemes | | Health care schemes | | Total | |
|---|---|---|---|---|---|---|
| | 2014 £m | 2013 £m | 2014 £m | 2013 £m | 2014 £m | 2013 £m |
| **Actual return on scheme assets** | **705** | 346 | **1** | 1 | **706** | 347 |

## 12 Retirement benefit schemes continued

The movements in the unrecognised scheme surpluses, recognised in other comprehensive income, are as follows:

| | Pension schemes | | Health care schemes | | Total | |
|---|---|---|---|---|---|---|
| | **2014 £m** | 2013 £m | **2014 £m** | 2013 £m | **2014 £m** | 2013 £m |
| **Unrecognised funded scheme surpluses at 1 January** | **(19)** | (15) | **–** | – | **(19)** | (15) |
| Differences on exchange | **–** | 2 | **–** | – | **–** | 2 |
| Interest on unrecognised funded scheme surpluses | **(1)** | (1) | **–** | – | **(1)** | (1) |
| Movement in year (note 20) | **7** | (5) | **–** | – | **7** | (5) |
| **Unrecognised funded scheme surpluses at 31 December** | **(13)** | (19) | **–** | – | **(13)** | (19) |

The principal actuarial assumptions (weighted to reflect individual scheme differences) used in the following principal countries are shown below. In both years, 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.

| | **UK %** | **Germany %** | **Canada %** | **Netherlands %** | **Switzerland %** |
|---|---|---|---|---|---|
| **31 December 2014** | | | | | |
| Rate of increase in salaries | **4.5** | **2.5** | **3.3** | **2.0** | **1.5** |
| Rate of increase in pensions in payment | **3.0** | **1.8** | **Nil** | **1.6** | **Nil** |
| Rate of increase in deferred pensions | **2.5** | **Nil** | **Nil** | **1.6** | **–** |
| Discount rate | **3.4** | **1.9** | **3.8** | **2.0** | **1.1** |
| General inflation | **3.0** | **1.8** | **2.3** | **2.0** | **Nil** |

| | **UK years** | **Germany years** | **Canada years** | **Netherlands years** | **Switzerland years** |
|---|---|---|---|---|---|
| **31 December 2014** | | | | | |
| Weighted average duration of liabilities | **17.2** | **14.0** | **11.2** | **19.4** | **14.8** |

For health care inflation in Canada, the assumption is 4.0%. For the remaining pension schemes, typical assumptions are that real salary increases will be from 0% to 4.5% per annum and discount rates will be from 0% to 5.9% above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

| | UK % | Germany % | Canada % | Netherlands % | Switzerland % |
|---|---|---|---|---|---|
| **31 December 2013** | | | | | |
| Rate of increase in salaries | 4.9 | 2.5 | 3.3 | 2.7 | 1.5 |
| Rate of increase in pensions in payment | 3.4 | 1.8 | Nil | 1.5 | Nil |
| Rate of increase in deferred pensions | 2.9 | Nil | Nil | 1.5 | – |
| Discount rate | 4.4 | 3.4 | 4.6 | 3.7 | 2.3 |
| General inflation | 3.4 | 1.8 | 2.3 | 1.5 | Nil |

| | UK years | Germany years | Canada years | Netherlands years | Switzerland years |
|---|---|---|---|---|---|
| **31 December 2013** | | | | | |
| Weighted average duration of liabilities | 16.6 | 11.2 | 11.1 | 16.0 | 15.6 |

For health care inflation in Canada, the assumption was 4.35% increasing to 5.0% by 2018. For the remaining pension schemes, typical assumptions were that real salary increases would be from 0.5% to 3.1% per annum and discount rates would be from 0.5% to 6.8% above inflation. Pension increases, where allowed for, were generally assumed to be in line with inflation.

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# Notes on the Accounts continued

## 12 Retirement benefit schemes continued

Mortality assumptions are subject to regular review. The principal schemes used the following tables:

| | | |
|---|---|---|
| UK | 2014: | 91.5% S1NA (year of birth) table with the Continuous Mortality Investigation (2013) model with a 1.75% long-term improvement rate |
| | 2013: | S1NA (year of birth) table with the Continuous Mortality Investigation (2009) model with a 1.5% long-term improvement rate |
| Germany | | Heubeck tables 2005G (both years) |
| Canada | 2014: | CPM-2014 Private Table |
| | 2013: | UP94 tables |
| Netherlands | 2014: | AG Prognosetafel 2014 |
| | 2013: | AG Prognosetafel 2012–2062 tables |
| Switzerland | | LPP 2010 tables (both years) |

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 2014** | | | | | | | | | | |
| Member age 65 (current life expectancy) | **23.6** | **26.1** | **18.9** | **23.0** | **20.8** | **23.3** | **20.8** | **24.7** | **21.4** | **23.9** |
| Member age 45 (life expectancy at age 65) | **26.3** | **28.9** | **21.6** | **25.5** | **22.0** | **24.3** | **23.3** | **26.7** | **23.2** | **25.6** |
| **31 December 2013** | | | | | | | | | | |
| Member age 65 (current life expectancy) | 22.8 | 25.0 | 18.8 | 22.8 | 19.8 | 22.1 | 20.4 | 24.8 | 21.3 | 23.8 |
| Member age 45 (life expectancy at age 65) | 25.1 | 27.4 | 21.4 | 25.4 | 21.3 | 22.9 | 22.4 | 25.7 | 23.1 | 25.5 |

Valuation of retirement benefit schemes involves judgements about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 December 2014 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, while asset values also change, 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 |
|---|---|---|---|---|
| Average life expectancy – increase/(decrease) of scheme liabilities | **187** | **(186)** | | |
| Rate of inflation – increase/(decrease) of scheme liabilities | | | **216** | **(204)** |
| Discount rate – (decrease)/increase of scheme liabilities | | | **(163)** | **177** |

A one percentage point increase in health care inflation would increase health care scheme liabilities by £13 million, and a one percentage point decrease would decrease liabilities by £10 million. The Income Statement effect of this change in assumption is not material.

## 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 losses/(gains) £m | Other temporary differences £m | Total £m |
|---|---|---|---|---|---|---|---|
| **At 1 January 2014** | **46** | **34** | **67** | **104** | **–** | **157** | **408** |
| Differences on exchange | **(5)** | **(2)** | **(4)** | **(7)** | **–** | **(5)** | **(23)** |
| (Charged)/credited to the Income Statement | **(10)** | **2** | **(17)** | **(7)** | **62** | **(14)** | **16** |
| Credited to other comprehensive income | **–** | **–** | **–** | **65** | **–** | **–** | **65** |
| **At 31 December 2014** | **31** | **34** | **46** | **155** | **62** | **138** | **466** |
| **At 1 January 2013** | 65 | 37 | 36 | 170 | 4 | 191 | 503 |
| Differences on exchange | (7) | (1) | (5) | (5) | – | (15) | (33) |
| Credited/(charged) to the Income Statement | (12) | (2) | 36 | (2) | (1) | (19) | – |
| Charged to other comprehensive income | – | – | – | (59) | (3) | – | (62) |
| **At 31 December 2013** | 46 | 34 | 67 | 104 | – | 157 | 408 |

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 (losses)/gains £m | Other temporary differences £m | Total £m |
|---|---|---|---|---|---|---|---|
| **At 1 January 2014** | **11** | **164** | **181** | **105** | **37** | **176** | **674** |
| Differences on exchange | **2** | **(5)** | **6** | **(8)** | **–** | **(11)** | **(16)** |
| (Credited)/charged to the Income Statement | **(5)** | **17** | **12** | **2** | **–** | **(5)** | **21** |
| Charged/(credited) to other comprehensive income | **–** | **–** | **5** | **(23)** | **(14)** | **3** | **(29)** |
| **At 31 December 2014** | **8** | **176** | **204** | **76** | **23** | **163** | **650** |
| **At 1 January 2013** | 16 | 182 | 168 | 119 | 24 | 167 | 676 |
| Differences on exchange | 1 | (13) | (13) | 2 | – | (3) | (26) |
| (Credited)/charged to the Income Statement | (6) | (5) | 26 | 5 | 1 | 12 | 33 |
| (Credited)/charged to other comprehensive income | – | – | – | (21) | 12 | – | (9) |
| **At 31 December 2013** | 11 | 164 | 181 | 105 | 37 | 176 | 674 |

| | **2014 £m** | 2013 £m |
|---|---|---|
| **Net deferred tax liabilities** | **184** | 266 |

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# Notes on the Accounts continued

## 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.

| | 2014 £m | 2013 £m |
|---|---|---|
| Deferred tax assets | **(311)** | (248) |
| Deferred tax liabilities | **495** | 514 |
| | **184** | 266 |

Deferred tax expected to be recovered within 12 months:

| | 2014 £m | 2013 £m |
|---|---|---|
| Deferred tax assets | **(112)** | (115) |
| Deferred tax liabilities | **364** | 300 |
| | **252** | 185 |

At the balance sheet date, the Group has unused tax losses of £704 million (2013: £598 million) which have no expiry date and unused tax losses of £642 million (2013: £558 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 £971 million (2013: £1,005 million), which have no expiry date and £193 million (2013: £159 million), which will expire within the next 10 years.

At the balance sheet date, the Group has unused tax credits of £80 million (2013: £80 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 undistributed earnings of subsidiaries which would be subject to dividend withholding tax was £2 billion (2013: £2 billion). No liability has been recognised in respect of this withholding tax because the Group is in a position to control the timing of these distributions and it is probable that these distributions will not be made in the foreseeable future.

## 14 Trade and other receivables

| | 2014 £m | 2013 £m |
|---|---|---|
| Trade receivables | **2,071** | 2,208 |
| Loans and other receivables | **697** | 692 |
| Prepayments and accrued income | **153** | 147 |
| | **2,921** | 3,047 |
| Current | **2,768** | 2,876 |
| Non-current | **153** | 171 |
| | **2,921** | 3,047 |

Amounts receivable from related parties including associated undertakings are shown in note 29.

Trade and other receivables have been reported in the Balance Sheet net of allowances as follows:

| | 2014 £m | 2013 £m |
|---|---|---|
| Gross trade and other receivables | **2,975** | 3,103 |
| Allowance account | **(54)** | (56) |
| **Net trade and other receivables per Balance Sheet** | **2,921** | 3,047 |

## 14 Trade and other receivables continued

The movements in the allowance account are as follows:

| | 2014 £m | 2013 £m |
|---|---|---|
| **1 January** | **56** | 52 |
| Differences on exchange | **(3)** | (3) |
| Provided in the year | **11** | 10 |
| Amounts reversed during the year | **(10)** | (3) |
| **31 December** | **54** | 56 |

Impairment of trade receivables, including write-offs and allowances, charged during the year is included as part of other operating expenses. For 2014, the net impairment charge was £4 million (2013: £9 million) of which £1 million (2013: £7 million), is reflected in the above table.

As at 31 December 2014, trade and other receivables of £39 million (2013: £46 million) were past their contractual payment date but not impaired. These relate to a number of external parties where there is no expectation of default. The aged analysis of these trade receivables is as follows:

| | 2014 £m | 2013 £m |
|---|---|---|
| Less than three months | **31** | 34 |
| Between three and six months | **2** | 4 |
| Between six months and one year | **3** | 3 |
| Greater than one year | **3** | 5 |

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:

| | 2014 £m | 2013 £m |
|---|---|---|
| US dollar | **141** | 107 |
| UK sterling | **195** | 131 |
| Euro | **62** | 31 |
| Other currencies | **185** | 172 |

Trade and other receivables also include certain interest bearing amounts and their effective interest rates are as follows:

| | 2014 £m | 2013 £m | 2014 % | 2013 % |
|---|---|---|---|---|
| UK sterling | **5** | 5 | **10.0** | 10.0 |
| Euro | **3** | 5 | **4.0** | 4.0 |
| Other currencies | **2** | 3 | **5.5** | 5.1 |

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 as determined using discounted cash flow analysis. There is no concentration of credit risk with respect to trade receivables as the Group has a large number of internationally dispersed customers.

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# Notes on the Accounts continued

## 15 Available-for-sale investments

| | 2014 £m | 2013 £m |
|---|---|---|
| **1 January** | **90** | 63 |
| Differences on exchange | **(4)** | 1 |
| Additions and advances | **32** | 46 |
| Disposals and repayments | **(32)** | (20) |
| **31 December** | **86** | 90 |
| | | |
| Current | **50** | 54 |
| Non-current | **36** | 36 |
| | **86** | 90 |

The classification of these investments under the IFRS 13 fair value hierarchy is given in note 24.

Investments have the following maturities:

| | As per Balance Sheet | |
|---|---|---|
| | 2014 £m | 2013 £m |
| Equity investments | **36** | 36 |
| Non-equity investments | | |
| – within one year | **49** | 53 |
| – beyond two years and within three years | **1** | – |
| – beyond three years and within four years | **–** | 1 |
| | **86** | 90 |

There is no material difference between the maturity profile of investments in the table above and the maturity profile on a gross contractual basis where the values 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.

Included within non-equity investments are cash deposits of £32 million (2013: £nil) which do not meet the definition of cash and cash equivalents.

Investments are all denominated in the functional currency of the subsidiary undertaking holding the investments.

## 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 derivative assets and liabilities under the IFRS 13 fair value hierarchy is given in note 24.

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Assets £m | Liabilities £m | Assets £m | Liabilities £m |
| Fair value hedges | | | | |
| – interest rate swaps | **300** | **102** | 121 | 63 |
| – cross-currency swaps | **6** | **18** | 6 | 38 |
| Cash flow hedges | | | | |
| – cross-currency swaps | **30** | **5** | – | 3 |
| – forward foreign currency contracts | **139** | **38** | 106 | 25 |
| Net investment hedges | | | | |
| – forward foreign currency contracts | **55** | **52** | 161 | 5 |
| Held-for-trading* | | | | |
| – forward foreign currency contracts | **31** | **34** | 31 | 30 |
| **Total** | **561** | **249** | 425 | 164 |
| | | | | |
| Current | **274** | **126** | 312 | 34 |
| Non-current | **287** | **123** | 113 | 130 |
| | **561** | **249** | 425 | 164 |
| Derivatives | | | | |
| – in respect of net debt | **362** | **137** | 146 | 125 |
| – other | **199** | **112** | 279 | 39 |
| | **561** | **249** | 425 | 164 |

*As explained in note 4, some derivative financial instruments are not designated as hedges and so are required to be classified as held-for-trading.

For cash flow hedges, the timing of expected cash flows is as follows:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Assets £m | Liabilities £m | Assets £m | Liabilities £m |
| Within one year | **150** | **38** | 92 | 27 |
| Between one and two years | **17** | **5** | 14 | 1 |
| Between two and three years | **2** | **–** | – | – |
| | **169** | **43** | 106 | 28 |

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 time periods when the hedged item will affect profit or loss.

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# Notes on the Accounts continued

## 16 Derivative financial instruments continued

The tables below set out the maturities of the Group's derivative financial instruments on an undiscounted contractual basis, based on spot rates.

The maturity dates of all gross-settled derivative financial instruments are as follows:

| | 2014 | | | | 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| | Assets | | Liabilities | | Assets | | Liabilities | |
| | Inflow £m | Outflow £m | Inflow £m | Outflow £m | Inflow £m | Outflow £m | Inflow £m | Outflow £m |
| Within one year | | | | | | | | |
| – forward foreign currency contracts | 4,993 | (4,803) | 2,960 | (2,935) | 5,681 | (5,405) | 2,949 | (3,006) |
| – cross-currency swaps | 186 | (149) | 18 | (4) | 4 | (2) | 195 | (182) |
| Between one and two years | | | | | | | | |
| – forward foreign currency contracts | 398 | (377) | 112 | (115) | 276 | (260) | 63 | (64) |
| – cross-currency swaps | 19 | (16) | 343 | (370) | 4 | (2) | 33 | (16) |
| Between two and three years | | | | | | | | |
| – forward foreign currency contracts | 49 | (46) | – | – | – | – | – | – |
| – cross-currency swaps | 19 | (20) | – | – | 4 | (3) | 358 | (415) |
| Between three and four years | | | | | | | | |
| – cross-currency swaps | 19 | (22) | – | – | 4 | (4) | 15 | (19) |
| Between four and five years | | | | | | | | |
| – cross-currency swaps | 34 | (23) | – | (14) | 4 | (4) | 15 | (21) |
| Beyond five years | | | | | | | | |
| – cross-currency swaps | 709 | (774) | – | – | 110 | (100) | 461 | (513) |
| | 6,426 | (6,230) | 3,433 | (3,438) | 6,087 | (5,780) | 4,089 | (4,236) |

The maturity dates of net-settled derivative financial instruments are as follows:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Assets Inflow/ (Outflow) £m | Liabilities (Inflow)/ Outflow £m | Assets Inflow/ (Outflow) £m | Liabilities (Inflow)/ Outflow £m |
| Within one year | 62 | (61) | 50 | (22) |
| Between one and two years | 59 | 25 | 27 | (14) |
| Between two and three years | 49 | 24 | 10 | 1 |
| Between three and four years | 41 | 10 | 9 | 11 |
| Between four and five years | 35 | 9 | 9 | 12 |
| Beyond five years | 55 | 30 | 23 | 89 |
| | 301 | 37 | 128 | 77 |

The above analysis of derivatives settled on a net basis primarily relates to the Group's interest rate swaps.

The fair value of derivative financial instruments is summarised as follows:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Assets £m | Liabilities £m | Assets £m | Liabilities £m |
| Interest rate swaps | 300 | 102 | 121 | 63 |
| Cross-currency swaps | 36 | 23 | 6 | 41 |
| Forward foreign currency contracts | 225 | 124 | 298 | 60 |
| | 561 | 249 | 425 | 164 |

## 16 Derivative financial instruments continued

### (a) Interest rate swaps

| | | | | | | | | 2014 |
|---|---|---|---|---|---|---|---|---|
| | | | | | Interest rate % | | | |
| | Maturity date | Principal currency | m | £m | Original | Swapped | Assets £m | Liabilities £m |
| Fixed to floating | **2017** | **USD** | **600** | **385** | **2.1** | **note (a)** | **–** | **1** |
| | **2019** | **GBP** | **250** | **250** | **6.4** | **note (a)** | **47** | **–** |
| | **2020** | **EUR** | **600** | **466** | **4.0** | **note (a)** | **70** | **–** |
| | **2020** | **GBP** | **650** | **650** | **4.0** | **note (a)** | **27** | **–** |
| | **2021** | **EUR** | **600** | **466** | **3.1** | **note (a)** | **34** | **–** |
| | **2022** | **USD** | **900** | **577** | **3.3** | **note (a)** | **2** | **–** |
| | **2023** | **EUR** | **750** | **582** | **2.4** | **note (a)** | **60** | **–** |
| | **2025** | **EUR** | **650** | **504** | **2.8** | **note (a)** | **60** | **–** |
| Floating to fixed | **2017** | **EUR** | **600** | **466** | **note (a)** | **3.7** | **–** | **33** |
| | **2023*** | **EUR** | **750** | **582** | **note (a)** | **2.8** | **–** | **68** |
| | | | | | | | **300** | **102** |

| | | | | | | | | 2013 |
|---|---|---|---|---|---|---|---|---|
| | | | | | Interest rate % | | | |
| | Maturity date | Principal currency | m | £m | Original | Swapped | Assets £m | Liabilities £m |
| Fixed to floating | 2014 | GBP | 500 | 500 | 6.0 | note (a) | 13 | – |
| | 2014 | GBP | 250 | 250 | 6.0 | note (a) | 11 | – |
| | 2017 | USD | 600 | 362 | 2.1 | note (a) | – | 1 |
| | 2019 | GBP | 250 | 250 | 6.4 | note (a) | 43 | – |
| | 2020 | EUR | 600 | 499 | 4.0 | note (a) | 47 | – |
| | 2020 | GBP | 650 | 650 | 4.0 | note (a) | – | 8 |
| | 2023 | EUR | 750 | 624 | 2.4 | note (a) | – | 4 |
| | 2025 | EUR | 650 | 541 | 2.8 | note (a) | – | 15 |
| Floating to fixed | 2017 | EUR | 600 | 499 | note (a) | 3.7 | – | 35 |
| | 2023* | EUR | 750 | 624 | note (a) | 2.8 | 7 | – |
| | | | | | | | 121 | 63 |

* The €750 million euro interest rate swap maturing in 2023 has a start date of 2015.

Note (a): the floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 67 and 176 basis points (2013: between 67 and 268 basis points).

These swaps have been used to manage the interest rate profile of external borrowings and are reflected in the repricing table in note 21.

