

Transforming Tobacco

Sustainability Report 2017



Introduction

British American Tobacco (BAT) is one of the world's leading consumer goods companies, with brands sold around the globe.

As a key strategic focus area, sustainability is crucial to the delivery of our Group strategy and is integrated across all areas of our business.

Our Sustainability Agenda was developed through a detailed materiality process, which we refreshed in 2017. It has identified three key areas that have the greatest significance to our business and our stakeholders:

- Harm Reduction;
- Sustainable Agriculture and Farmer Livelihoods; and
- Corporate Behaviour.

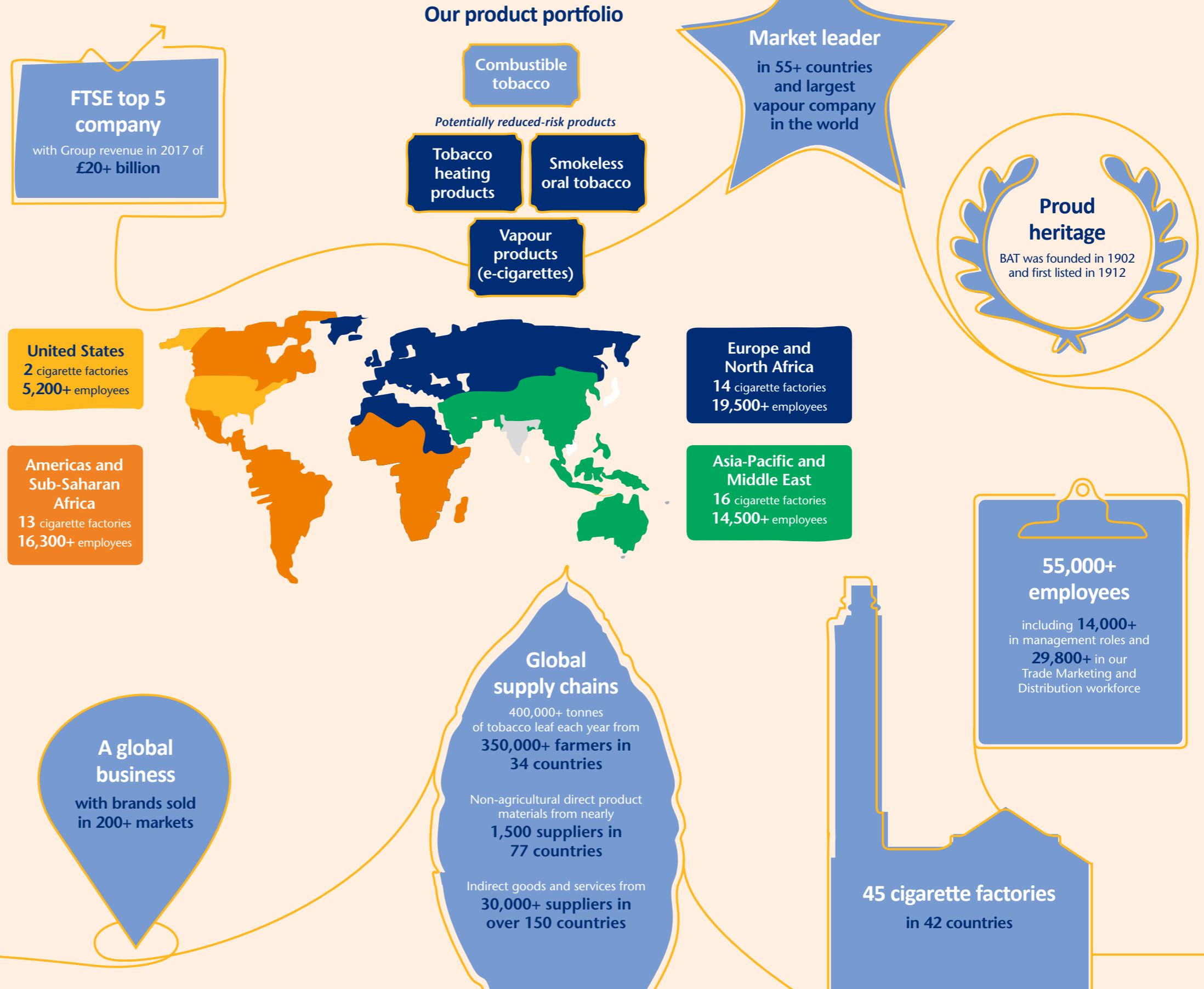
These are underpinned by our ongoing focus to reduce the environmental impact of our operations, and to build a diverse and engaging culture for our people.