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# Notes on the Accounts continued

## 16 Derivative financial instruments continued

### (b) Cross-currency swaps

**2014**

| | Maturity date | Original currency | Interest rate % | Principal original currency m | £m | Swapped currency | Interest rate % | Principal swapped currency m | £m | Assets £m | Liabilities £m |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Fixed to floating | 2016 | GBP | 5.5 | 325 | 325 | EUR | note (b) | 473 | 367 | – | 17 |
| | 2019 | EUR | 4.6 | 20 | 16 | USD | note (b) | 22 | 14 | 5 | – |
| | 2021 | EUR | 3.6 | 600 | 466 | GBP | note (b) | 518 | 518 | 1 | – |
| | 2021 | CHF | 0.6 | 320 | 207 | GBP | note (b) | 210 | 210 | – | 1 |
| Floating to fixed | 2015 | BRL | note (b) | 150 | 36 | USD | 1.0 | 68 | 44 | – | 5 |
| | 2015 | USD | note (b) | 261 | 167 | COP | 6.8 | 502,692 | 136 | 30 | – |
| | | | | | | | | | | 36 | 23 |

**2013**

| | Maturity date | Original currency | Interest rate % | Principal original currency m | £m | Swapped currency | Interest rate % | Principal swapped currency m | £m | Assets £m | Liabilities £m |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Fixed to floating | 2016 | GBP | 5.5 | 325 | 325 | EUR | note (b) | 473 | 394 | – | 37 |
| | 2019 | EUR | 4.6 | 20 | 17 | USD | note (b) | 22 | 12 | 6 | – |
| | 2021 | EUR | 3.6 | 600 | 499 | GBP | note (b) | 518 | 518 | – | 1 |
| Floating to fixed | 2014 | USD | note (b) | 261 | 158 | COP | 7.2 | 504,158 | 158 | – | 3 |
| | | | | | | | | | | 6 | 41 |

Note (b): the floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 65 and 250 basis points (2013: between 82 and 250 basis points).

## 16 Derivative financial instruments continued

### (c) Forward foreign currency contracts

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.

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Assets £m | Liabilities £m | Assets £m | Liabilities £m |
| Purchase/Sell | | | | |
| GBP/EUR | 32 | – | 17 | 1 |
| GBP/AUD | 18 | – | 70 | – |
| GBP/ZAR | – | 1 | 19 | – |
| GBP/CHF | 6 | – | 5 | 1 |
| GBP/USD | – | 49 | 56 | – |
| GBP/CAD | 2 | 1 | 16 | – |
| GBP/JPY | 22 | – | – | – |
| EUR/USD | – | 8 | 5 | – |
| USD/EUR | 38 | – | – | 13 |
| USD/GBP | 15 | – | – | 14 |
| USD/JPY | 43 | – | 82 | – |
| BRL/USD | – | 35 | – | 2 |
| Other | 49 | 30 | 28 | 29 |
| | 225 | 124 | 298 | 60 |

Certain of these contracts were used to manage the currency profile of external borrowings and are reflected in the currency table in note 21. The nominal values of these contracts are as follows:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Purchase £m | Sell £m | Purchase £m | Sell £m |
| Purchase/Sell | | | | |
| GBP/CHF | – | – | (226) | 225 |
| GBP/CAD | (204) | 202 | (211) | 207 |
| GBP/USD | (192) | 192 | (187) | 181 |
| GBP/EUR | (76) | 75 | (125) | 124 |
| EUR/DKK | (339) | 339 | (313) | 313 |
| EUR/SEK | (116) | 114 | (129) | 131 |
| EUR/NOK | (137) | 128 | (150) | 149 |
| CHF/GBP | (223) | 228 | – | – |

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 17 Inventories

| | 2014 £m | 2013 £m |
|---|---|---|
| Raw materials and consumables | **1,732** | 1,700 |
| Finished goods and work in progress | **2,211** | 2,144 |
| Goods purchased for resale | **190** | 198 |
| | **4,133** | 4,042 |

Inventories pledged as security for liabilities amount to £4 million (2013: £14 million). Write-offs taken to other operating expenses in the Group Income Statement comprise £47 million (2013: £45 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 2014 and 2013.

## 19 Cash and cash equivalents

| | 2014 £m | 2013 £m |
|---|---|---|
| Cash and bank balances | **1,199** | 1,399 |
| Cash equivalents | **619** | 707 |
| | **1,818** | 2,106 |

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:

| | 2014 £m | 2013 £m |
|---|---|---|
| Functional currency | **1,559** | 1,804 |
| US dollar | **115** | 104 |
| UK sterling | **13** | 57 |
| Euro | **47** | 54 |
| Other currencies | **84** | 87 |
| | **1,818** | 2,106 |

At 31 December 2014, cash and cash equivalents of £nil (2013: £3 million) were pledged as collateral.

In the Group Cash Flow Statement, net cash and cash equivalents are shown after deducting bank overdrafts and accrued interest where applicable, as follows:

| | 2014 £m | 2013 £m |
|---|---|---|
| Cash and cash equivalents as above | **1,818** | 2,106 |
| Less accrued interest | **(1)** | (1) |
| Less overdrafts | **(325)** | (329) |
| **Net cash and cash equivalents** | **1,492** | 1,776 |

Cash and cash equivalents include restricted amounts of £190 million (2013: £158 million), principally due to exchange control regulations in certain countries.

## 20 Capital and reserves – reconciliation of movement in total equity

| | Attributable to owners of the parent | | | | | | |
|---|---|---|---|---|---|---|---|
| | Share capital £m | Share premium, capital redemption and merger reserves £m | Other reserves £m | Retained earnings £m | Total attributable to owners of the parent £m | Non-controlling interests £m | Total equity £m |
| **1 January 2014** | **507** | **3,919** | **(190)** | **2,398** | **6,634** | **301** | **6,935** |
| **Comprehensive income and expense** | | | | | | | |
| Profit for the year | – | – | – | 3,115 | 3,115 | 278 | 3,393 |
| Differences on exchange | | | | | | | |
| – subsidiaries | – | – | (526) | – | (526) | (13) | (539) |
| – associates | – | – | 113 | – | 113 | – | 113 |
| Cash flow hedges | | | | | | | |
| – net fair value gains | – | – | 75 | – | 75 | (18) | 57 |
| – reclassified and reported in profit for the year | – | – | (76) | – | (76) | 9 | (67) |
| – reclassified and reported in net assets | – | – | 8 | – | 8 | – | 8 |
| Available-for-sale investments of associates | | | | | | | |
| – net fair value gains | – | – | 15 | – | 15 | – | 15 |
| Net investment hedges | | | | | | | |
| – net fair value gains | – | – | 2 | – | 2 | – | 2 |
| – differences on exchange on borrowings | – | – | 60 | – | 60 | – | 60 |
| Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss (note 6(e)) | – | – | 21 | – | 21 | 3 | 24 |
| Retirement benefit schemes | | | | | | | |
| – net actuarial losses in respect of subsidiaries (note 12) | – | – | – | (428) | (428) | – | (428) |
| – surplus recognition and minimum funding obligations in respect of subsidiaries (note 12) | – | – | – | 7 | 7 | – | 7 |
| – actuarial losses in respect of associates net of tax (note 5) | – | – | – | (124) | (124) | – | (124) |
| Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss (note 6(e)) | – | – | – | 87 | 87 | – | 87 |
| **Other changes in equity** | | | | | | | |
| Employee share options | | | | | | | |
| – value of employee services | – | – | – | 66 | 66 | – | 66 |
| – proceeds from shares issued | – | 4 | – | 1 | 5 | – | 5 |
| Dividends and other appropriations | | | | | | | |
| – ordinary shares | – | – | – | (2,712) | (2,712) | – | (2,712) |
| – to non-controlling interests | – | – | – | – | – | (260) | (260) |
| Purchase of own shares | | | | | | | |
| – held in employee share ownership trusts | – | – | – | (49) | (49) | – | (49) |
| – share buy-back programme | – | – | – | (800) | (800) | – | (800) |
| Non-controlling interests – acquisitions (note 29) | – | – | – | (4) | (4) | – | (4) |
| Non-controlling interests – capital injection (note 26 (c)) | – | – | – | – | – | 4 | 4 |
| Other movements | – | – | – | 21 | 21 | – | 21 |
| **31 December 2014** | **507** | **3,923** | **(498)** | **1,578** | **5,510** | **304** | **5,814** |

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 20 Capital and reserves – reconciliation of movement in total equity continued

| | Attributable to owners of the parent | | | | | | |
|---|---|---|---|---|---|---|---|
| | Share capital £m | Share premium, capital redemption and merger reserves £m | Other reserves £m | Retained earnings £m | Total attributable to owners of the parent £m | Non-controlling interests £m | Total equity £m |
| **1 January 2013** | 507 | 3,916 | 796 | 2,253 | 7,472 | 307 | 7,779 |
| **Comprehensive income and expense** | | | | | | | |
| Profit for the year | – | – | – | 3,904 | 3,904 | 295 | 4,199 |
| Differences on exchange | | | | | | | |
| – subsidiaries | – | – | (935) | – | (935) | (37) | (972) |
| – associates | – | – | (141) | – | (141) | – | (141) |
| Cash flow hedges | | | | | | | |
| – net fair value gains | – | – | 103 | – | 103 | (9) | 94 |
| – reclassified and reported in profit for the year | – | – | (56) | – | (56) | 7 | (49) |
| – reclassified and reported in net assets | – | – | (1) | – | (1) | – | (1) |
| Available-for-sale investments of associates | | | | | | | |
| – net fair value losses | – | – | (7) | – | (7) | – | (7) |
| Net investment hedges | | | | | | | |
| – net fair value gains | – | – | 89 | – | 89 | – | 89 |
| – differences on exchange on borrowings | – | – | (25) | – | (25) | – | (25) |
| Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss (note 6(e)) | – | – | (13) | – | (13) | – | (13) |
| Retirement benefit schemes | | | | | | | |
| – net actuarial gains in respect of subsidiaries (note 12) | – | – | – | 309 | 309 | (1) | 308 |
| – surplus recognition and minimum funding obligations in respect of subsidiaries (note 12) | – | – | – | (6) | (6) | 1 | (5) |
| – actuarial gains in respect of associates net of tax (note 5) | – | – | – | 90 | 90 | – | 90 |
| Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss (note 6(e)) | – | – | – | (39) | (39) | 1 | (38) |
| **Other changes in equity** | | | | | | | |
| Employee share options | | | | | | | |
| – value of employee services | – | – | – | 61 | 61 | – | 61 |
| – proceeds from shares issued | – | 3 | – | 1 | 4 | – | 4 |
| Dividends and other appropriations | | | | | | | |
| – ordinary shares | – | – | – | (2,611) | (2,611) | – | (2,611) |
| – to non-controlling interests | – | – | – | – | – | (271) | (271) |
| Purchase of own shares | | | | | | | |
| – held in employee share ownership trusts | – | – | – | (74) | (74) | – | (74) |
| – share buy-back programme | – | – | – | (1,509) | (1,509) | – | (1,509) |
| Non-controlling interests – capital injection (note 26(b)) | – | – | – | – | – | 8 | 8 |
| Other movements | – | – | – | 19 | 19 | – | 19 |
| **31 December 2013** | 507 | 3,919 | (190) | 2,398 | 6,634 | 301 | 6,935 |

Details relating to the 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

(a) 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 2013 | 67 | 101 | 3,748 | 3,916 |
| 31 December 2013 | 70 | 101 | 3,748 | 3,919 |
| **31 December 2014** | **74** | **101** | **3,748** | **3,923** |

The share premium account includes the difference between the value of shares issued and their nominal value. The increase of £4 million (2013: £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.

Total equity attributable to owners of the parent is stated after deducting the cost of treasury shares which include £4,845 million (2013: £4,045 million) for shares repurchased and not cancelled and £228 million (2013: £280 million) in respect of the cost of own shares held in employee share ownership trusts.

During 2014, 23 million shares were bought back at a cost of £795 million (2013: 44 million shares at a cost of £1,500 million) excluding transaction costs of £5 million (2013: £9 million). The share buy-back programme was suspended from 30 July 2014.

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.

(b) Information on the principal components of non-controlling interests is provided in note 31.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 20 Capital and reserves – reconciliation of movement in total equity continued

Movements in other reserves and retained earnings (which are after deducting treasury shares) shown above comprise:

| | 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 2014** | **(1,015)** | **44** | **29** | **179** | **573** | **(190)** | **(4,325)** | **6,723** |
| **Comprehensive income and expense** | | | | | | | | |
| Profit for the year | – | – | – | – | – | – | – | 3,115 |
| Differences on exchange | | | | | | | | |
| – subsidiaries | (526) | – | – | – | – | (526) | – | – |
| – associates | 113 | – | – | – | – | 113 | – | – |
| Cash flow hedges | | | | | | | | |
| – net fair value gains | – | 75 | – | – | – | 75 | – | – |
| – reclassified and reported in profit for the year | – | (76) | – | – | – | (76) | – | – |
| – reclassified and reported in net assets | – | 8 | – | – | – | 8 | – | – |
| Available-for-sale investments of associates | | | | | | | | |
| – net fair value gains | – | – | 15 | – | – | 15 | – | – |
| Net investment hedges | | | | | | | | |
| – net fair value gains | 2 | – | – | – | – | 2 | – | – |
| – differences on exchange on borrowings | 60 | – | – | – | – | 60 | – | – |
| Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss | (3) | 24 | – | – | – | 21 | – | – |
| Retirement benefit schemes | | | | | | | | |
| – net actuarial losses in respect of subsidiaries (note 12) | – | – | – | – | – | – | – | (428) |
| – surplus recognition and minimum funding obligations in respect of subsidiaries (note 12) | – | – | – | – | – | – | – | 7 |
| – actuarial losses in respect of associates net of tax (note 5) | – | – | – | – | – | – | – | (124) |
| Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss | – | – | – | – | – | – | – | 87 |
| **Other changes in equity** | | | | | | | | |
| Employee share options | | | | | | | | |
| – value of employee services | – | – | – | – | – | – | – | 66 |
| – proceeds from shares issued | – | – | – | – | – | – | 1 | – |
| Dividends and other appropriations | | | | | | | | |
| – ordinary shares | – | – | – | – | – | – | – | (2,712) |
| Purchase of own shares | | | | | | | | |
| – held in employee share ownership trusts | – | – | – | – | – | – | (49) | – |
| – share buy-back programme | – | – | – | – | – | – | (800) | – |
| Non-controlling interests – acquisitions (note 29) | – | – | – | – | – | – | – | (4) |
| Other movements | – | – | – | – | – | – | 100 | (79) |
| **31 December 2014** | **(1,369)** | **75** | **44** | **179** | **573** | **(498)** | **(5,073)** | **6,651** |

## 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 2013** | (3) | 11 | 36 | 179 | 573 | 796 | (2,824) | 5,077 |
| **Comprehensive income and expense** | | | | | | | | |
| Profit for the year | – | – | – | – | – | – | – | 3,904 |
| Differences on exchange | | | | | | | | |
| – subsidiaries | (935) | – | – | – | – | (935) | – | – |
| – associates | (141) | – | – | – | – | (141) | – | – |
| Cash flow hedges | | | | | | | | |
| – net fair value gains | – | 103 | – | – | – | 103 | – | – |
| – reclassified and reported in profit for the year | – | (56) | – | – | – | (56) | – | – |
| – reclassified and reported in net assets | – | (1) | – | – | – | (1) | – | – |
| Available-for-sale investments of associates | | | | | | | | |
| – net fair value losses | – | – | (7) | – | – | (7) | – | – |
| Net investment hedges | | | | | | | | |
| – net fair value gains | 89 | – | – | – | – | 89 | – | – |
| – differences on exchange on borrowings | (25) | – | – | – | – | (25) | – | – |
| Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss | – | (13) | – | – | – | (13) | – | – |
| Retirement benefit schemes | | | | | | | | |
| – net actuarial gains in respect of subsidiaries (note 12) | – | – | – | – | – | – | – | 309 |
| – surplus recognition and minimum funding obligations in respect of subsidiaries (note 12) | – | – | – | – | – | – | – | (6) |
| – actuarial gains in respect of associates net of tax (note 5) | – | – | – | – | – | – | – | 90 |
| Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss | – | – | – | – | – | – | – | (39) |
| **Other changes in equity** | | | | | | | | |
| Employee share options | | | | | | | | |
| – value of employee services | – | – | – | – | – | – | – | 61 |
| – proceeds from shares issued | – | – | – | – | – | – | 1 | – |
| Dividends and other appropriations | | | | | | | | |
| – ordinary shares | – | – | – | – | – | – | – | (2,611) |
| Purchase of own shares | | | | | | | | |
| – held in employee share ownership trusts | – | – | – | – | – | – | (74) | – |
| – share buy-back programme | – | – | – | – | – | – | (1,509) | – |
| Other movements | – | – | – | – | – | – | 81 | (62) |
| **31 December 2013** | (1,015) | 44 | 29 | 179 | 573 | (190) | (4,325) | 6,723 |

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.

The revaluation reserve relates to the acquisition of the cigarette and snus business of ST in 2008.

Of the amounts released from the hedging reserve during the year, gains of £21 million (2013: £28 million gain) and gains of £27 million (2013: £11 million gain) were reported within revenue and raw materials and consumables respectively, together with a loss of £13 million (2013: £3 million loss) reported in other operating expenses and a gain of £31 million (2013: £13 million gain) reported within net finance costs.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 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 was 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:

| | 2014 £m | 2013 £m |
|---|---|---|
| **Translation reserve** | | |
| Net investment hedges | | |
| – difference on exchange on borrowings | (3) | – |
| | (3) | – |
| **Hedging reserve** | | |
| Cash flow hedges | | |
| – net fair value gains | (3) | (36) |
| – reclassified and reported in profit for the year | 27 | 23 |
| | 24 | (13) |
| **Retained earnings** | | |
| – actuarial losses/(gains) in respect of subsidiaries | 89 | (41) |
| – surplus recognition and minimum funding obligations in respect of subsidiaries | (2) | 2 |
| | 87 | (39) |
| Owners of the parent | 108 | (52) |
| Non-controlling interests | 3 | 1 |
| **Total tax recognised in other comprehensive income for the year (note 6(e))** | 111 | (51) |

## 21 Borrowings

| | Currency | Maturity dates | Interest rates | 2014 £m | 2013 £m |
|---|---|---|---|---|---|
| Eurobonds | Euro | 2015 to 2029 | 2.4% to 5.9% | **5,211** | 5,372 |
| | Euro | 2018 | 3m EURIBOR + 50bps | **309** | – |
| | UK sterling | 2016 to 2040 | 4.0% to 7.3% | **3,083** | 3,118 |
| | US dollar | 2016 | 1.1% | **192** | 182 |
| | Swiss franc | 2016 | CHF 3m LIBOR + 16bps | **226** | – |
| | Swiss franc | 2021 to 2026 | 0.7% to 1.4% | **419** | – |
| Bonds issued pursuant to Rule 144A and RegS under the US Securities Act (as amended) | US dollar | 2015 to 2022 | 1.4% to 9.5% | **1,726** | 1,620 |
| Other notes | Malaysian ringgit | 2014 | 4.1% to 4.5% | **–** | 47 |
| | Other currencies | | | **–** | 24 |
| **Bonds and notes** | | | | **11,166** | 10,363 |
| Commercial paper | | | | **160** | 521 |
| Other loans | | | | **223** | 136 |
| Bank loans | | | | **374** | 341 |
| Bank overdrafts | | | | **325** | 329 |
| Finance leases | | | | **10** | 6 |
| | | | | **12,258** | 11,696 |

The interest on the commercial paper referred to in the table above is based on USD LIBOR plus a margin ranging between 10 and 43 basis points (2013: 10 and 15 basis points).

| | 2014 £m | 2013 £m |
|---|---|---|
| Current | **2,479** | 1,980 |
| Non-current | **9,779** | 9,716 |
| | **12,258** | 11,696 |

Current borrowings include interest payable of £240 million at 31 December 2014 (2013: £247 million). Included within borrowings are £4,522 million (2013: £4,466 million) of borrowings subject to fair value hedges where their amortised cost has been increased by £228 million (2013: £69 million) in the table above.

The fair value of borrowings is estimated to be £13,606 million (2013: £12,701 million). £12,533 million (2013: £11,873 million) has been calculated using quoted market prices and is within level 1 of the fair value hierarchy. £1,073 million (2013: £828 million) has been calculated based on discounted cash flow analysis and is within level 2 of the fair value hierarchy.

| | 2014 £m | 2013 £m |
|---|---|---|
| Amounts secured on Group assets | **14** | 20 |

In both years amounts secured on Group assets include finance leases of £10 million (2013: £6 million) and amounts secured on certain inventory of the Group (see note 17).

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# Notes on the Accounts continued

## 21 Borrowings continued

Borrowings are repayable as follows:

| | Per Balance Sheet | | Contractual gross maturities | |
|---|---|---|---|---|
| | 2014 £m | 2013 £m | 2014 £m | 2013 £m |
| Within one year | **2,479** | 1,980 | **2,656** | 2,220 |
| Between one and two years | **877** | 1,343 | **1,262** | 1,798 |
| Between two and three years | **1,349** | 534 | **1,756** | 899 |
| Between three and four years | **758** | 1,513 | **1,085** | 1,790 |
| Between four and five years | **560** | 421 | **799** | 853 |
| Beyond five years | **6,235** | 5,905 | **7,814** | 7,732 |
| | **12,258** | 11,696 | **15,372** | 15,292 |

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.

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 | Other currencies £m | Total £m |
|---|---|---|---|---|---|---|---|
| **31 December 2014** | | | | | | | |
| Total borrowings | **5,419** | **2,240** | **330** | **3,478** | **–** | **791** | **12,258** |
| Effect of derivative financial instruments | | | | | | | |
| – cross-currency swaps | **1,195** | **(109)** | **(325)** | **(482)** | **–** | **(207)** | **72** |
| – forward foreign currency contracts | **(244)** | **192** | **–** | **(517)** | **202** | **358** | **(9)** |
| | **6,370** | **2,323** | **5** | **2,479** | **202** | **942** | **12,321** |
| **31 December 2013** | | | | | | | |
| Total borrowings | 5,643 | 2,353 | 329 | 3,248 | – | 123 | 11,696 |
| Effect of derivative financial instruments | | | | | | | |
| – cross-currency swaps | 1,070 | (146) | (325) | (516) | – | – | 83 |
| – forward foreign currency contracts | (749) | 181 | – | (468) | 207 | 818 | (11) |
| | 5,964 | 2,388 | 4 | 2,264 | 207 | 941 | 11,768 |

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 2014** | | | | | | | |
| Total borrowings | **2,492** | **879** | **1,347** | **758** | **559** | **6,223** | **12,258** |
| Effect of derivative financial instruments | | | | | | | |
| – interest rate swaps | **2,832** | **–** | **81** | **–** | **(250)** | **(2,663)** | **–** |
| – cross-currency swaps | **1,086** | **(325)** | **–** | **–** | **(16)** | **(673)** | **72** |
| | **6,410** | **554** | **1,428** | **758** | **293** | **2,887** | **12,330** |
| **31 December 2013** | | | | | | | |
| Total borrowings | 2,013 | 1,341 | 655 | 1,392 | 420 | 5,875 | 11,696 |
| Effect of derivative financial instruments | | | | | | | |
| – interest rate swaps | 2,427 | (624) | – | 137 | – | (1,940) | – |
| – cross-currency swaps | 924 | – | (325) | – | – | (516) | 83 |
| | 5,364 | 717 | 330 | 1,529 | 420 | 3,419 | 11,779 |

Details of the derivative financial instruments included in these tables are given in note 16.

## 21 Borrowings continued

Finance lease liabilities per the Balance Sheet and on a contractual gross maturity basis are payable as follows:

| | 2014 £m | 2013 £m |
|---|---|---|
| Within one year | **3** | 2 |
| Between one and two years | **2** | 2 |
| Between two and three years | **2** | 1 |
| Between three and four years | **1** | 1 |
| Between four and five years | **1** | – |
| Beyond five years | **1** | – |
| | **10** | 6 |

There is no material difference between the repayable principal and the total gross cash flows shown above.

Borrowings facilities – undrawn committed facilities (see note 24) expire as follows:

| | 2014 £m | 2013 £m |
|---|---|---|
| Within one year | **3,165** | 169 |
| Between one and two years | **–** | 2,000 |
| Between two and three years | **96** | – |
| Between three and four years | **–** | 91 |
| Between four and five years | **3,000** | – |
| | **6,261** | 2,260 |

The Group defines net debt as follows:

| | 2014 £m | 2013 £m |
|---|---|---|
| Borrowings (note 21) | **12,258** | 11,696 |
| Derivatives in respect of net debt: | | |
| – assets (note 16) | **(362)** | (146) |
| – liabilities (note 16) | **137** | 125 |
| Cash and cash equivalents (note 19) | **(1,818)** | (2,106) |
| Current available-for-sale investments (note 15) | **(50)** | (54) |
| | **10,165** | 9,515 |

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 22 Other provisions for liabilities and charges

| | Restructuring of existing businesses £m | Employee related benefits £m | Fox River £m | Other provisions £m | Total £m |
|---|---|---|---|---|---|
| **1 January 2014** | 88 | 42 | 267 | 184 | 581 |
| Differences on exchange | (4) | (1) | – | (7) | (12) |
| Provided/(reversed) in respect of the year | 56 | 8 | (27) | 47 | 84 |
| Utilised during the year | (36) | (9) | (63) | (57) | (165) |
| **31 December 2014** | 104 | 40 | 177 | 167 | 488 |
| Analysed on the Balance Sheet as | | | | | |
| – current | 49 | 13 | 36 | 112 | 210 |
| – non-current | 55 | 27 | 141 | 55 | 278 |
| | 104 | 40 | 177 | 167 | 488 |
| **1 January 2013** | 92 | 45 | 271 | 221 | 629 |
| Differences on exchange | (4) | (4) | – | (26) | (34) |
| Provided in respect of the year | 42 | 12 | – | 52 | 106 |
| Utilised during the year | (42) | (11) | (4) | (63) | (120) |
| **31 December 2013** | 88 | 42 | 267 | 184 | 581 |
| Analysed on the Balance Sheet as | | | | | |
| – current | 49 | 18 | – | 127 | 194 |
| – non-current | 39 | 24 | 267 | 57 | 387 |
| | 88 | 42 | 267 | 184 | 581 |

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 2014 and 2013 are as described in note 3(e). While some elements of the non-current provisions of £55 million will unwind over several years, as termination payments are made over extended periods in some countries, it is estimated that approximately 25% will unwind in 2016 and over 82% within five years.

Employee related benefits mainly relate to long-term employee benefits other than post-employment 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 46% of the non-current provisions of £27 million will unwind within five years.

A provision of £274 million was made in 2011 for a potential claim under a 1998 settlement agreement entered into by a Group subsidiary in respect of the clean-up of sediment in the Fox River. On 30 September 2014, the Group, NCR, Appvion and Windward Prospects entered into the Funding Agreement. The details of this agreement are explained in note 30. This agreement led to payments of £56 million in the year. In addition, the Group incurred other costs of £7 million which were also charged against the provision. In light of the conclusion of the Funding Agreement, the sums that the Group has agreed to pay thereunder, as well as the available information in relation to the extent of the clean-up related costs, the Group has reviewed the Fox River provision and £27 million has been released from the provision in 2014. It is expected that the non-current provision 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 reversals of £18 million for restructuring of existing businesses, £nil for employee benefits and £17 million for other provisions.

## 23 Trade and other payables

| | 2014 £m | 2013 £m |
|---|---|---|
| Trade payables | **764** | 814 |
| Duty, excise and other taxes | **3,539** | 3,642 |
| Accrued charges and deferred income | **1,033** | 1,038 |
| Social security and other taxation | **7** | 18 |
| Sundry payables | **309** | 360 |
| | **5,652** | 5,872 |
| Current | **5,524** | 5,741 |
| Non-current | **128** | 131 |
| | **5,652** | 5,872 |

Accrued charges and deferred income include £67 million of deferred income (2013: £87 million) and £6 million (2013: £3 million) in respect of interest payable. Deferred income relates primarily to government grants for property acquired in Brazil. Amounts payable to related parties including associated undertakings are shown in note 29.

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, as determined using discounted cash flow analysis.

Trade and other payables are predominantly denominated in the functional currencies of subsidiary undertakings with less than 5% in other currencies (2013: less than 5%).

## 24 Financial instruments and risk management

### 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 set by the Group's Main Board and Corporate Finance Committee (CFC), the Group's exposure to funding and liquidity, interest rate, foreign exchange and counterparty risks. The Group's treasury position is monitored by the CFC which meets regularly throughout the year and is chaired by the Group Finance Director. 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, net debt and interest cover. Group policies include a set of financing principles and key performance indicators 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 key objective of the financing principles is to appropriately balance the interests of equity and debt holders in driving an efficient financing mix for the Group.

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 at least five years with no more than 20% of centrally managed debt maturing in a single rolling year. As at 31 December 2014, the average centrally managed debt maturity was 6.8 years (2013: 7.2 years) and the highest proportion of centrally managed debt maturing in a single rolling year was 18.7% (2013: 18.3%).

It is Group policy that short-term sources of funds (including drawings under both the Group US$2 billion commercial paper programme, and the Group £1 billion euro commercial paper (ECP) programme) are backed by undrawn committed lines of credit and cash. The Group's commercial paper programme is mainly issued by B.A.T. International Finance p.l.c., British American Tobacco Holdings (The Netherlands) B.V. and B.A.T. Netherlands (Finance) B.V. At 31 December 2014, commercial paper of £160 million was outstanding (2013: £521 million).

In May 2014, the Group through B.A.T. International Finance p.l.c. negotiated a new central banking facility of £3 billion with a final maturity of May 2019 (with two additional one-year extensions at the option of the banks). This facility is provided by 22 banks. The new facility is on significantly improved terms compared to the previous central banking facility of £2 billion, with a maturity of December 2015, which was cancelled at the same time. The new facility was undrawn as at 31 December 2014 (2013: undrawn).

In September 2014, the Group signed a one-year bridge facility of US$4.7 billion with an extension option of up to one year for its proposed investment in Reynolds American Inc.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 24 Financial instruments and risk management continued

In September 2014, the Group repaid a maturing €600 million bond, this repayment was financed from Group cash balances.

In September 2014, the Group issued a new CHF 350 million bond with a maturity of 2016, a new CHF 400 million bond with a maturity of 2021 and a new CHF 250 million bond with a maturity of 2026.

In August 2014, the Group repaid a maturing MYR 250 million note, this repayment was financed from Group cash balances.

In June 2014, the Group purchased and cancelled an existing US$40 million bond with a maturity of 2029; this purchase was financed from Group cash balances.

In March 2014, the Group issued a new €400 million bond with a maturity of 2018 and a new €600 million bond with a maturity of 2029.

In December 2013, a maturing £152 million bond was repaid, this repayment was financed from Group cash balances.

In November 2013, a maturing US$300 million bond was repaid, this repayment was financed from Group cash balances.

In September 2013, the Group issued a new £650 million bond with a maturity of 2026.

In July 2013, the Group repaid a maturing €519 million bond, this repayment was financed from Group cash balances.

In March 2013, the Group issued a new €650 million bond with a maturity of 2025 and a new US$300 million bond with a maturity of 2016.

During the year, the Group's subsidiary in Brazil received proceeds of £411 million (2013: £399 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £271 million (2013: £436 million).

The Group has a US$240 million facility, maturing in 2016. This facility is drawable in Chilean peso and was drawn to the value of US$225 million at 31 December 2014 (2013: US$225 million).

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 key objectives of Treasury in respect of cash and cash equivalents are to protect the principal value of cash and cash equivalents, to concentrate cash at the centre to minimise the required long-term debt issuance, and to optimise the yield earned. 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 2014 the ratings from Moody's and S&P were A3 (stable outlook)/A- (stable outlook) (2013: A3/A-). The Moody's rating was upgraded from Baa1 to A3 on 12 March 2013. The strength of the ratings has underpinned the debt issuance during 2014 and 2013 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 bonds in the Swiss franc, euro, US dollar and sterling markets in 2014 and 2013.

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 2014, cash and cash equivalents include £nil invested in money market funds (2013: £156 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, Swiss franc, South African rand, Russian rouble, Brazilian real, Australian dollar, Malaysian ringgit and Singapore 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. The main objective of these policies is to protect shareholder value by increasing certainty and minimising volatility in earnings per share. At 31 December 2014, the currency profile of the Group's gross debt, after taking into account derivative contracts, was 19% (2013: 21%) US dollar, 40% (2013: 41%) euro, 2% (2013: 2%) Canadian dollar, 26% (2013: 21%) sterling, and 13% (2013: 15%) other currencies.

The Group faces currency exposures arising from the translation of profits earned in foreign currency subsidiaries and associates and joint arrangements; 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 enters into forward foreign exchange contracts which are designated as net investment hedges of the foreign exchange risk arising from the investments in these subsidiaries.

## 24 Financial instruments and risk management continued

IFRS 7 *Financial Instruments: Disclosures* 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. 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% 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% strengthening of functional currencies against non-functional currencies would result in pre-tax profit being £2 million higher (2013: £24 million higher) and items recognised directly in other comprehensive income being £49 million higher (2013: £15 million higher). A 10% weakening of functional currencies against non-functional currencies would result in pre-tax profit being £3 million lower (2013: £31 million lower) and items recognised directly in other comprehensive income being £59 million lower (2013: £19 million lower).

The exchange sensitivities on items recognised directly in other comprehensive income relate to hedging of certain net asset currency positions in the Group as well as on cash flow hedges in respect of future transactions, but does not include sensitivities in respect of exchange on non-financial assets or liabilities.

### 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 an interest cover ratio, as calculated under its key central banking facilities, of greater than 5 and for 2014 it is 12.0 times (2013: 12.3 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 and net basis (at least 50% fixed on a net basis in the short to the medium term) 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 2014, the relevant ratios of floating to fixed rate borrowings were 45:55 (2013: 43:57) on a gross basis and 30:70 (2013: 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 *Financial Instruments: Disclosures* 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 (2013: £22 million lower). A 100 basis point decrease in interest rates, or less where applicable, would result in pre-tax profit being £20 million higher (2013: £1 million higher). The effect of these interest rate changes on items recognised directly in other comprehensive income is not material in either year.

### 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.

All derivatives are subject to ISDA agreements or equivalent documentation.

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-/A3. 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 and for this, the Group identifies 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.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 24 Financial instruments and risk management continued

With the following exceptions, 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. The Group has issued guarantees to third parties, part of which has been recognised on the Balance Sheet in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. The unrecognised portion of these guaranteed amounts was £28 million (2013: £30 million). During 2014, the Group has guaranteed the borrowings of the non-controlling interest in respect of the capital injection made to the Group's Algerian business (see note 26(c)). In addition, the Group has entered into short-term risk participation agreements in relation to certain leaf supply arrangements and the maximum exposure under these would be £106 million (2013: £91 million).

The impact of own credit risk on the fair value of derivatives and other obligations held at fair value is not material.

### 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.

### 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 13 classification hierarchy:

| | | | | 2014 |
|---|---|---|---|---|
| | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
| **Assets at fair value** | | | | |
| Available-for-sale investments (note 15) | 50 | – | 36 | 86 |
| Derivatives relating to | | | | |
| – interest rate swaps (note 16) | – | 300 | – | 300 |
| – cross-currency swaps (note 16) | – | 36 | – | 36 |
| – forward foreign currency contracts (note 16) | – | 225 | – | 225 |
| **Assets at fair value** | 50 | 561 | 36 | 647 |
| **Liabilities at fair value** | | | | |
| Derivatives relating to | | | | |
| – interest rate swaps (note 16) | – | 102 | – | 102 |
| – cross-currency swaps (note 16) | – | 23 | – | 23 |
| – forward foreign currency contracts (note 16) | – | 124 | – | 124 |
| **Liabilities at fair value** | – | 249 | – | 249 |

## 24 Financial instruments and risk management continued

| | 2013 | | | |
|---|---|---|---|---|
| | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
| **Assets at fair value** | | | | |
| Available-for-sale investments (note 15) | 54 | – | 36 | 90 |
| Derivatives relating to | | | | |
| – interest rate swaps (note 16) | – | 121 | – | 121 |
| – cross-currency swaps (note 16) | – | 6 | – | 6 |
| – forward foreign currency contracts (note 16) | – | 298 | – | 298 |
| **Assets at fair value** | 54 | 425 | 36 | 515 |
| **Liabilities at fair value** | | | | |
| Derivatives relating to | | | | |
| – interest rate swaps (note 16) | – | 63 | – | 63 |
| – cross-currency swaps (note 16) | – | 41 | – | 41 |
| – forward foreign currency contracts (note 16) | – | 60 | – | 60 |
| **Liabilities at fair value** | – | 164 | – | 164 |

Level 1 financial instruments are traded in an active market and fair value is based on quoted prices at the year-end.

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. The Group's level 2 financial instruments include 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. The Group's 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 2.0% (2013: 2.0%) and a 100 basis points decrease in the growth rate would result in the valuation being £6 million lower (2013: £6 million lower); and
- discount rate of 6.5% (2013: 6.5%) and a 100 basis points decrease in the discount rate would result in the valuation being £10 million higher (2013: £10 million higher).

The following table presents the changes in level 3 financial instruments:

| | **2014** | 2013 |
|---|---|---|
| | **Available-for-sale investments £m** | Available-for-sale investments £m |
| **1 January** | **36** | 37 |
| Differences on exchange | **–** | (1) |
| **31 December** | **36** | 36 |

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 24 Financial instruments and risk management continued

### Netting arrangements of derivative financial instruments

The gross fair value of derivative financial instruments as presented in the Group Balance Sheet, together with the Group's rights of offset associated with recognised financial assets and recognised financial liabilities subject to enforceable master netting arrangements and similar agreements, is summarised as follows:

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Amount presented in the Group Balance Sheet* £m | Related amounts not offset in the Group Balance Sheet £m | Net amount £m | Amount presented in the Group Balance Sheet* £m | Related amounts not offset in the Group Balance Sheet £m | Net amount £m |
| Financial assets | | | | | | |
| – Derivative financial instruments (note 16) | **561** | **(227)** | **334** | 425 | (144) | 281 |
| Financial liabilities | | | | | | |
| – Derivative financial instruments (note 16) | **(249)** | **227** | **(22)** | (164) | 144 | (20) |
| | **312** | **–** | **312** | 261 | – | 261 |

* No financial instruments have been offset in the Group Balance Sheet.

The Group is subject to master netting arrangements in force with financial counterparties with whom the Group trades derivatives.

The master netting arrangements determine the proceedings should either party default on their obligations. In case of any event of default: the non-defaulting party will calculate the sum of the replacement cost of outstanding transactions and amounts owed to it by the defaulting party. If that sum exceeds the amounts owed to the defaulting party, the defaulting party will pay the balance to the non-defaulting party. If the sum is less than the amounts owed to the defaulting party, the non-defaulting party will pay the balance to the defaulting party.

## 25 Cash flow

### Cash generated from operations

| | 2014 £m | 2013 £m |
|---|---|---|
| Profit from operations | **4,546** | 5,526 |
| Adjustments for | | |
| – amortisation of trademarks and similar intangibles | **58** | 74 |
| – amortisation and impairment of other intangible assets | **69** | 48 |
| – gain on deemed partial disposal of a trademark | **–** | (26) |
| – depreciation and impairment of property, plant and equipment | **396** | 355 |
| – increase in inventories | **(405)** | (386) |
| – increase in trade and other receivables | **(36)** | (246) |
| – increase in trade and other payables | **203** | 311 |
| – decrease in net retirement benefit liabilities | **(170)** | (222) |
| – decrease in provisions for liabilities and charges | **(76)** | (19) |
| – other non-cash items | **49** | (49) |
| **Cash generated from operations** | **4,634** | 5,366 |

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, impairment, inventories, receivables, payables and provisions above and in the proceeds on disposal of property, plant and equipment shown in the Group Cash Flow Statement. The cash outflow in respect of the Group's restructuring costs was £325 million (2013: £310 million).

Profit from operations includes a release in respect of the Fox River provision referred to in note 3(h) and is reflected in the movement in provisions, above. The cash outflow in respect of this provision was £63 million (2013: £nil).

Profit from operations includes a charge in respect of Flintkote referred to in note 3(i) and this corresponds with the cash outflow of £374 million (2013: £nil).

## 25 Cash flow continued

### Cash flows from investing activities

#### (a) Property, plant and equipment

In 2014, proceeds on disposal of property, plant and equipment include receipts in respect of Turkey, Uganda and the Democratic Republic of Congo, the gains on which have been included in restructuring and integration costs (note 3(e)).

In 2013, proceeds on disposal of property, plant and equipment include receipts in respect of Australia, Denmark and Russia, the gains on which have been included in restructuring and integration costs (note 3(e)).

#### (b) Purchases of investments

The purchases of investments (which comprise available-for-sale investments and loans and receivables) comprise a cash outflow in respect of current investments of £31 million (2013: £47 million outflow).

#### (c) Proceeds from disposals of investments

The disposals of investments (which comprise available-for-sale investments and loans and receivables) comprise a cash inflow in respect of current investments of £34 million (2013: £15 million inflow).

#### (d) Proceeds from associates' share buy-backs

The proceeds from associates' share buy-backs reflect proceeds of £94 million (2013: £189 million) in respect of the Group's participation in the share buy-back programme conducted by Reynolds American Inc.

#### (e) Purchase of subsidiaries

In 2013, the cash outflow relates to further cash consideration paid on the purchase of CN Creative Limited of £16 million.

### Cash flows from financing activities

#### (a) Cash flows from borrowings

In September 2014, the Group repaid a maturing €600 million bond, this repayment was financed from Group cash balances.

In September 2014, the Group issued a new CHF 350 million bond with a maturity of 2016; a new CHF 400 million bond with a maturity of 2021 and a new CHF 250 million bond with a maturity of 2026.

In August 2014, the Group repaid a maturing MYR 250 million note, this repayment was financed from Group cash balances.

In June 2014, the Group purchased and cancelled an existing US$40 million bond with a maturity of 2029; this purchase was financed from Group cash balances.

In March 2014, the Group issued a new €400 million bond with a maturity of 2018 and a new €600 million bond with a maturity of 2029.

In December 2013, a maturing £152 million bond was repaid, this repayment was financed from Group cash balances.

In November 2013, a maturing US$300 million bond was repaid, this repayment was financed from Group cash balances.

In September 2013, the Group issued a new £650 million bond with a maturity of 2026.

In July 2013, the Group repaid a maturing €519 million bond, this repayment was financed from Group cash balances.

In March 2013, the Group issued a new €650 million bond with a maturity of 2025 and a new US$300 million bond with a maturity of 2016.

During the year, the Group's subsidiary in Brazil received proceeds of £411 million (2013: £399 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £271 million (2013: £436 million).

#### (b) Movements relating to derivative financial instruments

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.

#### (c) Purchases of non-controlling interests

In 2014, the purchases of non-controlling interests of £4 million (2013: £nil) relates to the acquisition of part of the non-controlling interests in BAT Chile Operaciones, S.A. and BAT Central America S.A. (see note 26 (c)).

#### (d) Non-controlling interests – capital injection

In 2014, a £4 million capital injection (2013: £nil) was made by the non-controlling interest to BAT Algérie S.P.A. (see note 26 (c)).

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 26 Business combinations, disposals and other changes in the Group

### (a) CTBAT International Limited

On 30 August 2013 the Group announced that CTBAT International Limited (CTBAT), a joint investment incorporated in Hong Kong between subsidiaries of China National Tobacco Corporation (CNTC) and the Group, had commenced official business operations. The joint venture was created in accordance with the Joint Venture Agreement signed by both companies. It owns and manages the worldwide international cigarette trademark State Express 555, and also, the worldwide rights outside China to the leading CNTC brand, Shuang Xi.

CTBAT is reported as part of the Asia-Pacific region with the majority of its international sales (non-China domestic sales) made through existing end markets of the Group in that region. All sales to mainland China are via CNTC. CTBAT operates as an extension of the existing tobacco businesses of its investors and is therefore treated as a joint operation as defined under IFRS 11 *Joint Arrangements*. The Group recognises its share (50%) of the assets, liabilities, income and expenses of the arrangement on a line-by-line basis in the consolidated financial statements.

The contribution of brands and businesses into CTBAT were recognised by the new entity at fair value, resulting in a gain on the deemed partial disposal of the State Express 555 brand, which was treated as an adjusting item (see note 3(g)).

The impact of the arrangement on operating results for 2014 and 2013 is not material.

### (b) British American Tobacco Myanmar Limited

On 8 July 2013, the Group announced the completion of a joint venture in Myanmar with I.M.U. Enterprise Limited to manufacture, distribute and market the Group's brands. Under the terms of the agreement, the Group has contributed plant and machinery and cash to the venture in return for a controlling stake, and will therefore, account for the transaction as a business combination. Goodwill of £1 million in relation to the acquisition of the 51% stake in the business reflects the strategic premium to acquire the opportunity to re-enter the Myanmar market. The Group's proportion of the total net assets acquired at fair value amounted to £8 million with non-controlling interests of £8 million.

### (c) Non-controlling interests

#### BAT Algérie S.P.A.

On 8 June 2014, the Group made a capital injection to BAT Algérie S.P.A. at a cost of £4 million. This injection was in proportion to a capital injection made by the non-controlling interest to the Group company and as such, the Group's shareholding remains unchanged.

#### BAT Chile Operaciones, S.A.

During 2014, the Group acquired in total a further 1% interest in BAT Chile Operaciones, S.A. at a cost of £3 million. This increased the Group's shareholding to 99%.

#### BAT Central America S.A.

On 15 December 2014, the Group acquired a further 1% interest in BAT Central America S.A. at a cost of £1 million. This increased the Group's shareholding to 79%.

### (d) Items classified as held-for-sale

At 31 December 2014, held-for-sale assets comprised mainly plant and equipment in Souza Cruz and land and buildings in Denmark which were being actively marketed for sale. At 31 December 2013, held-for-sale assets comprised mainly land and buildings in Denmark.

## 27 Share-based payments

The Group operates a number of share-based payment arrangements of which the two principal ones are:

### Long-Term Incentive Plan (LTIP)

Nil-cost options exercisable after three years from date of grant with a contractual life of 10 years. Payout is subject to performance conditions based on earnings per share (50% of grant), total shareholder return (25% of grant) and net turnover (25% of grant). Total shareholder return combines the share price and dividend performance of the Company by reference to one comparator group. Participants are not entitled to dividends prior to the exercise of the options. A cash equivalent dividend accrues through the vesting period and is paid on vesting. Both equity and cash-settled LTIPs are granted in March each year.

Prior to 2014, payout is subject to performance conditions based on earnings per share relative to inflation (50% of grant) and total shareholder return, combining the share price and dividend performance of the Company by reference to two comparator groups (50% of grant).

### Deferred Share Bonus Scheme (DSBS)

Free ordinary shares released three years from date of grant and may be subject to forfeit if a participant leaves employment before the end of the three-year holding period. Participants receive a separate payment equivalent to a proportion of the dividend payment during the holding period. Both equity and cash-settled deferred shares are granted in March each year.

The Group also has a number of other arrangements which are not material for the Group and these are as follows:

### Share Option Scheme (ESOS)

Options exercisable three years from date of grant with a contractual life of 10 years, 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.

The granting of options under this scheme ceased with the last grant made in March 2004 and final outstanding awards were exercised by March 2014.

### Sharesave Scheme (SAYE)

Options granted in March each year from 2011 onwards (previously November until 2009 and no options were granted during 2010) by invitation at a 20% discount to the market price. Options to this equity-settled scheme 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 £6,000 (2013: £3,000) in any tax year.

### Share Reward Scheme (SRS) and International Share Reward Scheme (ISRS)

Free shares granted in April each year (maximum £3,000 in any year) under the equity-settled scheme are subject to a three-year holding period. Participants receive dividends during the holding period which are reinvested to buy further shares.

### Partnership Share Scheme

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 £1,800 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.

### Share-based payment expense

The amounts recognised in the Income Statement in respect of share-based payments were as follows:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Equity-settled £m | Cash-settled £m | Equity-settled £m | Cash-settled £m |
| LTIP (note (a)) | 6 | 1 | 8 | 2 |
| DSBS (note (b)) | 54 | 7 | 48 | 11 |
| SAYE (note (c)) | 1 | – | 1 | – |
| SRS (note (c)) | 5 | – | 4 | – |
| **Total recognised in the Income Statement (note 3(a))** | **66** | **8** | 61 | 13 |

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 27 Share-based payments continued

### Share-based payment liability

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 in respect of vested and unvested grants at the end of 2014 and 2013:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Vested £m | Unvested £m | Vested £m | Unvested £m |
| LTIP | 2.1 | 3.4 | 3.8 | 3.6 |
| DSBS | 0.3 | 17.4 | 0.2 | 14.7 |
| **Total liability** | **2.4** | **20.8** | 4.0 | 18.3 |

### (a) Long-Term Incentive Plan

Details of the movements for the equity and cash-settled LTIP scheme during the years ended 31 December 2014 and 31 December 2013, were as follows:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Equity-settled Number of options in thousands | Cash-settled Number of options in thousands | Equity-settled Number of options in thousands | Cash-settled Number of options in thousands |
| Outstanding at start of year | 5,592 | 709 | 5,949 | 779 |
| Granted during the period | 2,477 | 112 | 1,697 | 131 |
| Exercised during the period | (1,278) | (281) | (1,508) | (179) |
| Forfeited during the period | (1,593) | (55) | (546) | (22) |
| **Outstanding at end of year** | **5,198** | **485** | 5,592 | 709 |
| Exercisable at end of year | 376 | 56 | 770 | 123 |

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the period was £34.40 (2013: £35.41) for equity-settled and £34.57 (2013: £34.97) for cash-settled options.

The outstanding shares for the year ended 31 December 2014 had a weighted average contractual life of 8.4 years (2013: 7.8 years) for the equity-settled scheme, and 8.0 years (2013: 7.6 years) for the cash-settled share-based payment arrangements.

## 27 Share-based payments continued

### (b) Deferred Share Bonus Scheme

Details of the movements for the equity and cash-settled DSBS scheme during the years ended 31 December 2014 and 31 December 2013, were as follows:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | **Equity-settled Number of options in thousands** | **Cash-settled Number of options in thousands** | Equity-settled Number of options in thousands | Cash-settled Number of options in thousands |
| Outstanding at start of year | **5,105** | **754** | 5,368 | 878 |
| Granted during the period | **1,695** | **175** | 1,628 | 158 |
| Exercised during the period | **(2,486)** | **(367)** | (1,796) | (270) |
| Forfeited during the period | **(52)** | **(7)** | (95) | (12) |
| **Outstanding at end of year** | **4,262** | **555** | 5,105 | 754 |
| Exercisable at end of year | **18** | **4** | – | 5 |

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the financial year was £33.70 (2013: £34.96) for equity-settled and £33.43 (2013: £34.99) for cash-settled options.

The outstanding shares for the year ended 31 December 2014 had a weighted average contractual life of 1.1 years (2013: 1.2 years) for the equity-settled scheme, and 1.0 year (2013: 1.0 year) for the cash-settled scheme.

### (c) Other schemes

#### ESOS

The number of outstanding equity-settled options at the end of the year was nil (2013: 95,266).

#### SAYE

The number of outstanding options at the end of the year for the three-year scheme was 352,504 (2013: 263,599) and for the five-year scheme was 558,756 (2013: 465,274).

#### SRS and ISRS

The number of outstanding shares at the end of the year for the Share Reward Scheme was 456,057 (2013: 546,983) and for the International Share Reward Scheme was 34,748 (2013: 41,205).

#### Valuation assumptions

Assumptions used in the Black-Scholes models to determine the fair value of share options at grant date were as follows:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | **LTIP** | **DSBS** | LTIP | DSBS |
| Expected volatility (%) | **18** | **18** | 25 | 25 |
| Average expected term to exercise (years) | **3.5** | **3.0** | 3.5 | 3.0 |
| Risk-free rate (%) | **1.4** | **1.1** | 0.4 | 0.3 |
| Expected dividend yield (%) | **4.2** | **4.2** | 3.8 | 3.8 |
| Share price at date of grant (£) | **32.60** | **32.60** | 35.05 | 35.05 |
| Fair value at grant date (£)* | **17.72** | **19.55** | 23.69/23.44 | 31.23 |

* Where two figures have been quoted for the Long-Term Incentive Plan, the first number represents the awards made to employees below Management Board level and the second number to awards made to the members of the Management Board, as at the date of award.

Market condition features were incorporated into the Monte-Carlo models for the total shareholder return elements of the LTIP, in determining fair value at grant date. Assumptions used in these models were as follows:

| | **2014 %** | 2013 % |
|---|---|---|
| Average share price volatility FTSE 100 comparator group | **–** | 37 |
| Average share price volatility FMCG comparator group | **20** | 26 |
| Average correlation FTSE 100 comparator group | **–** | 37 |
| Average correlation FMCG comparator group | **31** | 37 |

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 27 Share-based payments continued

Fair values determined from the Black-Scholes and Monte-Carlo models use assumptions revised at the end of each reporting period for cash-settled share-based payment arrangements.

The expected British American Tobacco p.l.c. share price volatility was determined taking account of the return index, (the share price index plus the dividend reinvested) 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.

In addition to these valuation assumptions, LTIP awards contain earnings per share performance conditions. As these are non-market performance conditions they are not included in the determination of fair value of share options at the grant date, however they are used to estimate the number of awards expected to vest. This pay-out calculation is based on expectations published in analysts' forecasts.

## 28 Group employees

The average number of persons employed by the Group and its associates during the year, including Directors, was 90,118 (2013: 89,820).

| | 2014 Number | 2013 Number |
|---|---|---|
| Asia-Pacific | 17,108 | 17,156 |
| Americas | 16,011 | 16,489 |
| Western Europe | 12,355 | 11,824 |
| EEMEA | 12,488 | 12,261 |
| Subsidiary undertakings | 57,962 | 57,730 |
| Associates | 32,156 | 32,090 |
| | 90,118 | 89,820 |

Details of Directors' remuneration, share options and retirement benefits are given in the Remuneration Report.

Included within the employee numbers for Western 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 with CTBAT International Limited (see note 26(a)) are not included in these disclosures as it is a joint operation.

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 £96 million (2013: £86 million). The Group's share of dividends from associates, included in other net income in the table below, was £518 million (2013: £512 million).

| | 2014 £m | 2013 £m |
|---|---|---|
| Transactions | | |
| – revenue | **38** | 54 |
| – purchases | **(279)** | (345) |
| – other net income | **512** | 501 |
| Amounts receivable at 31 December | **98** | 96 |
| Amounts payable at 31 December | **(25)** | (33) |

On 17 December 2012, a wholly-owned subsidiary of the Group, BATUS Japan Inc. (BATUSJ), entered into an Amendment and Extension Agreement (referred to as the Amendment) with a wholly-owned subsidiary of Reynolds American Inc (RAI), R.J. Reynolds Tobacco Company (referred to as RJRTC). The Amendment modifies the American blend Cigarette Manufacturing Agreement (referred to as the 2010 Agreement), effective as of 1 January 2010.

Prior to the Amendment, the term of the 2010 Agreement was scheduled to expire on 31 December 2014, subject to early termination and extension provisions. Pursuant to the Amendment, the Manufacturing Agreement will remain in effect beyond 31 December 2014, provided that either RJRTC or BATUSJ may terminate the Manufacturing Agreement by furnishing three years' notice to the other party, with any such notice to be given no earlier than 1 January 2016.

During the year, the Group received proceeds of £94 million (2013: £189 million) in respect of its participation in the share buy-back programme conducted by RAI. This programme ceased in the second quarter of 2014.

On 15 July 2014, the Group announced that it has agreed to invest US$4.7 billion as part of RAI's proposed acquisition of Lorillard enabling the Group to maintain its 42% equity position in the enlarged business. The investment is contingent upon the completion of RAI's acquisition of Lorillard, which has been approved by the shareholders of RAI and Lorillard, and the proposed acquisition, while subject to a number of regulatory approvals in the US, is anticipated to be completed in the first half of 2015.

In addition, the Group and RAI have agreed in principle to collaborate on next-generation products and negotiations are ongoing.

During 2014, the Group acquired a further 1% interest in BAT Chile Operaciones, S.A. at a cost of £3 million. This increased the Group's shareholding to 99%. This transaction is shown as a £3 million reduction to reserves attributable to the owners of the parent in note 20.

On 15 December 2014, the Group acquired a further 1% interest in BAT Central America S.A. at a cost of £1 million. This increased the Group's shareholding to 79%. This transaction is shown as a £1 million reduction to reserves attributable to the owners of the parent in note 20.

As explained in note 12, contributions to the British American Tobacco UK Pension Fund are secured by a charge over the Group's Head Office (Globe House) up to a maximum of £150 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.

| | 2014 £m | 2013 £m |
|---|---|---|
| The total compensation for key management personnel, including Directors, was: | | |
| – salaries and other short-term employee benefits | **20** | 20 |
| – post-employment benefits | **3** | 3 |
| – share-based payments | **13** | 11 |
| | **36** | 34 |

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.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 30 Contingent liabilities and financial commitments

1. The Group is subject to contingencies pursuant to requirements that it complies with relevant laws, regulations and standards.

2. 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 if the amount of the obligation can be reliably estimated, a provision will be recognised based on best estimates and management judgment.

3. There are, however, contingent liabilities in respect of litigation, taxes in some countries and guarantees for which no provisions have been made.

### General litigation

#### Product liability litigation

4. Group companies, notably Brown & Williamson Holdings, Inc. (formerly Brown & Williamson Tobacco Corporation) ('B&W') as well as other leading cigarette manufacturers, are defendants in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

#### Indemnity

5. On 30 July 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% equity ownership interest in Reynolds American Inc.

6. As a result of the Business Combination, 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 United States on or prior to 30 July 2004. In addition, RJRT agreed to indemnify B&W and each of its associates (other than Reynolds American Inc. and its subsidiaries) against, among other matters, all losses (including those arising from Environmental Tobacco Smoke ('ETS') claims), 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').

7. 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').

8. 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.

9. Included in the US Litigation section below are all significant cases where B&W and/or a UK company is named as a defendant and all cases where RJRT is named as a defendant as a successor to B&W (the 'RJRT Successor Cases'). The RJRT Successor Cases are covered by the RJRT Indemnification.

#### US litigation

10. The total number of US product liability cases pending at 31 December 2014 involving B&W was approximately 6,057 (compared to approximately 7,312 in 2013). Of these, 2,999 cases are RJRT Successor Cases. For all of the 6,057 cases involving B&W, British American Tobacco Group companies have the protection of the RJRT Indemnification. As at 31 December 2014, British American Tobacco (Investments) Limited ('Investments') has been served as a co-defendant in one of those cases (compared to one in 2013). No other UK-based Group company has been served as a co-defendant in any US product liability case pending as at 31 December 2014. 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: medical reimbursement cases; class actions; individual cases; and other claims.

#### (a) Medical reimbursement cases

11. 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.

12. At 31 December 2014, one US medical reimbursement suit was pending against B&W by an Indian tribe in an Indian tribal court in South Dakota. No other suits are pending against B&W by county or other political subdivisions of the states.

#### (b) Class actions

13. At 31 December 2014, B&W was named as a defendant in five 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 states against individual cigarette manufacturers and their parent corporations, alleging that the use of the terms 'lights' and 'ultralights' constitutes unfair and deceptive trade practices.

14. Black is a 'lights' class action filed in November 2000 in the Circuit Court, City of St. Louis, Missouri. B&W removed the case to the US District Court for the Eastern District of Missouri on 23 September 2005. On 25 October 2005, the plaintiffs filed a motion to remand, which was granted on 17 March 2006. On 16 April 2008, the Court stayed the case pending US Supreme Court review in Good v Altria Group, Inc. On 28 June 2011, the Court issued a memorandum removing the case from the trial docket. A status conference is scheduled for 22 February 2016.

## 30 Contingent liabilities and financial commitments continued

15. Howard is a 'lights' class action filed in February 2000 in the Circuit Court, Madison County, Illinois. A judge certified a class on 18 December 2001. On 6 June 2003, the trial judge issued an order staying all proceedings pending resolution of Price v Philip Morris, Inc., a 'lights' class action against Philip Morris, Inc. in the Illinois state court. The plaintiffs appealed this stay order to the Illinois Fifth District Court of Appeals, which affirmed the Circuit Court's stay order on 19 August 2005. There is currently no activity in the case.
16. Jones is a case filed in December 1998 in the Circuit Court, Jackson County, Missouri. The defendants removed the case to the US District Court for the Western District of Missouri on 16 February 1999. The action was brought by tobacco product users and purchasers on behalf of all similarly situated Missouri consumers. The plaintiffs allege that their use of the defendants' tobacco products has caused them to become addicted to nicotine. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. The case was remanded to the Circuit Court on 17 February 1999. There has been limited activity in this case.
17. Parsons is a case filed in February 1998 in the Circuit Court, Ohio County, West Virginia. The plaintiff sued asbestos manufacturers and US cigarette manufacturers, including B&W, seeking compensatory and punitive damages (US$1 million individually and an unspecified sum for the class) for alleged personal injuries arising from their exposure to respirable asbestos fibres and cigarette smoke. The case has been stayed pending a final resolution of the plaintiffs' motion to refer tobacco litigation to the judicial panel on multidistrict litigation filed in In Re: Tobacco Litigation in the Supreme Court of Appeals of West Virginia. Moreover, Parsons has been stayed pursuant to the Bankruptcy Code because three defendants filed bankruptcy petitions on 26 December 2000.
18. Young is a case filed in November 1997 in the Circuit Court, Orleans Parish, Louisiana. The plaintiffs brought an Environmental Tobacco Smoke (ETS) class action on behalf of all residents of Louisiana who, though not themselves cigarette smokers, have been exposed to second-hand smoke from cigarettes which were manufactured by the defendants, and who allegedly suffered injury as a result of that exposure. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. On 13 October 2004, the trial court stayed this case pending the outcome of appellate review in the Scott class action in Louisiana. With appellate review completed and final judgment entered in the Scott class action, the trial court granted the plaintiffs' request to continue the stay of this action during the implementation of the Scott smoking cessation programme on 6 March 2013.
19. In Engle (a case in Florida), a jury awarded a total of US$12.7 million to three class representatives, and in a later stage of the three-phase trial procedure adopted in this case, a jury assessed US$17.6 billion in punitive damages against B&W. On 21 May 2003, the intermediate appellate court reversed the trial court's judgment and remanded the case to the trial court with instructions to de-certify the class; this was upheld on 6 July 2006. Further, the Florida Supreme Court permitted the judgments entered for two of the three Engle class representatives to stand, but dismissed the judgment entered in favour of the third Engle class representative. Finally, the Florida Supreme Court 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).

### 20. Engle progeny cases, as at 31 December 2014:

| | Engle progeny cases in which B&W has been served (both state and federal courts in Florida) | Engle progeny cases in which RJRT is named as a successor to B&W |
|---|---|---|
| Number of cases | 42 | 2,988 |
| Number of plaintiffs | 98 | 3,773 |

### 21. Phase three trials of individual Engle class members, as at 31 December 2014:

| | Additional Phase 3 Engle Trials naming RJRT as successor to B&W proceeding to verdict |
|---|---|
| Total number of trials | 73 |
| Number of trials resulting in plaintiffs' verdicts | 42 |
| Total damages awarded in final judgments against RJRT as successor to B&W (approximately) | US$176,923,848 |
| Amount of overall damages comprising 'compensatory damages' (approximately) | US$90,273,848 (of overall US$176,923,848) |
| Amount of overall damages comprising 'punitive damages' (approximately) | US$86,650,000 (of overall US$176,923,848) |
| Number of adverse judgments appealed by RJRT | 36* |
| Number of adverse judgments (not yet appealed), in which RJRT still has time to file an appeal | 0 |

* Of the 36 adverse judgments appealed by RJRT, 15 were decided and/or closed, and 21 appeals remain undecided (including four that have petitions for review pending in the Florida Supreme Court). In one of the appeals that was decided, the Florida intermediate appellate court affirmed the liability finding but vacated the damages award and remanded the matter to the trial court. In four of the appeals that were decided, the Florida intermediate appellate courts reversed the final judgment and remanded the matter to the trial court for a new trial on all issues. In another 13 appeals that were decided, the Florida intermediate appellate courts affirmed final judgments in favour of plaintiffs. RJRT has paid damages to plaintiffs in 10 cases that are now closed.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 30 Contingent liabilities and financial commitments continued

22. In June 2009, the Florida legislature amended its existing bond cap statute by adding a US$200 million bond cap that applies to all phase three Engle progeny cases in the aggregate and establishing individual bond caps for individual cases in amounts that vary depending on the number of judgments in effect at a given time. In May 2011, Florida removed the provision in this legislation that would have permitted this bond cap to expire on 31 December 2012. Plaintiffs in several Engle progeny cases have unsuccessfully challenged the constitutionality of the bond cap. One of these appellate courts has since certified to the Florida Supreme Court the question of whether the bond cap violates the Florida Constitution. The Florida Supreme Court accepted jurisdiction over the issue of the constitutionality of the bond cap on 23 January 2012. On 31 August 2012, the Florida Supreme Court entered an order dismissing this case based on RJRT's mootness argument. Plaintiff subsequently moved for a rehearing. On 12 October 2012, the Florida Supreme Court denied plaintiff's motion. Plaintiff did not file a petition for writ of certiorari to the United States Supreme Court.

### (c) Individual cases

| | As at: | Total number of cases | | |
|---|---|---|---|---|
| | 31 December 2013 | 3,063 | | |
| Cases pending against B&W which were filed by or on behalf of individuals and in which it is contended that diseases or deaths have been caused by cigarette smoking or by exposure to ETS | 31 December 2014 | 3,052 | 2,558 | 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 |
| | | | 396 | Cases brought in consolidated proceedings in West Virginia, where the first phase of the trial began on 15 April 2013 and on 15 May 2013 the jury returned a verdict for defendants on all but one of plaintiffs' claims; the verdict is currently on appeal |
| | | | 42 | Engle progeny cases that have been filed directly against B&W (please see earlier table on page 191) |
| | | | 56 | Cases filed by other individuals |

In addition to the 2,988 Engle progeny cases which name RJRT as successor to B&W, there are 11 cases filed by other individuals naming RJRT as successor to B&W. These cases are subject to the RJRT Indemnification and are not detailed here.

### (d) Conduct-based claims

23. In the Daric Smith case, 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 the defendants participated in a conspiracy to fix or maintain the price of cigarettes sold in the US, including in the state of Kansas, in violation of the Kansas Restraint of Trade Act.

24. After the close of discovery, all defendants, including Investments, moved for summary judgment in late October and early November 2010. On 13 May 2011, Investments supplemented its summary judgment motion on the basis of its de minimis market share and the inapplicability of the Kansas Restraint of Trade Act to a non-resident (such as Investments) that did not purchase, sell or manufacture goods in the state of Kansas.

25. On 26 March 2012, the Court entered an order granting all of the defendants' summary judgment motions and dismissing the plaintiff's first amended petition with prejudice. On 18 July 2012, plaintiff filed a notice of appeal on various points. On or about 1 August 2012, all defendants filed notices of cross-appeal, with Investments filing its own separate notice of cross-appeal to address, amongst other issues, various orders denying the defendants' claims of privilege over certain categories of documents during discovery.

26. The plaintiff filed his appeal on 25 January 2013 and the defendants' opposition and cross-appeal briefs were filed on 29 May 2013. The plaintiff filed his combined reply/response to Investments' cross-appeal on 19 July 2013. Investments filed a reply brief addressing the novel arguments raised in the plaintiff's reply/response relating to Investments' cross-appeal on privilege issues. The Court of Appeals heard oral argument in the case on 11 December 2013.

27. On 18 July 2014, the Court of Appeals of Kansas affirmed the trial court's order granting summary judgment for all the defendants. On 18 August 2014, the plaintiff filed a Petition for Review by the Supreme Court of Kansas. On 29 August 2014, the defendants filed their response to the plaintiff's Petition for Review. On 12 September 2014, the plaintiff filed his reply. A decision in this matter is pending.

### UK-based Group companies

Investments has been served in the following US cases pending as at 31 December 2014: one class action alleging violations of Kansas antitrust and consumer protection laws, the Daric Smith case mentioned above; and one individual action, the Perry case.

## 30 Contingent liabilities and financial commitments continued

### Product liability outside the United States of America

28. As at 31 December 2014, active product liability claims against the Group's companies existed in 15 markets outside the US (2013:16) but the only markets with more than five claims were Argentina, Brazil, Canada, Chile, Italy and Nigeria. As at 31 December 2014, medical reimbursement actions are being brought in Argentina, Brazil, Canada, Nigeria and South Korea.

### (a) Medical reimbursement cases

#### Argentina

29. In 2007, the non-governmental organisation the Argentina Tort Law Association ('ATLA') and Emma Mendoza Voguet brought a reimbursement action against Nobleza Piccardo S.A.I.C.y.F. ('Nobleza') and Massalín Particulares. Several defences were filed by Nobleza on 1 October 2009. Nobleza and the federal government's preliminary objections regarding lack of jurisdiction were considered by the Civil Court in late 2009. On 23 December 2009, the Civil Court declared its lack of jurisdiction to hear the claim. On 11 March 2010, the case was sent to the Contentious-Administrative Court, which determined that it had jurisdiction over the case. On 24 June 2011, the Contentious-Administrative Court issued an Order stating that it would decide the defendants' outstanding procedural objections together with the merits of the case. The case is currently at the evidentiary stage. Confessional hearings took place on 14 August 2013 (Emma Mendoza Voguet) and 29 August 2013 (ATLA). In February 2014, plaintiffs renounced several of their prior evidentiary requests that included a request for copies of certain historical advertising published by Nobleza. In April 2014, plaintiffs filed a motion seeking to revoke this prior renunciation. In September 2014 the Contentious-Administrative Court rejected the motion and plaintiffs have not appealed this rejection.

#### Brazil

30. In August 2007, the São Paulo Public Prosecutor's Office filed a medical reimbursement claim against Souza Cruz S.A. ('Souza Cruz'). A similar claim was lodged against Philip Morris. On 4 October 2011, the Court dismissed the action against Souza Cruz, with a judgment on the merits. The plaintiff filed an appeal on 9 January 2012 and Souza Cruz filed its counter arguments on 17 February 2012. On 29 September 2012, the case records arrived at the São Paulo Court of Appeals.

31. On 7 March 2013, the case records returned from the Public Prosecutor's Office with a non-binding unfavourable opinion. On 23 April 2013, the Justices of the 2nd Civil Chamber of the Court of Appeals of the State of São Paulo, by unanimous vote (3 to 0), denied the appeal of the Prosecution Office, thereby confirming the favourable Lower Court ruling. In this ruling, the Justices, citing case precedents of the Superior Court of Justice, emphasised: (i) the widespread public knowledge of the risks associated with smoking cigarettes; (ii) the free will of the smokers; (iii) the absence of any defect in the product; (iv) the absence of any duty to provide information on the risks associated with smoking before 1988; and (v) the lawfulness of manufacturing and producing cigarettes. The Public Prosecutor's Office has filed a Special Appeal and the case is anticipated to be sent for judgment to Superior Court of Justice within several months.

#### Canada

32. In Canada there are 10 active statutory actions for recovery of health care costs arising from the treatment of smoking and health-related diseases. These proceedings name various Group companies as defendants, including the Company, Investments, B.A.T Industries p.l.c. ('Industries'), Carreras Rothmans Limited (collectively the 'UK Companies') and Imperial Tobacco Canada Limited ('Imperial'), the Group's operating company in Canada. Legislation enabling provincial governments to recover the health care costs has been enacted in all 10 provinces and two of three territories in Canada and has been proclaimed in force in 10 provinces. The Acts have received Royal Assent in Northwest Territories and Nunavut but have yet to be proclaimed into force. Actions have begun against various Group companies, including Imperial, in British Columbia, New Brunswick, Newfoundland and Labrador, Ontario, Quebec, Manitoba, Alberta, Saskatchewan, Nova Scotia and Prince Edward Island ('PEI'). In Quebec, three Canadian manufacturers, including Imperial, are challenging the enabling legislation; the Quebec government has commenced an action.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 30 Contingent liabilities and financial commitments continued

33.

| Canadian province | Act pursuant to which claim was brought | Companies named as defendants and date served | Current stage |
|---|---|---|---|
| British Columbia | Tobacco Damages and Health Care Costs Recovery Act 2000 | Imperial.<br>Investments.<br>Industries.<br>Other former Rothmans Group companies. | The underlying medical reimbursement action remains at a preliminary case management stage. Damages have not been quantified by the province. Given the prior pendency of the Supreme Court application, and a number of other factors including delay on the part of the plaintiff in producing damages modelling materials, the trial date was adjourned generally and no trial date is currently set. The federal government has commenced a cost assessment in connection with the motion and appeals relating to the federal government claim, seeking CAD$5 million jointly from all the defendants and an additional CAD$5 million from Imperial. No hearing date has been set. |
| New Brunswick | Tobacco Damages and Health Care Costs Recovery Act 2006 | The UK Companies have all been named as defendants.<br>Imperial and the UK Companies have all been served. | Both Imperial and the UK Companies have now filed their defences and document production by the defendants is substantially complete. A first round of oral discoveries of the province began in September 2014 and will continue at least through the end of Q2 of 2015. Damages have been quantified at CAD$19 billion. No trial date has been set. |
| Ontario | Tobacco Damages and Health Care Costs Recovery Act 2009 | The UK Companies have all been named as defendants.<br>Imperial and the UK Companies have all been served. | On 5–7 November 2012, appeals by the BAT defendants of both the jurisdictional and costs orders were heard by the Court of Appeal.<br>On 30 May 2013, the Court of Appeal dismissed the appeals and upheld the adverse costs award in respect of the first instance hearing. A motion for leave to appeal that decision to the Supreme Court of Canada was filed in August 2013. The Supreme Court of Canada dismissed the leave application on 19 December 2013.<br>On 22 October 2013, the Court of Appeal issued an endorsement awarding the plaintiff its costs of the appeals.<br>Imperial filed a third-party notice against several native manufacturers claiming contribution and indemnity as well as damages in the amount of CAD$1.5 billion.<br>Imperial also filed a Third Party Claim against the Federal government claiming malfeasance in public office due to the government's failure to enforce the law against illicit manufacturers. These claims have been discontinued.<br>Following the Supreme Court of Canada's dismissal of the jurisdiction leave application, the case is under case management. The province has stated its claim to be worth CAD$50 billion, but has not yet tendered evidence to substantiate this figure. No trial date has been set. |
| Newfoundland and Labrador | Tobacco Health Care Costs Recovery Act 2006 | The UK Companies have all been named as defendants.<br>Imperial and the UK Companies have all been served. | There have been preliminary hearings, including a successful application in January 2012 to strike certain affidavits filed by the plaintiff in opposition to the UK Companies' jurisdiction motions, and a hearing in June 2013 at which, in response to a request of the case management judge, the parties debated the elements of the 'legal framework' for a jurisdiction challenge. Judgment in respect of that hearing was issued on 19 December 2013. Jurisdiction has been resolved. Particulars and other preliminary motions were filed on 16 January 2015, and a case management conference took place on 22 January 2015. The hearing on the preliminary motions is scheduled for 4–6 March 2015, and a further case management conference is scheduled for 16 April 2015. Damages have not been quantified by the province. |

## 30 Contingent liabilities and financial commitments continued

| Canadian province | Act pursuant to which claim was brought | Companies named as defendants and date served | Current stage |
|---|---|---|---|
| Saskatchewan | Tobacco Damages and Health Care Costs Recovery Act 2012 | The UK Companies have all been named as defendants.<br><br>Imperial and the UK Companies have all been served. | This case is at an early case management stage.<br><br>The UK Companies challenged the jurisdiction of the Saskatchewan court at a hearing that commenced on 29 April 2013. On 1 October 2013, the Court denied the UK Companies' challenges. Leave to appeal this ruling was sought and a hearing was scheduled for 11 December 2013. This hearing was adjourned on consent of the parties pending the outcome of the Supreme Court of Canada leave application in the Ontario jurisdiction challenge. The leave application was dismissed on 19 December 2013. No further case management meetings have been set.<br><br>Damages have not been quantified by the province. No trial date has been set.<br><br>Imperial served a motion (which was granted) to defer filing defences until pending jurisdictional challenges have been resolved. There are no discovery motions to date in this jurisdiction. Jurisdiction has been resolved. A standstill agreement has been negotiated under which the next step would be to file defences by 27 February 2015 and the matter will remain in abeyance until document production begins in September 2017. |
| Manitoba | Tobacco Damages Health Care Costs Recovery Act 2006 | Imperial.<br><br>Investments.<br><br>Industries.<br><br>Other former Rothmans Group companies. | Imperial served a motion (which was denied) to defer filing defences until pending jurisdictional challenges have been resolved. Imperial delivered a request for particulars on 30 September 2013. The province filed a response on 16 January 2014.<br><br>The jurisdiction motions were scheduled to be heard on 25–28 November 2013. This hearing was adjourned on consent of the parties pending the outcome of the Supreme Court of Canada leave application in the Ontario jurisdiction challenge. The leave application was dismissed on 19 December 2013. Particulars motions have been argued and defences have been filed.<br><br>Damages have not been quantified by the province. No trial date has been set. A standstill agreement has been negotiated, under which the next step will be document production to commence in January in 2017. |
| Alberta | Crown's Right of Recovery Act 2009 | Imperial and the UK Companies have all been named as defendants and served. | On 8 August 2012, Imperial was served with the Alberta Medicaid suit. The UK Companies were served on 15 May 2013. The UK Companies informed the plaintiff that they intended to challenge the jurisdiction of the Alberta court.<br><br>A case management judge has been appointed and an initial case management meeting was held on 17 December 2013 at which it was agreed to put preliminary matters on hold pending the outcome of the Supreme Court of Canada leave application in the Ontario jurisdiction challenge. The leave application was dismissed on 19 December 2013. Case management is ongoing. Particulars motions have been filed and were argued on 26 and 27 January 2015. Judgment was reserved.<br><br>The province has stated its claim to be worth CAD$10 billion, but has not yet tendered evidence to substantiate this figure. No trial date has been set. |

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 30 Contingent liabilities and financial commitments continued

33. continued

| Canadian province | Act pursuant to which claim was brought | Companies named as defendants and date served | Current stage |
|---|---|---|---|
| Quebec | Tobacco Related Damages and Health Care Costs Recovery Act 2005 | Investments, Industries, and Carreras Rothmans Limited have been named as defendants.<br><br>Imperial and the UK Companies have been served. | On 25 August 2009, Imperial and the other Canadian manufacturers filed a constitutional challenge to the Quebec Medicaid Legislation. The Quebec Attorney-General (AG) filed a motion to dismiss the constitutional challenge and following a hearing, the Quebec Superior Court dismissed that motion.<br><br>On 28 January 2011, the Court of Appeal denied the AG's leave application, permitting Imperial's challenge to proceed.<br><br>On 8 June 2012, the Quebec Medicaid suit was served upon Imperial. The government is seeking CAD$60 billion. On 14 December 2012, Imperial's motion to stay the Medicaid suit pending the resolution of the constitutional challenge, was heard by the Court and taken under advisement. It was subsequently dismissed.<br><br>The Constitutional Challenge was heard on 30 September–3 October 2013 and was subsequently dismissed.<br><br>The three UK Companies filed jurisdictional challenges on 15 March 2013 which were heard on 3–5 June 2013. On 4 July 2013, the Court denied the jurisdictional objections. Leave to appeal the ruling was refused in a judgment issued by a Court of Appeal judge on 4 October 2013. Defendants' motions for further and better particulars and concerning other pleadings issues were heard on 15 and 22 November and 20 December 2013 and judgment was reserved.<br><br>A case management judge has been appointed. Motions for particulars have been completed, defences filed, document subpoenas served on the AG and requests to admit the authenticity of documents were responded to on 21 January 2015. No trial date has been set. |
| Prince Edward Island | Tobacco Damages and Health Care Costs Recovery Act 2009 | Imperial and the UK Companies. | On 15 November 2012, Imperial was served with the PEI Medicaid suit. Damages have not been quantified by the province.<br><br>This case is at a preliminary case management stage. Motions to challenge jurisdiction were filed and served by the UK Companies on 11 January 2013. A case management judge has been appointed. A standstill agreement has been negotiated. Defences are to be filed by 27 February 2015 and the next step will be document production, which will commence in September 2017. |
| Nova Scotia | Tobacco Health Care Costs Recovery Act 2005 | Imperial and the UK Companies. | On 22 January 2015 Imperial and the UK Companies were served with the Nova Scotia Medicaid suit. Damages have not been quantified by the province.<br><br>A standstill agreement has been negotiated. Under the agreement, the defendants must deliver statements of defence or demands for particulars by 31 March 2015. If demands for particulars are delivered, the responses from the province are due by 15 May 2015. Statements of defence are to be filed by 3 July 2015, and document production by the defendants is to commence on or before 1 September 2017. |

## 30 Contingent liabilities and financial commitments continued

### Nigeria

34. As at 31 December 2014, six medical reimbursement actions filed by the federal government and five Nigerian states (Lagos, Kano, Gombe, Oyo, Ogun) were pending in the Nigerian courts. British American Tobacco (Nigeria) Limited ('BAT Nigeria'), the Company and Investments have been named as defendants in each of the cases. The plaintiffs in the six cases seek a total of approximately £44.8 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief. On 13 and 25 May 2010, respectively, the plaintiffs in the Kano and Ogun state cases filed motions for preliminary injunctive relief, seeking, inter alia, orders to restrain the defendants from various alleged marketing and distribution practices including the sale of tobacco products within 1,000 metres of any public places that are predominantly locations for minors. The Company and Investments have filed preliminary objections challenging the jurisdiction of the Nigerian courts over them. On 22 June 2010, the Oyo High Court partially granted the Company's and Investments' preliminary objections and set aside the service of the writ of summons. The Company and Investments appealed the Court's order insofar as it denied the remainder of the relief requested, and the Court of Appeal has yet to set a date for hearing of the appeals.

35. The Federal High Court and the High Courts of Lagos, Kano, Gombe and Ogun states denied the preliminary objections filed by the Company and Investments, and the companies have appealed. High Court proceedings in the Lagos and Kano state cases have been stayed pending the appeals filed by the Company and Investments. In the Gombe and Ogun cases, the High Courts have adjourned proceedings without date, pending the resolution of appeals filed by the Company, Investments and BAT Nigeria. As at 31 December 2014, the appeal filed by the Company in the Lagos case and the appeals filed by the Company and Investments in the Federal and Kano cases remain pending and have yet to be heard by the Court of Appeal. On 23 April 2013 and 16 May 2013, the Court of Appeal (Ibadan Judicial Division) issued decisions affirming the Ogun High Court's denial of the preliminary objections filed by the Company, Investments and BAT Nigeria. On 13 June 2014, the Court of Appeal (Jos Judicial Division) affirmed the denial of the Company's and Investments' preliminary objections in the Gombe action, and on 30 June 2014 the Court of Appeal (Lagos Judicial Division) affirmed the denial of Investments' preliminary objections in the Lagos action. The companies have appealed the decisions to the Supreme Court of Nigeria.

### South Korea

36. In April 2014, Korea's National Health Insurance Service ('NHIS') filed a health care recoupment action against KT&G (the state-owned former monopoly), PM Korea and BAT Korea (including BAT Korea Manufacturing). The lawsuit relates to health care costs allegedly incurred by the NHIS treating patients with lung (small cell and squamous cell) and laryngeal cancer between 2003 and 2012. The claim is based on allegations of defective design, failure to warn, fraud/misrepresentation, marketing to youth, use of additives and causing addiction. The NHIS is seeking damages of roughly £32 million from the defendants.

### Spain

37. In early 2006, the Government of Andalusia and the Andalusian Health Services (hereinafter referred to as the 'Junta'), in Spain, filed a medical reimbursement action against the State and tobacco companies (including BAT España S.A.) before the contentious-administrative courts. The State filed preliminary objections to the Junta's claim, with tobacco companies filing supporting briefs. The Court upheld these preliminary objections and dismissed the claim in November 2007. The Junta's appeal of this ruling to the Supreme Court was dismissed in September 2009. However, in May 2009, the Junta filed a new contentious-administrative claim with similar allegations. The defendants filed procedural objections, which were rejected by the Court.

38. On 31 May 2013, the Court notified BAT España of the commencement of a 20-day period to answer the Junta's claim and produced copies of the documents attached to the statement of claim. BAT España filed its response to the claim by the deadline of 27 June 2013.

39. By order dated 26 July 2013, the Court refused to open the evidence phase of the proceedings. The Court accepted the defendants' allegations that the Junta did not fulfil its procedural duty to establish the issues of fact to which the evidence would relate. In October 2013, the Court declared the proceedings closed pending its judgment. In a judgment dated 23 December 2013, the Court rejected the Junta's claim against the tobacco companies as inadmissible. The Junta did not appeal the decision and the judgment became final in February 2014. This case is now closed and will be removed from future reports.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 30 Contingent liabilities and financial commitments continued

### (b) Class actions

#### Brazil

40. There are currently two class actions being brought in Brazil. One is also a medical reimbursement claim (São Paulo Public Prosecutor's Office), and is therefore discussed above. A third class action ended in July 2014 when a judgment in favour of the defendants became final, as described below.

41. In 1995, the Associação de Defesa da Saúde do Fumante ('ADESF') class action was filed against Souza Cruz and Philip Morris in the São Paulo Lower Civil Court alleging that the defendants are liable to a class of smokers and former smokers for failing to warn of cigarette addiction. The case was stayed in 2004 pending the defendants' appeal from a decision issued by the Lower Civil Court that held that the defendants had not met their burden of proving that cigarette smoking was not addictive or harmful to health, notwithstanding an earlier interlocutory order that the São Paulo Court of Appeals had issued, which directed the trial court to allow more evidence to be taken before rendering its decision. 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 the defendants with an opportunity to produce evidence. The case was returned to the lower court for production of evidence and a new judgment. On 19 March 2009, the Lower Civil Court ordered designation of court-appointed medical and advertising experts. The parties submitted questions to these court-appointed experts who subsequently delivered their reports. Each party also provided expert reports commenting on the court-appointed experts' conclusions. On 16 May 2011, the Court granted Souza Cruz's motion to dismiss the action in its entirety on the merits. Plaintiffs filed an appeal of the dismissal on 22 July 2011. Souza Cruz filed its response on 5 October 2011. On 10 November 2011, the case records were sent to the Public Prosecutor's Office. On 20 December 2011, the Public Prosecutor's Office presented a non-binding, advisory opinion that rejected most of Souza Cruz's legal defence arguments. The case records were sent to the São Paulo State Court of Appeals and were immediately sent to the Public Prosecutor's Office for General Public and Collective Interest. On 1 March 2012, the case files returned with an unfavourable opinion given by the Public Prosecutor, who advised that the Court should find in favour of the appeal brought by ADESF and thereby fully reverse the appealed judgment. On 6 September 2012, the case was assigned to a new temporary Reporting Justice in the 7th Chamber of Private Law of the São Paulo Court of Appeals, pending reference to a permanent Reporting Justice of the case. On 10 October 2013, a Reporting Justice of the case was designated. At a hearing on 28 January 2015, the Court reserved its decision on the appeal pending further consideration, with no designated deadline for reaching a decision.

42. The Brazilian Association for the Defense of Consumers' Health ('Saudecon') filed a class action against Souza Cruz and Philip Morris in the City of Porto Alegre, Brazil on 3 November 2008. The plaintiff purported to represent all Brazilian smokers whom, it alleged, were unable to quit smoking and lack access to cessation treatments. On 18 December 2013, the Rio Grande do Sul State Court rendered a decision in favour of defendants, based on free will, awareness and lawful activity. The plaintiff did not appeal the decision and the judgment became final on 2 July 2014. This case is now closed and will be removed from future reports.

#### Canada

43. There are 10 class actions being brought in Canada against Group companies.

44. Knight is a 'lights' class action in which the 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. Although the claim arises from health concerns, it does not seek compensation for personal injury. Instead it seeks compensation for amounts spent on 'light and mild' products and a disgorgement of profits from Imperial.

45. The Supreme Court of British Columbia certified a class of all consumers who purchased in British-Columbia Imperial cigarettes bearing 'light' or 'mild' descriptors since 1974. Imperial filed an appeal against the certification which was heard in February 2006. The appellate court confirmed the certification of the class but has limited any financial liability, if proven, to 1997 onward.

46. The motion of the federal government to strike out the third-party notice issued against it by Imperial was upheld by the Supreme Court which dismissed the third-party claim on the basis that the federal government's impugned conduct constituted valid policy benefiting public health and was therefore not subject to civil liability. The federal government is seeking a parallel cost order in this action as it is in the British Columbia government recoupment case.

47. On 9 December 2009, Imperial was served with a class action filed by Ontario tobacco farmers and the Ontario Flue-Cured Tobacco Growers' Marketing Board ('Growers' claim'). The plaintiffs allege that, during a specific timeframe, Imperial and two other domestic defendants improperly paid lower prices for tobacco leaf destined for duty-free products and then were smuggled back into Canada and sold in the domestic market. In reaction to the suit, Imperial deposited the amount owing to the government of Ontario, pursuant to the Comprehensive Agreement, into an escrow account, alleging that the Comprehensive Agreement permitted Imperial to set-off that amount against costs incurred as a result of the claim (including damages, if any). In response, the Ontario government commenced an application against Imperial, seeking the release of the funds ('Ontario claim'). No monetary damages are being claimed against Imperial by the government of Ontario.

48. On 26 July 2010, Imperial argued a preliminary motion in the Ontario claim seeking a stay in favour of arbitration given an arbitration clause in the Comprehensive Agreement. Imperial was successful in its application and the Court ordered that the Ontario claim be stayed. The Court of Appeal denied the Ontario government's appeal in July 2011, but also ruled that the question of whether the Growers' claim constitutes a 'Released Claim' under the Comprehensive Agreement must be determined by the courts, thereby splitting the issues. On 2 January 2013, the Court rendered a decision in favour of Ontario and held that the Growers' claim is not a 'Released Claim' brought by a 'Releasing Entity'. On 16 July 2013, the Court of Appeal dismissed Imperial's appeal on whether the Growers' claim is a 'Released Claim' made by a 'Released Entity', allowing the class action to proceed.

## 30 Contingent liabilities and financial commitments continued

49. The question of whether Imperial may continue to set-off payments due to Ontario under the Comprehensive Agreement against costs incurred as a result of the Growers' claim proceeded to arbitration in September 2014. By decision dated 24 October 2014, the tribunal ruled against Imperial, holding that the Growers' claim was not captured by the set-off provisions of the Comprehensive Agreement. Imperial has now released the previously escrowed funds, plus accrued interest.

50. As a further preliminary challenge, Imperial has alleged that the Growers' claim is time barred. The other domestic defendants have made the same preliminary challenge. That preliminary issue was heard by the Court on 30 and 31 January 2014. By decision dated 30 June 2014, the Court dismissed the preliminary challenge. Imperial and the domestic defendants have sought leave to appeal that decision. If Imperial is ultimately successful, the Growers' claim will be dismissed; if not successful, the action will proceed to a class action certification hearing.

51. There are currently two class actions in Quebec. On 21 February 2005, the Quebec Superior Court granted certification in two class actions against Imperial and two other domestic manufacturers, which have a combined value of CAD$21 billion plus interest and costs. The Court certified two classes, which include residents of Quebec who suffered from lung, throat and laryngeal cancer or emphysema as of November 1998 or developed these diseases thereafter and who smoked a minimum of 15 cigarettes a day for at least five years, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. The plaintiffs' application to amend the scope of the definition of the disease and addiction classes was granted on 3 July 2013. The trial in this matter commenced on 12 March 2012 and was completed in December 2014. Judgment is anticipated in 2015 and is appealable.

52. In June 2009, four new smoking and health class actions were filed in Nova Scotia, Manitoba, Saskatchewan and Alberta, against Canadian manufacturers and foreign companies, including the UK Companies and Imperial. In Saskatchewan, the Company and Carreras Rothmans have been released from the action. No date has been set for the certification motion hearing. There are service issues in relation to the UK Companies in Alberta and Manitoba.

53. In July 2010, two further smoking and health class actions in British Columbia were served on Imperial and the UK Companies. The Bourassa claim is allegedly on behalf of all individuals who have suffered chronic respiratory disease and the McDermid claim proposes a class based on heart disease. Both claims state that they have been brought on behalf of those who have "smoked a minimum of 25,000 cigarettes". The UK Companies objected to jurisdiction. Subsequently a number of the UK Companies were released from the action. No certification motion hearing date has been set. In Bourassa, the case management judge ordered the claim to be amended which has been done. Plaintiffs were due to deliver certification motion materials by 31 January 2015, but have not yet done so. Once the materials are delivered, the motions regarding abuse of process will be dealt with.

54. In June 2012, a new smoking and health class action was filed in Ontario against the domestic manufacturers and foreign companies, including Imperial and the UK Companies. Imperial was served on 20 November 2012, and the UK Companies were served on 30 November 2012. The claim is presently in abeyance.

### Italy

55. In or about June 2010, BAT Italia was served with a class action filed in the Civil Court of Rome by the consumer association, Codacons, and three class representatives. Plaintiffs primarily asserted addiction-related claims. The class action lawsuit was rejected at the first instance (Civil Court of Rome) and appellate (Rome Court of Appeal) court levels. In July 2012, Codacons filed an appeal before the Italian Supreme Court. BAT Italia filed its answer to the appeal on 13 November 2012. At a hearing on 21 January 2015, the Public Prosecutor's Office agreed that the appeal should be rejected, and the Supreme Court reserved its decision with no firm date for issuing judgment.

### Venezuela

56. In April 2008, the Venezuelan Federation of Associations of Users and Consumers and Giorgio Di Muro Di Nunno, the president of the Association of Users of Electric Services of Venezuela ('ASUSELECTRIC'), not ASUSELECTRIC itself, filed a class action against the Venezuelan government. The class action seeks regulatory controls on tobacco and recovery of medical expenses for future expenses of treating smoking-related illnesses in Venezuela. On 19 January 2009, C.A Cigarrera Bigott Sucs. ('Cigarrera Bigott') notified the Court of its intention to appear as a third-party. The Court adjourned a public hearing, initially scheduled for 28 July 2009, where Cigarrera Bigott's status as a third-party would be determined and parties would present evidence and make arguments. On 16 September 2009, the Venezuelan Republic ordered the Court to continue the judicial process.

57. On 12 April 2011, however, the Constitutional Chamber of the Supreme Court of Justice issued decision number 494, which established the rules for class action procedures. On 5 December 2012 Cigarrera Bigott was admitted as a third-party and presented its defences and evidence on 26 February 2013. The parties will now be asked to attend a hearing at the Constitutional Chamber; however, no date for the hearing has yet been scheduled by the Court. On 23 October 2014, ASUSELECTRIC, which is not a party to the case, filed a petition requiring the Constitutional Chamber to schedule the hearing.

### (c) Individual personal injury claims

58. As at 31 December 2014, the jurisdictions with the most number of active individual cases against Group companies were, in descending order: Brazil (141), Italy (26), Argentina (20), Chile (11), Canada (5) and Ireland (2). There were a further four jurisdictions with one active case only.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 30 Contingent liabilities and financial commitments continued

### Non-tobacco related litigation

#### Flintkote

59. The Flintkote Company ('Flintkote'), a US company formerly engaged in the production and sale of asbestos-containing products, was included in the acquisition of Genstar Corporation by Imasco Limited in 1986 and became a Group subsidiary following the restructuring of Imasco Limited (now Imperial Tobacco Canada Limited ('Imperial'), the Group's operating company in Canada) in 2000. Soon after this acquisition, and as part of the acquisition plan, Genstar Corporation 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 ('S&C') and other advice that sufficient assets would remain to satisfy reasonably foreseeable liabilities, Flintkote's Board of Directors authorised the payment of a dividend of US$170.2 million in 1986 and a further dividend of US$355 million in 1987. In 2003, Imperial 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 plaintiffs (collectively, the 'Flintkote Plaintiffs'), and certain individual asbestos plaintiffs (the 'Hopkins Plaintiffs') were permitted by the Bankruptcy Court to file a complaint in the California State Court against Imperial and numerous other defendants, including a malpractice claim against S&C, for the recovery of the dividends and other compensation under various legal and equitable theories.

60. Following a multi-day bench trial, the California State Court issued a preliminary decision dismissing the claim against S&C. Before the decision was made final, Flintkote settled with S&C for a nominal sum. All claims and cross claims in the litigation asserted by or against S&C have now been dismissed. After another series of bench trials, on 6 October 2011, the Court issued preliminary orders deciding multiple preliminary issues regarding Flintkote's claims to recover the dividends and Flintkote's claim that Imperial is its 'alter ego' for purposes of asbestos liabilities. Among other things, the Court has concluded that Flintkote is barred from seeking to recover, under any theory, transfers that occurred after 31 December 1986. The Court also concluded that Flintkote has no standing to pursue its claim that Imperial is its alter ego for purposes of asbestos liability, holding that any such claims must instead be pursued by individual asbestos plaintiffs. These rulings were made final on 6 January 2012. Thereafter, the Flintkote Plaintiffs agreed to dismiss certain of their claims, but continued to assert fraudulent conveyance claims and equitable restitution claims, as reflected in the Third Amended Complaint filed in January 2013. In August 2013, the Court implemented certain of its earlier decisions by granting summary judgment to Imperial on the plaintiffs' claims to recover the 1987 dividends. The Court also granted summary judgment to Imperial on the plaintiffs' fraudulent conveyance claims that were based on allegations that Flintkote was insolvent at the time of the dividend. Nonetheless, Flintkote continued to pursue claims that effectively sought recovery of the value of the 1987 dividend plus interest. Procedurally, the claims of the Flintkote Plaintiffs are now separated from the claims of the Hopkins Plaintiffs, and it is anticipated that, in the absence of the settlement described below, they would be tried separately.

61. On 17 December 2014, following a series of formal mediation sessions and other negotiations, Imperial and the Flintkote Plaintiffs executed a settlement agreement. In furtherance of this settlement, Imperial has placed into escrow the required settlement payment of US$575 million. The settlement is contingent upon further documentation and approval of the United States Bankruptcy Court for the District of Delaware, where Flintkote's bankruptcy case remains pending, and the United States District Court for the District of Delaware. Imperial filed bankruptcy motions and plan documents on 9 February 2015. The settlement will finally and completely resolve the existing Flintkote litigation, including the claims of the Hopkins Plaintiffs, and Imperial and its corporate affiliates will obtain protections from any potential future litigation related to Flintkote. On 4 February 2015 Imperial went before the California Superior Court to stay proceedings pending the settlement approval process. It is anticipated that final court approval of the settlement will occur in Q3 2015.

#### Reynolds American, Inc/Lorillard, Inc. Shareholder Litigation

62. On 15 July 2014, Reynolds American, Inc ('Reynolds') announced that it had entered into a definitive merger agreement with Lorillard Inc. ('Lorillard'), whereby Reynolds would acquire Lorillard in exchange for a combination of cash and Reynolds stock. As part of this transaction, the Company executed a Share Purchase Agreement to acquire a sufficient number of Reynolds shares to achieve a 42% equity stake in Reynolds after the merger with Lorillard, which is the same equity ownership it currently holds in Reynolds. In press releases announcing the transaction, Reynolds and BAT also announced that they had 'agreed in principle' to pursue a technology-sharing initiative for the development and commercialisation of next-generation tobacco products.

63. In summer 2014, the Company was named as a defendant in three actions stemming from the announcement of Reynolds' intended acquisition of Lorillard and related transactions (the 'Proposed Transaction'). Two of these actions were filed in the Delaware Court of Chancery on behalf of a putative class of Lorillard shareholders alleging that the directors of Lorillard breached their fiduciary duties by failing to obtain the highest value for Lorillard and that Reynolds and the Company aided and abetted that breach. Nine other related actions were filed in Delaware by Lorillard shareholders that did not name the Company as a defendant. All 11 Delaware actions were consolidated on 25 November 2014, and the Company was not named as a defendant in the consolidated action.

64. The third action against the Company was filed in state court in North Carolina on 8 August 2014. The action was brought on behalf of a putative class of Reynolds shareholders alleging that the Company is a controlling shareholder of Reynolds and breached its fiduciary duty to the other Reynolds shareholders by 1) entering into the Share Purchase Agreement to acquire Reynolds shares at an allegedly unfair price in order to maintain its 42% interest in Reynolds after the Lorillard acquisition while diluting the interest of the other shareholders, and 2) entering into a purported agreement with Reynolds under which the plaintiff contends Reynolds will share next-generation technology with BAT for inadequate consideration. The plaintiff also alleges certain claims against Reynolds and its directors. The plaintiff seeks to enjoin the Proposed Transaction and to recover damages in an unspecified amount and attorneys' fees and costs.

## 30 Contingent liabilities and financial commitments continued

65. On 5 December and 8 December 2014, all defendants moved to dismiss the Amended Complaint and to stay discovery pending the motions to dismiss. On 2 January 2015, the plaintiff filed a motion for a preliminary injunction to enjoin the vote of Reynolds shareholders regarding aspects of the Proposed Transaction pending additional disclosures to shareholders regarding issues that the plaintiff contended were material to the vote. On 17 January 2015, Reynolds and its directors settled the disclosure claims with the plaintiff pursuant to a Memorandum of Understanding filed with the Court and the plaintiff withdrew his motion for a preliminary injunction. The Court has not yet scheduled oral argument on the motions to dismiss, but it is expected to occur in the first half of 2015.

### Fox River

**Background to environmental liabilities arising out of contamination of the Fox River**

66. In Wisconsin, the authorities have identified potentially responsible parties ('PRPs') to fund the clean-up of river sediments in the lower Fox River. The pollution was caused by discharges of Polychlorinated Biphenyls ('PCBs') from paper mills and other facilities operating close to the river. Among the PRPs is NCR Corporation ('NCR').

67. There has been a substantial amount of litigation in the US regarding the responsibility for the costs of the clean-up operations. This can be summarised as follows:

   a. As regards the mid and lower portions of the Fox River:

      i. NCR was initially made subject to an injunction filed by the US Government against it and Appvion Inc. ('Appvion') in the courts of Wisconsin in 2012.

      ii. A subsequent ruling by the same Court in April 2012 found that Appvion was not a PRP, and the injunction was accordingly granted against NCR alone. NCR sought to appeal this decision, but it was affirmed on 3 August 2012.

      iii. A full trial of the merits of the US Government's application for a permanent injunction took place in December 2012 and the Court entered a permanent injunction against NCR.

      iv. On 1 May 2013, the Wisconsin Court ruled that the pollution in the Fox River is not divisible. In a series of rulings, the Wisconsin Court also held that NCR was not entitled to recover any amounts in contribution from other PRPs and that the other PRPs were entitled to recover Fox River clean-up costs from NCR. Cross-claims by Appvion against other PRPs to recover its own Fox River related expenditures were rejected by the Wisconsin Court on 25 June 2013. As a result of these decisions NCR was found wholly responsible for the clean-up of those portions of the river. NCR and Appvion appealed against these decisions.

      v. On 25 September 2014, the US Court of Appeals for the Seventh Circuit:

         1. vacated the decisions finding NCR wholly liable. The Court remanded the case to the district court for further consideration of defence of divisibility available to NCR. The Court also vacated the permanent injunction against NCR, reasoning that such relief is unnecessary;

         2. remanded the issue of contribution to the district court for reconsideration; and

         3. found that Appvion is entitled to bring actions against other PRPs to recover its expenses, thereby reversing the trial court's finding in relation to this.

      vi. As a result of the findings of the US Court of Appeals for the Seventh Circuit, a trial of the matters remanded back to the district court is currently set to commence on 13 June 2016.

   b. As regards the upper portion of the Fox River:

      i. In July 2012, the Wisconsin Court ruled that NCR was not liable for the clean-up costs in the upper portion of the Fox River. This judgement considered whether NCR was liable as a result of the sale, by a predecessor of NCR's Appleton Papers Division, of scrap paper, or 'broke', to other PRPs which, in turn, discharged PCBs into the upper portion of the river in the course of recycling the broke. This order was made final on 27 June 2013.

      ii. On 25 September 2014, the US Court of Appeals for the Seventh Circuit dismissed the other PRPs' appeal against this order.

68. In NCR's Form 10-Q Quarterly Report for the quarterly period ended 30 September 2014, the total clean-up costs for the Fox River are estimated at US$825 million. This estimate is subject to uncertainties and does not include natural resource damages which NCR estimates may range from US$0 to US$246 million (albeit the US Government in one court filing in 2009 indicated that natural resource damages could be as high as US$382 million). There are however ongoing proceedings that may ultimately lead to the dismissal of all claims for natural resource damages.

**Industries' involvement with environmental liabilities arising out of the contamination of the Fox River**

69. Industries' involvement with the environmental liabilities arises out of indemnity arrangements which it became party to due to a series of transactions that took place from the late-1970s onwards. US authorities have never identified Industries or BATUS as PRPs.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 30 Contingent liabilities and financial commitments continued

70. In 1978, a subsidiary of Industries, later known as Appleton Papers Inc. and now known as Appvion, purchased what was then NCR's Appleton Papers Division from NCR. Under the terms of the agreement, Industries and Appvion both provided indemnities to NCR concerning certain environmental liabilities. 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 Appvion. 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 Appvion business in 1990 via a Demerger Agreement with Wiggins Teape Appleton p.l.c., now known as Windward Prospects Ltd ('Windward'), and Wiggins Teape Appleton (Holdings) p.l.c., now known as Arjo Wiggins US Holdings Ltd (collectively, the 'AWA Entities'), obtaining what Industries believes were full indemnities from the AWA Entities and Appvion for past and future environmental claims.

71. Disputes between NCR, Appvion, and Industries as to the indemnities given and received under the original purchase agreement in 1978 have been the subject of litigation that was commenced in 1995, a settlement agreement effective from 1998 (the 'Settlement Agreement'), and an arbitration award in 2005. NCR took the position that, under the terms of the Settlement Agreement and the arbitration award, Industries and Appvion generally had a joint and several obligation to bear 60% of the Fox River environmental remediation costs imposed on NCR. Until May 2012, Appvion and the AWA Entities paid the 60% share of the clean-up costs and Industries was never required to contribute.

72. Following the May 2013 ruling of the Wisconsin Court described above which found, in April 2012, that Appvion was not a PRP, Appvion and the AWA Entities ceased making payments in relation to the clean-up. That led to NCR making demands on Appvion and Industries for payments under the terms of the Settlement Agreement. NCR later commenced an arbitration against Appvion on 29 March 2013 seeking US$39.9 million (plus interest and cost; later this rose to US$80.7 million) and a declaration that Appvion was liable to NCR under the Settlement Agreement for 60% of all 'Claims, Damages and Group Defence Costs' (as defined in the Settlement Agreement). An arbitration award has been finalised, but under the terms of the Funding Agreement described below, the parties have agreed that the award will not be released.

**Litigation surrounding Windward's indemnities to Appvion and to Industries**

73. In December 2011, following a request by Industries to confirm its indemnity obligation, Windward asserted that it did not indemnify Industries pursuant to the terms of the 1990 Demerger Agreement in respect of Industries' obligations under the Settlement Agreement. Industries disputed Windward's position and commenced proceedings in the High Court against both Windward and Appvion (which has also denied owing Industries an indemnity) (the 'English Indemnity Proceedings'). Appvion also issued a Counterclaim seeking recovery of 50% of its previous clean-up related payments (alleged to be 50% of US$211.25 million, or US$105.6 million) (the 'Appvion Counterclaim'). These proceedings were scheduled to go to trial in June 2015, but have now been discontinued pursuant to the Funding Agreement, described below.

74. The refusal of Appvion and Windward to continue to pay clean-up costs after May 2012 led to NCR making the demands on Industries referenced above. This led to Industries investigating the respective financial positions of Appvion and Windward. Industries is aware that Windward settled the majority of Appvion's insurance claims (over which it had control) at what Industries believes constituted a significant discount, and has made dividend payments to its former and current shareholders of approximately US$810 million, leaving it holding, according to its latest accounts for the year ended 31 October 2013, approximately US$60 million of net assets. Appvion's own accounts indicated that it also had limited financial resources. Accordingly, Industries considered that there was a significant risk that the assets of Windward/Appvion would be insufficient to meet their obligations under the indemnities Industries believes it was granted.

75. In order to preserve the value of the assets within Windward, Industries applied to the High Court of Justice of England and Wales (the 'High Court') seeking to appoint a receiver over claims Industries considered Windward has against its former shareholder, Sequana S.A. ('Sequana') and the former directors of Windward, in relation to the dividend payments. Judgement was handed down on 21 November 2013, with the judge finding that, absent an appropriate undertaking from Windward that it would commence the claims in question, receivers should be appointed in order to commence the dividend claims in its name. Windward commenced its claim against Sequana and the former Windward directors on 9 May 2014. Industries filed its own direct claims seeking to recover the dividend payments from Sequana in both the High Court and before the Commercial Court of Nanterre, France, in December 2013.

## 30 Contingent liabilities and financial commitments continued

**Funding Agreement of 30 September 2014**

76. On 30 September 2014, Industries entered into the Funding Agreement with Windward, Appvion, NCR and BTI 2014 LLC (a wholly-owned subsidiary of Industries). Pursuant to the Funding Agreement, the English Indemnity Proceedings, Appvion Counterclaim and the NCR-Appvion arbitration described above were discontinued as part of an overall agreement between the parties providing a framework through which they would together fund the ongoing costs of the Fox River clean-up. Under the agreement, NCR has agreed to accept funding by BAT at the lower level of 50% of the ongoing clean-up related costs of the Fox River (rather than the 60% referenced above; this remains subject to an ability to litigate the extent to which a further 10% of the costs ought to be allocated at a later stage). In addition Windward and Appvion each committed to contribute to the funding – Windward has contributed US$10 million and Appvion will contribute up to a maximum of US$25 million respectively for each of Fox River and Kalamazoo River (see further below). The parties have also agreed to cooperate in order to maximise recoveries from certain claims that exist against third parties, including those claims which exist against Sequana (as referenced above). Any proceeds resulting from third-party claims will be applied to meet river clean-up costs first, thereby reducing Industries' obligations under the Funding Agreement and Industries then ranks first in the agreed repayment waterfall should surplus remain. Windward has provided Industries with an agreed direct indemnity to potentially cover shortfalls in recoveries by Industries against the amounts paid out. The Funding Agreement also assigned the claims which Windward has against Sequana, as well as certain claims against former advisers to Windward, to BTI 2014 LLC.

77. Sequana is seeking to challenge Windward's ability to enter into the Funding Agreement, on the basis of certain restrictions it alleges affect its ability to do so. The trial of this issue is scheduled to take place on 22 June 2015. The Funding Agreement contains provisions that mean that it will be set aside as between all of the parties to it if this challenge is successful, and the disputes between the parties described above will be revived.

78. The sums Industries has agreed to pay under the Funding Agreement are subject to ongoing adjustment, as clean-up costs can only be estimated in advance of the work being carried out and as certain sums payable are the subject of ongoing US litigation. In addition, Sequana's challenge referred to above is yet to be determined. Based on information currently at hand, Industries believes it may have a further exposure of some £177 million (as at 31 December 2014 and after payment of £56 million in 2014) in relation to clean-up related costs. Accordingly, Industries has retained a provision of £177 million, after releasing £27 million from the provision created in 2011 to the Income Statement as an adjusting item – see note 22 'Provisions'.

**Kalamazoo**

79. Industries is aware that NCR is also being pursued by Georgia-Pacific, as the owner of a facility on the Kalamazoo River in Michigan which released PCBs into that river. Georgia-Pacific has been designated as a PRP in respect of the river.

80. Georgia-Pacific contends that NCR is responsible for, or should contribute to, the clean-up costs, because:

   a. a predecessor to NCR's Appleton Papers Division sold 'broke' containing PCBs to Georgia-Pacific or others for recycling;

   b. NCR itself sold paper containing PCBs to Georgia-Pacific or others for recycling; and/or

   c. NCR is liable for sales to Georgia-Pacific or others of PCB-containing broke by Mead Corporation, which, like the predecessor to NCR's Appleton Papers Division, coated paper with the PCB containing emulsion manufactured by NCR.

81. A full trial on liability took place in February 2013. On 26 September 2013, the Michigan Court held that NCR was liable as a PRP on the basis that broke sales constituted an arrangement for the disposal of hazardous material for the purposes of CERCLA. The decision was based on NCR's knowledge of the hazards of PCBs from at least 1969, but the Court did not specify directly the entity(ies) whose broke sales form the basis of NCR's liability. NCR will have the ability to appeal the ruling once a final judgement has been entered or it has been otherwise certified for appeal.

82. The second phase of the Kalamazoo trial, scheduled to commence on 22 September 2015, will determine the apportionment of liability amongst NCR, Georgia-Pacific and the other PRPs (International Paper Company and Weyerhauser Company). Industries anticipates that NCR may seek to recover from Appvion and/or Industries 60% of any Kalamazoo clean-up costs for which it is found liable on the basis, it would be asserted, that the river constitutes a 'Future Site' for the purposes of the Settlement Agreement. Industries believes it may have defences to any such claim by NCR. The Funding Agreement described above does not resolve any such claims, but does provide an agreed mechanism pursuant to which any surplus from the valuable recoveries of any third-party claims that remains after all Fox River related clean-up costs have been paid and Industries and NCR have been made whole may be applied towards Kalamazoo clean-up costs, in the event that NCR were to be successful in any claim for a portion of them from Industries or Appvion. The quantum of the clean-up costs for the Kalamazoo River is presently unclear (as is the extent of NCR's liability in respect of such costs), but could run into the hundreds of millions of dollars.

83. As detailed above, Industries is taking active steps to protect its interests, including seeking to procure the repayment of the Windward dividends, pursuing the other valuable claims that are now within its control, and working with the other parties to the Funding Agreement to maximise recoveries from third parties with a view to ensuring that amounts funded towards clean-up related costs are later recouped under the agreed repayment mechanisms.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 30 Contingent liabilities and financial commitments continued

### General litigation conclusion

84. 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 judgement is entered against any of the Group's companies in any case, 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 judgement. In any event, the Group has the benefit of the RJRT Indemnification with regard to US litigation, excluding the litigation brought by the shareholders of Reynolds and Lorillard. 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 this and by the final outcome of any particular litigation.
85. Having regard to all these matters, with the exception of Fox River, 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.

### Tax disputes

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 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.

The following matters may proceed to litigation:

#### Brazil

The Brazilian Federal Tax Authority has filed claims against Souza Cruz seeking to reassess the profits of overseas subsidiaries to corporate income tax and social contribution tax. The first reassessment was for the years 2004–2006 in the sum of R$495 million (£119 million) to cover tax, interest and penalties. The second reassessment was for the years 2007 and 2008 in the amount of R$248 million (£60 million) to cover tax, interest and penalties.

Souza Cruz appealed both reassessments and the matters are at the second tier administrative appeal process. Regarding the first assessment the Souza Cruz appeal was rejected although the written judgment of that tribunal is still awaited. The appeal against the second assessment was upheld at the second tier tribunal and is closed. There is one further administrative appeal level before the matter enters the judicial system.

Souza Cruz received a further reassessment in 2014 for 2009 in the sum of R$219 million (£53 million) covering tax, interest and penalties and have appealed against the reassessment in full.

#### Canada

The Canada Revenue Agency (CRA) had challenged the treatment of dividend income received by Imperial Tobacco Canada Ltd (ITCAN) from its investments in fellow group subsidiaries. Following the outcome of other cases in Canada, CRA have decided not to pursue the matter. A refund of payments made by ITCAN to pursue the appeal has been received from the federal and provincial authorities, including interest, with CAD$53 million (£29 million) being refunded in 2014 and the final balance of CAD$10 million (£5 million) being received in January 2015.

#### South Africa

In 2011 SARS challenged the debt financing of British American Tobacco South Africa (BATSA) and reassessed the years 2006 to 2008. BATSA has objected to and appealed this reassessment. In 2014, SARS have also reassessed the years 2009 and 2010. BATSA have filed a detailed objection letter to the 2009/10 reassessments. Across the period from 2006 to 2010 the reassessments are for R1.74 billion (£96 million) covering both tax and interest.

The Group believes that the Group's companies have meritorious defences in law and fact in each of the above matters and intends to pursue each dispute through the judicial system as necessary. The Group does not consider it appropriate to make provision for these amounts assessed nor for any potential further amounts which may be assessed in subsequent years.

While the amounts that may be payable or receivable in relation to tax disputes 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.

### VAT and duty disputes

#### Bangladesh

The operating company received a retrospective notice of imposition and realisation of VAT and supplementary duty on low price category brands from the National Board of Revenue (NBR) for approximately £158 million. The company is alleged to have evaded tax by selling the products in the low price segments rather than the mid-tier price segments.

Litigation has proceeded during 2014. A High Court Order to conclude the NBR hearing in 120 days (by 24 March 2015) was served to the Commissioner on 24 November 2014. Hearings scheduled for January and February 2015 were postponed and a new date for the hearing of the case by the NBR has not been set. The Ministry of Law has issued an opinion in respect of retrospective claims, supporting the company's view.

## 30 Contingent liabilities and financial commitments continued

### Operating leases

Total future minimum lease payments under non-cancellable operating leases comprise leases where payments fall due:

| | 2014 £m | 2013 £m |
|---|---|---|
| **Property** | | |
| Within one year | **52** | 55 |
| Between one and five years | **117** | 114 |
| Beyond five years | **25** | 29 |
| | **194** | 198 |
| **Plant and equipment** | | |
| Within one year | **24** | 25 |
| Between one and five years | **40** | 40 |
| | **64** | 65 |

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 31 Interests in subsidiaries

### Subsidiaries with material non-controlling interests

Non-controlling interests principally arise from the Group's listed investments in Brazil (Souza Cruz SA) and Malaysia (British American Tobacco (Malaysia) Berhad) where the Group held 75% and 50% of the respective listed holding companies in both 2014 and 2013. The Group has assessed that it exercises de facto control over Malaysia as it has the practical ability to direct the business through effective control of the Company's Board as a result of the Group controlling the largest shareholding block in comparison to other shareholdings which are widely dispersed. Summarised financial information for these subsidiaries is shown below as required by IFRS 12 *Disclosure of Interests in Other Entities*. As part of the Group's reporting processes, both entities report consolidated financial information for their respective groups which have been adjusted to comply with Group accounting policies which may differ to local accounting practice. Goodwill in respect of Malaysia, which arose as a result of the acquisition of the Rothmans Group referred to in note 9, has not been included as part of the net assets below. No adjustments have been made to the information below for the elimination of inter-company transactions and balances with the rest of the Group.

| | Souza Cruz Group | | Malaysia Group | |
|---|---|---|---|---|
| Summarised financial information | 2014 £m | 2013 £m | 2014 £m | 2013 £m |
| Revenue | **1,602** | 1,838 | **485** | 504 |
| Profit for the year | **441** | 504 | **167** | 167 |
| *– Attributable to non-controlling interests* | ***111*** | *126* | ***84*** | *84* |
| Total comprehensive income | **380** | 388 | **167** | 167 |
| *– Attributable to non-controlling interests* | ***95*** | *94* | ***83*** | *83* |
| Dividends paid to non-controlling interests | **(98)** | (117) | **(82)** | (81) |
| **Summary net assets:** | | | | |
| Non-current assets | **399** | 424 | **55** | 61 |
| Current assets | **1,236** | 1,261 | **93** | 104 |
| Non-current liabilities | **(106)** | (118) | **(8)** | (7) |
| Current liabilities | **(899)** | (908) | **(131)** | (152) |
| Held for sale assets | **13** | – | **–** | – |
| Total equity at the end of the year | **643** | 659 | **9** | 6 |
| *– Attributable to non-controlling interests* | ***174*** | *181* | ***4*** | *3* |
| Net cash generated from operating activities | **380** | 588 | **182** | 166 |
| Net cash generated/(used) in investing activities | **211** | 61 | **2** | (5) |
| Net cash used in financing activities | **(474)** | (619) | **(195)** | (165) |
| Differences on exchange | **(31)** | (63) | **1** | (1) |
| Increase/(decrease) in net cash and cash equivalents | **86** | (33) | **(10)** | (5) |
| Net cash and cash equivalents at 1 January | **358** | 391 | **11** | 16 |
| Net cash and cash equivalents at 31 December | **444** | 358 | **1** | 11 |

### Other shareholdings

In Principal subsidiary and other Group undertakings, the Group discloses that it holds 85% (2013: 85%) of the equity shares of PT Bentoel Internasional Investama Tbk ('Bentoel'). In 2011, the Group sold 984 million shares, representing approximately 14% of Bentoel's share capital, for the purposes of fulfilling certain obligations pursuant to Bapepam LK (Indonesia) takeover regulations. The Group simultaneously entered into a total return swap on 971 million of the shares. As a consequence of this and for the duration of the swap, while the Group does not have legal ownership of these shares, it retains the risks and rewards which results in the Group continuing to recognise an effective interest in 99% of Bentoel's net assets and results.

## 32 Post balance sheet date announcement

On 23 February 2015, the Group announced that it is evaluating a possible public tender offer to acquire up to all of the 24.7% of Souza Cruz shares which are not currently owned by British American Tobacco and to delist the company.

An offer for Souza Cruz's shares would be at a price per share of R$26.75, to be paid in cash, in Brazilian reais, and to be reduced by any dividend paid by Souza Cruz. A price of R$26.75 per share would represent a premium of 30.0% to Souza Cruz's volume weighted average closing price over the three months to Friday 20 February 2015.

FINANCIAL STATEMENTS

# Five-Year Summary

| For the years ended 31 December | 2014 £m | 2013 £m | 2012 £m | 2011 £m | 2010 £m |
|---|---|---|---|---|---|
| **Income Statement** | | | | | |
| Gross turnover (including duty, excise and other taxes) | **42,506** | 46,185 | 45,872 | 46,123 | 43,855 |
| Revenue (after deducting duty, excise and other taxes) | **13,971** | 15,260 | 15,190 | 15,399 | 14,883 |
| Profit from operations | **4,546** | 5,526 | 5,372 | 4,675 | 4,278 |
| Adjusted profit from operations | **5,403** | 5,820 | 5,641 | 5,473 | 4,944 |
| Profit before taxation | **4,848** | 5,799 | 5,592 | 4,870 | 4,334 |
| **Profit for the year** | **3,393** | 4,199 | 4,076 | 3,321 | 3,092 |

| | 2014 pence | 2013 pence | 2012 pence | 2011 pence | 2010 pence |
|---|---|---|---|---|---|
| **Earnings per share** | | | | | |
| – basic unadjusted | **167.1** | 205.4 | 195.8 | 154.4 | 142.9 |
| – diluted unadjusted | **166.6** | 204.6 | 194.8 | 153.5 | 142.1 |
| – diluted adjusted | **208.1** | 216.6 | 205.2 | 191.9 | 173.4 |
| **Dividends declared per share** | **148.1** | 142.4 | 134.9 | 126.5 | 114.2 |

| At 31 December | 2014 £m | 2013 £m | 2012 £m | 2011 £m | 2010 £m |
|---|---|---|---|---|---|
| **Balance Sheet** | | | | | |
| Non-current assets | **17,035** | 17,363 | 18,141 | 18,624 | 19,203 |
| Current assets | **9,132** | 9,518 | 9,186 | 8,495 | 8,657 |
| **Total assets** | **26,167** | 26,881 | 27,327 | 27,119 | 27,860 |
| Owners of the parent | **5,510** | 6,634 | 7,472 | 8,167 | 9,206 |
| Non-controlling interests | **304** | 301 | 307 | 307 | 342 |
| **Total equity** | **5,814** | 6,935 | 7,779 | 8,474 | 9,548 |
| Non-current liabilities | **11,584** | 11,510 | 11,406 | 10,798 | 10,667 |
| Current liabilities | **8,769** | 8,436 | 8,142 | 7,847 | 7,645 |
| **Total liabilities** | **20,353** | 19,946 | 19,548 | 18,645 | 18,312 |
| **Total equity and liabilities** | **26,167** | 26,881 | 27,327 | 27,119 | 27,860 |

FINANCIAL STATEMENTS

# Half-Yearly Analysis 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 2014 £m | 31 Dec 2014 £m | 31 Dec 2014 £m |
| **Profit from operations** | **2,458** | **2,088** | **4,546** |
| Analysed as: | | | |
| – adjusted profit from operations | **2,665** | **2,738** | **5,403** |
| – restructuring and integration costs | **(179)** | **(273)** | **(452)** |
| – amortisation of trademarks and similar intangibles | **(28)** | **(30)** | **(58)** |
| – Fox River | **–** | **27** | **27** |
| – Flintkote | **–** | **(374)** | **(374)** |
| | **2,458** | **2,088** | **4,546** |
| Net finance costs | **(208)** | **(209)** | **(417)** |
| Share of post-tax results of associates and joint ventures | **364** | **355** | **719** |
| Analysed as: | | | |
| – adjusted share of post-tax results of associates and joint ventures | **349** | **363** | **712** |
| – issue of shares and change in shareholding | **16** | **(2)** | **14** |
| – restructuring and integration costs | **5** | **(1)** | **4** |
| – MSA receipts | **5** | **–** | **5** |
| – other | **(11)** | **(5)** | **(16)** |
| | **364** | **355** | **719** |
| **Profit before taxation** | **2,614** | **2,234** | **4,848** |
| **Earnings per share** | | | |
| Basic | **93.3p** | **73.8p** | **167.1p** |
| Diluted | **93.1p** | **73.5p** | **166.6p** |
| Adjusted diluted | **101.8p** | **106.3p** | **208.1p** |

| | 6 months to | | Year to |
|---|---|---|---|
| | 30 Jun 2013 £m | 31 Dec 2013 £m | 31 Dec 2013 £m |
| **Profit from operations** | 2,807 | 2,719 | 5,526 |
| Analysed as: | | | |
| – adjusted profit from operations | 2,944 | 2,876 | 5,820 |
| – restructuring and integration costs | (97) | (149) | (246) |
| – amortisation of trademarks and similar intangibles | (40) | (34) | (74) |
| – gain on deemed partial disposal of a trademark | – | 26 | 26 |
| | 2,807 | 2,719 | 5,526 |
| Net finance costs | (241) | (225) | (466) |
| Share of post-tax results of associates and joint ventures | 425 | 314 | 739 |
| Analysed as: | | | |
| – adjusted share of post-tax results of associates and joint ventures | 368 | 355 | 723 |
| – issue of shares and change in shareholding | 27 | (5) | 22 |
| – restructuring and integration costs | (2) | (2) | (4) |
| – MSA receipts | 34 | (1) | 33 |
| – other | (2) | (33) | (35) |
| | 425 | 314 | 739 |
| **Profit before taxation** | 2,991 | 2,808 | 5,799 |
| **Earnings per share** | | | |
| Basic | 106.6p | 98.8p | 205.4p |
| Diluted | 106.1p | 98.5p | 204.6p |
| Adjusted diluted | 109.1p | 107.5p | 216.6p |

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# Principal subsidiaries and other Group undertakings

## Principal subsidiary undertakings

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 subsidiary undertakings listed below are therefore the main corporate entities in those countries which, in aggregate, contributed over 80% of Group revenue and profit from operations.

| | % 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 |
| **Asia-Pacific** | |
| **Australia** | |
| British American Tobacco Australia Ltd. | 100 |
| **Bangladesh** | |
| British American Tobacco Bangladesh Company Ltd | 73 |
| **Indonesia** | |
| PT Bentoel Internasional Investama Tbk | 85 |
| **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 |
| **Philippines** | |
| British American Tobacco (Philippines) Limited (incorporated in the United Kingdom) | 100 |
| **South Korea** | |
| British American Tobacco Korea Ltd | 100 |
| British American Tobacco Korea Manufacturing Ltd | 100 |
| **Taiwan** | |
| B.A.T Services Ltd (incorporated in the United Kingdom) | 100 |
| **Vietnam** | |
| British-American Tobacco Marketing (Singapore) Private Limited (incorporated in Singapore) | 100 |

| | % equity shares held |
|---|---|
| **Americas** | |
| **Argentina** | |
| Nobleza-Piccardo S.A.I.C.y F. | 99 |
| **Brazil** | |
| Souza Cruz, S.A. | 75 |
| **Canada** | |
| Imperial Tobacco Canada Ltd | 100 |
| **Chile** | |
| British American Tobacco Chile Operaciones, S.A. | 99 |
| **Colombia** | |
| British American Tobacco Colombia S.A.S. | 100 |
| **Mexico** | |
| British American Tobacco Mexico, S.A. de C.V. | 100 |
| **Venezuela** | |
| C.A. Cigarrera Bigott Sucs. | 100 |
| **Western Europe** | |
| **Belgium** | |
| British American Tobacco Belgium S.A. | 100 |
| **Czech Republic** | |
| British American Tobacco (Czech Republic), s.r.o. | 100 |
| **Denmark** | |
| British American Tobacco Denmark A/S (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 |
| **Italy** | |
| British American Tobacco Italia S.p.A. | 100 |
| **Netherlands** | |
| British American Tobacco Nederland B.V. | 100 |
| British American Tobacco Western Europe Region B.V. | 100 |
| **Poland** | |
| British-American Tobacco Polska S.A. | 100 |
| British American Tobacco Polska Trading sp. zo.o. | 100 |
| **Romania** | |
| British-American Tobacco (Romania) Trading SRL | 100 |
| **Spain** | |
| British American Tobacco España, S.A. | 100 |
| **Switzerland** | |
| British American Tobacco Switzerland S.A. | 100 |
| **United Kingdom** | |
| British American Tobacco UK Ltd | 100 |

FINANCIAL STATEMENTS

# Principal subsidiaries and other Group undertakings

## Principal subsidiary undertakings continued

| | % equity shares held |
|---|---|
| **Eastern Europe, Middle East and Africa** | |
| **Algeria** | |
| British American Tobacco (Algérie) S.P.A. | 51 |
| **Egypt** | |
| British American Tobacco Egypt LLC | 100 |
| **Iran** | |
| B.A.T. Pars Company (Private Joint Stock) | 100 |
| **Kazakhstan** | |
| British American Tobacco Kazakhstan Trading LLP | 100 |
| **Morocco** | |
| British American Tobacco Exports B.V. (incorporated in the Netherlands) | 100 |
| **Nigeria** | |
| British American Tobacco (Nigeria) Ltd. | 100 |
| British American Tobacco Marketing Nigeria Ltd | 100 |
| **Russia** | |
| CJSC British American Tobacco – SPb | 100† |
| CJSC 'International Tobacco Marketing Services' | 100 |
| **South Africa** | |
| British American Tobacco Holdings South Africa (Pty) Ltd | 100 |
| **Turkey** | |
| British American Tobacco Tütün Mamulleri Sanayi ve Ticaret A.S. | 100 |
| **Ukraine** | |
| A/T B.A.T. – Prilucky Tobacco Co. | 99 |

Those subsidiary undertakings listed here that are 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 identified 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.

A complete list of Group subsidiary and associate undertakings will be attached to the next British American Tobacco p.l.c. annual return to the Registrar of Companies. A broader description of the Group's operations and sphere of activities can be found online at www.bat.com

## Principal joint operations

| | % equity shares held |
|---|---|
| **Asia-Pacific** | |
| **Hong Kong** | |
| CTBAT International Ltd | |
| – tobacco | 50 |

## Principal associate undertakings

| | | Latest published information | Total issued capital £m | % shares held |
|---|---|---|---|---|
| **Americas** | | | | |
| **United States of America** | | | | |
| Reynolds American Inc. | # Common Stock | 31.12.14 | * | 42.0 |
| – tobacco | # Preferred Stock | | ** | |
| **Asia-Pacific** | | | | |
| **India** | | | | |
| ITC Ltd | # Ordinary | 31.12.14 | 80 | 30.2 |
| – FMCG including tobacco | | | | |
| – agri-business | | | | |
| – paperboard, paper and packaging | | | | |
| – hotels | | | | |

# Listed overseas.

* As at 31 December 2014, Reynolds American Inc. had issued 531,283,513 shares (US$0.0001 Common Stock), of which the Group held 223,334,019.

** As at 31 December 2014, Reynolds American Inc. had issued 1,000,000 shares (US$0.01 Preferred Stock), in which the Group held no interest.

FINANCIAL STATEMENTS

# Independent auditors' report

## To the members of British American Tobacco p.l.c.

## Report on the Parent Company financial statements

### Our opinion

In our opinion, the Parent Company financial statements (the 'financial statements'):

– give a true and fair view of the state of the Parent Company's affairs as at 31 December 2014;

– 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.

### What we have audited

British American Tobacco p.l.c.'s financial statements comprise:

– the Parent Company Balance Sheet as at 31 December 2014; and

– the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

## Other required reporting

### Consistency of other information

#### Companies Act 2006 opinion

In our opinion, the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

#### ISAs (UK & Ireland) reporting

Under International Standards on Auditing (UK and Ireland) ('ISAs (UK & Ireland)') we are required to report to you if, in our opinion, information in the Annual Report is:

– materially inconsistent with the information in the audited financial statements; or

– apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Company acquired in the course of performing our audit; or

– otherwise misleading.

We have no exceptions to report arising from this responsibility.

### Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

– we have not received all the information and explanations we require for our audit; or

– 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 financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

### Directors' remuneration

#### Directors' Remuneration Report – Companies Act 2006 opinion

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

#### Other Companies Act 2006 reporting

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. We have no exceptions to report arising from this responsibility.

FINANCIAL STATEMENTS

# Independent auditors' report continued

## Responsibilities for the financial statements and the audit

### Our responsibilities and those of the Directors

As explained more fully in the 'Responsibility of Directors' set out on page 115 the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & 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 Parent 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.

### What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). 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.

We primarily focus our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## Other matter

We have reported separately on the Group financial statements of British American Tobacco p.l.c. for the year ended 31 December 2014.

**Paul Cragg (Senior Statutory Auditor)**
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom
25 February 2015

FINANCIAL STATEMENTS

# Balance Sheet – British American Tobacco p.l.c.

## At 31 December

| | Notes | 2014 £m | 2013 £m |
|---|---|---|---|
| **Assets** | | | |
| **Fixed assets** | | | |
| Investments in Group companies | 2 | **4,356** | 4,350 |
| | | **4,356** | 4,350 |
| **Current assets** | | | |
| Debtors | 3 | **9,116** | 8,101 |
| Cash at bank and in hand | | **4** | 3 |
| **Total current assets** | | **9,120** | 8,104 |
| **Total assets** | | **13,476** | 12,454 |
| **Equity** | | | |
| **Capital and reserves** | | | |
| Called up share capital | | **507** | 507 |
| Share premium account | | **74** | 70 |
| Capital redemption reserves | | **101** | 101 |
| Other reserves | | **90** | 90 |
| Profit and loss account | | **8,902** | 7,801 |
| after deducting | | | |
| – cost of treasury shares | | **(5,057)** | (4,309) |
| **Shareholders' funds** | 4 | **9,674** | 8,569 |
| **Liabilities** | | | |
| Creditors | 5 | **3,802** | 3,885 |
| **Total equity and liabilities** | | **13,476** | 12,454 |

The accompanying notes are an integral part of the Parent Company financial statements.

On behalf of the Board

**Richard Burrows**
Chairman
25 February 2015

FINANCIAL STATEMENTS

# 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 Principles.

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.

### 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 year, 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 the interim dividend distributions are recognised in the period in which the dividends are declared and paid.

Similarly, dividend income is recognised at the same time as the paying company recognises the liability to pay a dividend.

### 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(c) of FRS 8 from disclosing transactions with related parties that are wholly-owned subsidiaries of 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 initially recorded at fair value, and subsequently carried at this fair value less accumulated amortisation.

### Share-based payments

The Company has equity-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.

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.

### Future changes to accounting policies

The Financial Reporting Council has issued FRS 100 *Application of Financial Reporting Requirements*, FRS 101 *Reduced Disclosure Framework* and FRS 102 *The Financial Reporting Standard* applicable in the UK and Ireland. These standards will be applicable to all companies and entities in the UK and Republic of Ireland, other than listed groups which continue to report under EU-adopted International Financial Reporting Standards (IFRS), for accounting periods beginning on or after 1 January 2015.

FRS 100 sets out the overall financial reporting framework for companies in the UK and Ireland. FRS 101 applies to the individual financial statements of subsidiaries and ultimate parents, allowing them to apply the same accounting policies as in their listed group accounts, but with fewer disclosures. FRS 102 is a single financial reporting standard that applies to the financial statements of entities that are not applying EU-adopted IFRS, FRS 101 or the FRSSE. The primary statements of entities applying FRS 101 or FRS 102 would continue to follow the requirements of the Companies Act 2006.

The Company will adopt the accounting requirements of the reduced disclosure framework under FRS 101 in the Company's reporting for 2015. Given that the Company currently applies the fair value provisions of historic UK GAAP, the adoption of FRS 101 from 1 January 2015 will have no material impact on profit or equity.

## 2 Investments in Group companies

The Company's directly wholly-owned subsidiaries are British American Tobacco (1998) Limited, B.A.T. International Finance p.l.c., B.A.T Capital Corporation and BATMark Limited.

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.

| | 2014 £m | 2013 £m |
|---|---|---|
| **1 January** | **4,350** | 4,333 |
| Additions | **6** | 17 |
| **31 December** | **4,356** | 4,350 |

## 3 Debtors

| | 2014 £m | 2013 £m |
|---|---|---|
| **Amounts due from Group undertakings** | **9,116** | 8,101 |

Included within amounts due from Group undertakings is an amount of £9,036 million (2013: £8,024 million) which is unsecured, interest bearing and repayable on demand. The interest rate is based on LIBOR.

Amounts totalling £20 million (2013: £23 million) due from Group undertakings are unsecured, interest-free and repayable on demand.

Included in debtors are amounts of £60 million (2013: £54 million) falling due after one year, all of which is unsecured and interest-free.

## 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 2014** | **507** | **70** | **101** | **90** | **7,801** | **8,569** |
| Increase in share capital – share options | – | 4 | – | – | – | 4 |
| Profit for the year | – | – | – | – | 4,561 | 4,561 |
| Dividends and other appropriations ordinary shares | – | – | – | – | (2,712) | (2,712) |
| Consideration paid for share buy-back programme | – | – | – | – | (800) | (800) |
| Consideration paid for purchase of own shares held in employee share ownership trusts | – | – | – | – | (47) | (47) |
| Consideration received on the exercise of options over own shares held in employee share ownership trusts | – | – | – | – | 1 | 1 |
| Other movements | – | – | – | – | 98 | 98 |
| **31 December 2014** | **507** | **74** | **101** | **90** | **8,902** | **9,674** |

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 2014 is shown in note 8 to the Group financial statements and will be recognised in the financial statements for the year ended 31 December 2015.

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 2014 was £4,561 million (2013: £4,336 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 two employees at 31 December 2014 (2013: three). The costs of these employees are borne by another Group company.

Shareholders' funds are stated after deducting the cost of treasury shares which include £4,845 million (2013: £4,045 million) for shares repurchased and not cancelled and £212 million (2013: £264 million) in respect of the cost of own shares held in employee share ownership trusts.

During 2014, 23 million shares were bought back at a cost of £795 million (2013: 44 million shares at a cost of £1,500 million), excluding transaction costs of £5 million (2013: £9 million). The share buy-back programme was suspended from 30 July 2014. As at 31 December 2014 treasury shares include 6,357,513 of shares held in trust and 162,645,590 of shares repurchased and not cancelled as part of the Company's share buy-back programme.

Other movements in shareholders' funds principally relate to the release of treasury shares as a result of the exercise of share options.

FINANCIAL STATEMENTS

# Notes on the Accounts continued

## 4 Shareholders' funds continued

| Called-up share capital | Ordinary shares of 25p each Number of shares | £m |
|---|---|---|
| **Allotted and fully paid** | | |
| 1 January 2014 | **2,026,456,406** | **506.61** |
| Changes during the year | | |
| – share option schemes | **236,623** | **0.06** |
| **31 December 2014** | **2,026,693,029** | **506.67** |

| Called-up share capital | Ordinary shares of 25p each Number of shares | £m |
|---|---|---|
| Allotted and fully paid | | |
| 1 January 2013 | 2,026,267,623 | 506.57 |
| Changes during the year | | |
| – share option schemes | 188,783 | 0.04 |
| **31 December 2013** | 2,026,456,406 | 506.61 |

### Share premium

The increase of £4 million (2013: £3 million) relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration Report.

## 5 Creditors

| | 2014 £m | 2013 £m |
|---|---|---|
| Amounts due to Group undertakings | **9** | 101 |
| Loans due to Group undertakings | **3,617** | 3,617 |
| Sundry creditors | **176** | 167 |
| | **3,802** | 3,885 |

Amounts due to Group undertakings of £9 million (2013: £101 million) are unsecured, interest-free and repayable on demand.

Loans due to Group undertakings of £3,617 million (2013: £3,617 million) are unsecured, bear interest at rates between 1.87% and 1.92% (2013: 1.79% and 1.80%) and are repayable in 2017.

Included in sundry creditors is an amount of £47 million (2013: £47 million) due within one year and the remaining balance of £129 million (2013: £120 million) due after one year in respect of the fair value of guarantees.

## 6 Audit fees

| | 2014 | 2013 |
|---|---|---|
| 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 £11.1 billion (2013: £11.3 billion) and total borrowing facilities of £25.3 billion (2013: £17.4 billion).

There are contingent liabilities in respect of litigation in various countries (note 30 to the Group financial statements). In addition, the Company has cross-guaranteed the liabilities of the British American Tobacco UK Pension Fund which had a deficit according to the last formal triennial actuarial valuation in March 2014 of £264 million and which had a deficit on an IAS 19 basis at 31 December 2014 of £282,000 (2013: £75,169,000).

FINANCIAL STATEMENTS

# Shareholder and contact information

## Listings and shareholder services

### Premium 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 of Computershare Investor Services PLC for holders of shares on the UK share register; 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. The internet share dealing service is only available to shareholders resident in countries in the European Economic Area.

### 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 Proprietary Limited
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 MKT (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 brochure, We are BAT, 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 20 7511 7797; facsimile: +44 20 7540 4326
email: bat@team365.co.uk

Holders of shares held on the South Africa register can contact the Company's Representative office in South Africa using the contact details shown overleaf.

### Our website – www.bat.com

Access comprehensive information about British American Tobacco and download shareholder publications at the corporate website; visit the Investors section for valuation and charting tools and dividend and share price data and subscribe to the email alert services for key financial events in the British American Tobacco financial calendar; download the British American Tobacco Investor Relations app to access all the latest financial information on your iPad, iPhone or Android device.

### 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 PLC 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 1296 414 141
email enquiries: service@share.co.uk
website: www.share.co.uk

(The tax advantages of ISAs depend on your individual circumstances and the benefits of ISAs could change in the future. You should note that investments, their value and the income they provide can go down as well as up and you might not get back what you originally invested.)

### 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 20 7845 1000 or access online at www.bat.com/cgt

FINANCIAL STATEMENTS

# Shareholder and contact information continued

## Final dividend 2014 – dates in 2015

Please see 'Other corporate disclosures' (page 109) for further details.

| | |
|---|---|
| 26 February | Dividend announced (including amount of dividend per share in both sterling and rand, applicable exchange rate and conversion date – 24 February 2015; plus additional applicable information as required in respect of South Africa Dividends Tax) |
| 26 February to 20 March | From the commencement of trading on 26 February to 20 March 2015 (inclusive), no removal requests in either direction between the UK main register and the South Africa branch register will be permitted |
| 13 March | Last day to trade (JSE) |
| 16 March to 20 March | From the commencement of trading on 16 March to 20 March 2015 (inclusive), no transfers between the UK main register and the South Africa branch register; no shares may be dematerialised or rematerialised |
| 16 March | Ex-dividend date (JSE) |
| 19 March | Ex-dividend date (LSE) |
| 20 March | Record date (LSE and JSE) |
| 15 April | Last date for receipt of Dividend Reinvestment Plan (DRIP) elections (UK main register only) |
| 7 May | Payment date (sterling and rand) |

## Financial calendar 2015

| | |
|---|---|
| 29 April | Interim Management Statement |
| 29 April | Annual General Meeting<br>Milton Court Concert Hall,<br>Silk Street, London EC2Y 9BH |
| 29 July | Half-Yearly Report |
| 28 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 | £37.945 | £28.81 |
| JSE | R665.47 | R524.82 |

At 31 December 2014 there was a total of 2,026,693,029 ordinary shares in issue held by 119,800 shareholders. These shareholdings are analysed as follows:

### (a) by listing as at 31 December 2014:

| Register | Total number of shares | Percentage of issued share capital | Number of holders |
|---|---|---|---|
| UK | 1,713,604,682 | 84.55 | 47,441 |
| South Africa | 313,088,347 | 15.45 | 72,359 |

### b) by category of shareholder and size of shareholding as at 31 December 2014 (UK register) and 24 December 2014 (South Africa register), being the latest practicable dates on which equivalent information was available on both registers:

## 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 | 38,372 | 80.88 | 41,877,555 | 2.44 |
| Financial institutions/ Pension Funds | 274 | 0.58 | 3,809,176 | 0.22 |
| Nominee companies | 8,554 | 18.03 | 1,500,918,474 | 87.59 |
| Other corporate holders | 240 | 0.51 | 4,353,887 | 0.26 |
| Treasury Shares (UK) | 1 | <0.01 | 162,645,590 | 9.49 |

## South Africa 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 | 53,487 | 73.92 | 27,529,972 | 8.79 |
| Financial institutions/ Pension funds | 2,385 | 3.30 | 212,276,244 | 67.80 |
| Nominee companies | 14,206 | 19.63 | 62,475,446 | 19.96 |
| Other corporate holders | 2,281 | 3.15 | 10,806,685 | 3.45 |

## Combined Registers

| Category of shareholder | Number of holders | Percentage of total holders | Number of ordinary shares | Percentage of issued ordinary share capital |
|---|---|---|---|---|
| Individuals | 91,859 | 76.68 | 69,407,527 | 3.42 |
| Financial institutions/ Pension funds | 2,659 | 2.22 | 216,085,420 | 10.66 |
| Nominee companies | 22,760 | 19.00 | 1,563,393,920 | 77.14 |
| Other corporate holders | 2,521 | 2.10 | 15,160,572 | 0.75 |
| Treasury shares (UK) | 1 | <0.01 | 162,645,590 | 8.03 |

## UK Register

| | Number of holders | Percentage of UK ordinary share capital |
|---|---|---|
| 1 – 1,999 | 39,920 | 1.09 |
| 2,000 – 9,999 | 5,713 | 1.26 |
| 10,000 – 199,999 | 1,293 | 3.65 |
| 200,000 – 499,999 | 221 | 4.08 |
| 500,000 and over | 293 | 80.43 |
| Treasury shares (UK) | 1 | 9.49 |

## South Africa Register

| | Number of holders | Percentage of SA ordinary share capital |
|---|---|---|
| 1 – 1,999 | 65,743 | 6.55 |
| 2,000 – 9,999 | 4,747 | 6.03 |
| 10,000 – 199,999 | 1,686 | 21.06 |
| 200,000 – 499,999 | 102 | 10.28 |
| 500,000 and over | 81 | 56.08 |

## Combined Registers

| | Number of holders | Percentage of issued ordinary share capital |
|---|---|---|
| 1 – 1,999 | 105,663 | 1.94 |
| 2,000 – 9,999 | 10,460 | 1.99 |
| 10,000 – 199,999 | 2,979 | 6.34 |
| 200,000 – 499,999 | 323 | 5.04 |
| 500,000 and over | 374 | 76.66 |
| Treasury shares (UK) | 1 | 8.03 |

## Registered office

Globe House, 4 Temple Place, London WC2R 2PG
tel: +44 20 7845 1000, facsimile: +44 20 7240 0555
Incorporated in England and Wales No. 3407696

## Representative Office in South Africa

34 Alexander Street, Stellenbosch 7600, South Africa
PO Box 631, Cape Town 8000, South Africa
tel: +27 21 888 3194

## Secretary

Nicola Snook

## General Counsel

Neil Withington

## Investor relations

Enquiries should be directed to Mike Nightingale or Rachael Brierley
tel: +44 20 7845 1180

## Press office

Enquiries should be directed to Will Hill or Anna Vickerstaff
tel: +44 20 7845 2888
email: press_office@bat.com

## Auditors

PricewaterhouseCoopers LLP
1 Embankment Place, London WC2N 6RH

References in this publication to 'British American Tobacco', 'BAT, 'we', 'us', and 'our' when denoting opinion refer to British American Tobacco p.l.c. (the Company) (No. 3407696) and when denoting tobacco business activity refer to British American Tobacco Group operating companies, collectively or individually as the case may be.

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British American Tobacco

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