This Report details our sustainability performance and how we are shaping the future and transforming tobacco to create shared value for our consumers, our shareholders and stakeholders across our value chain. All Group data and information relates to the calendar year 2017. Data from Reynolds American Inc., our US business that we acquired in July 2017, is excluded from the Report unless stated otherwise.

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We are BAT



Letter from our CEO

“I’ve been working at BAT for more than 30 years and have never been more excited about the future. Changing consumer demands and a greater awareness of how innovative new technology can contribute to harm reduction have combined to herald a new era for the industry. We want to lead and help shape this future – we call this *Transforming Tobacco*.”

For me, *Transforming Tobacco* is all about having a sustainable business for the long term – one that continues to deliver shared value for our shareholders, our consumers and wider society. At the heart of this is our long-held ambition to reduce the public health impact of our products.

This ambition was first articulated in our Group strategy in 2012, when we relaunched our new vision to be the world’s best at satisfying consumer moments in tobacco *and beyond*.

What’s changed in 2017? Firstly, our acquisition of Reynolds American has made us a stronger and truly global company – giving us the muscle to really lead the industry. Secondly, the reason that I am so optimistic, is that all the investment we’ve put behind potentially reduced-risk products is now coming to fruition.

Our Next Generation Products (NGPs) are available to consumers in 16 markets worldwide, and we plan to significantly increase our global reach in 2018. With our acquisition of Reynolds American, we have also significantly increased the size of our existing smokeless oral tobacco business.

This transformation is larger than just BAT. Lasting change will only be achieved by a combination of the commitment and product investment from companies like BAT, and the support of regulators through the establishment of sensible regulation promoting a spectrum of potentially reduced-risk products. We also need the objective and balanced support of public health bodies, politicians, media and academics in driving informed choice and consumer trust.

“If we can all work successfully together, we can drive a triple win scenario. Our consumers will have a range of potentially safer choices; our shareholders will own an even more sustainable and profitable business; and society could benefit from real progress in tobacco harm reduction.”

Transforming Tobacco isn’t just about harm reduction, though. To respond to evolving challenges and opportunities, we need to continue to focus on the other key areas of our Sustainability Agenda. These are fundamental imperatives that set the foundations for our business for years to come.

Sustainable Agriculture and Farmer Livelihoods

Even with the growth of our NGPs and progress in harm reduction, tobacco leaf remains at the core of our products, so our agricultural supply chain is central to the future of our business. We understand that there are many challenges in this area, so our ongoing work to support farmers and collaborate with others as part of wider, multi-stakeholder projects is helping to enhance livelihoods, protect human rights and lessen the environmental impacts of tobacco farming.

Close to my own heart is the fact that this year marks the 100-year anniversary of our integrated approach to working with tobacco farmers in my home country of Brazil. Souza Cruz, our Brazilian business, has pioneered the development of this approach, focused on increasing the prosperity of family farming and protecting the natural environment.

Indeed, our global Leaf Research and Development Centre was first formed in Rio de Janeiro in 1974, and today it’s developing innovative farming technologies and techniques for 90,000+ farmers worldwide – helping to advance sustainable agriculture and enable farming communities to thrive.

Corporate Behaviour

Over the last year, we’ve made enormous progress in building on, and reinforcing, our strong foundations. Our new *Delivery with Integrity* global compliance programme is providing our people with support, training and tools to act responsibly in everything they do, and to speak up if something doesn’t seem right.

“The standards and ethical values that guide us, including the ways in which we respect human rights and always market our products responsibly, are all key to the role we want to play in *Transforming Tobacco*.”

We’ve also made great strides in our ongoing work to further align our human rights management to the UN Guiding Principles, with strengthened due diligence processes helping to identify risks, drive continuous improvement and raise standards.

Reducing our environmental impacts and valuing our people

I personally feel very passionate about supporting our people and building a culture where they can develop and thrive – after all, they’re our greatest asset. Keeping all our people safe is central to this and it goes without saying that any loss of life is unacceptable. So, it deeply saddens me that one of our employees and eleven

contractors working for us lost their lives in 2017. Continuing our efforts to respond to the increasing security and road safety risks our people face will be a top priority for 2018.

Although tobacco and nicotine product manufacturing isn’t traditionally considered to be a heavily polluting industry, any business, especially one with the size and scale of BAT, needs to manage its environmental impact. We’re continuing to make steady progress against our operational environmental targets, and have already achieved a 46% reduction in CO2e emissions from our year 2000 baseline.

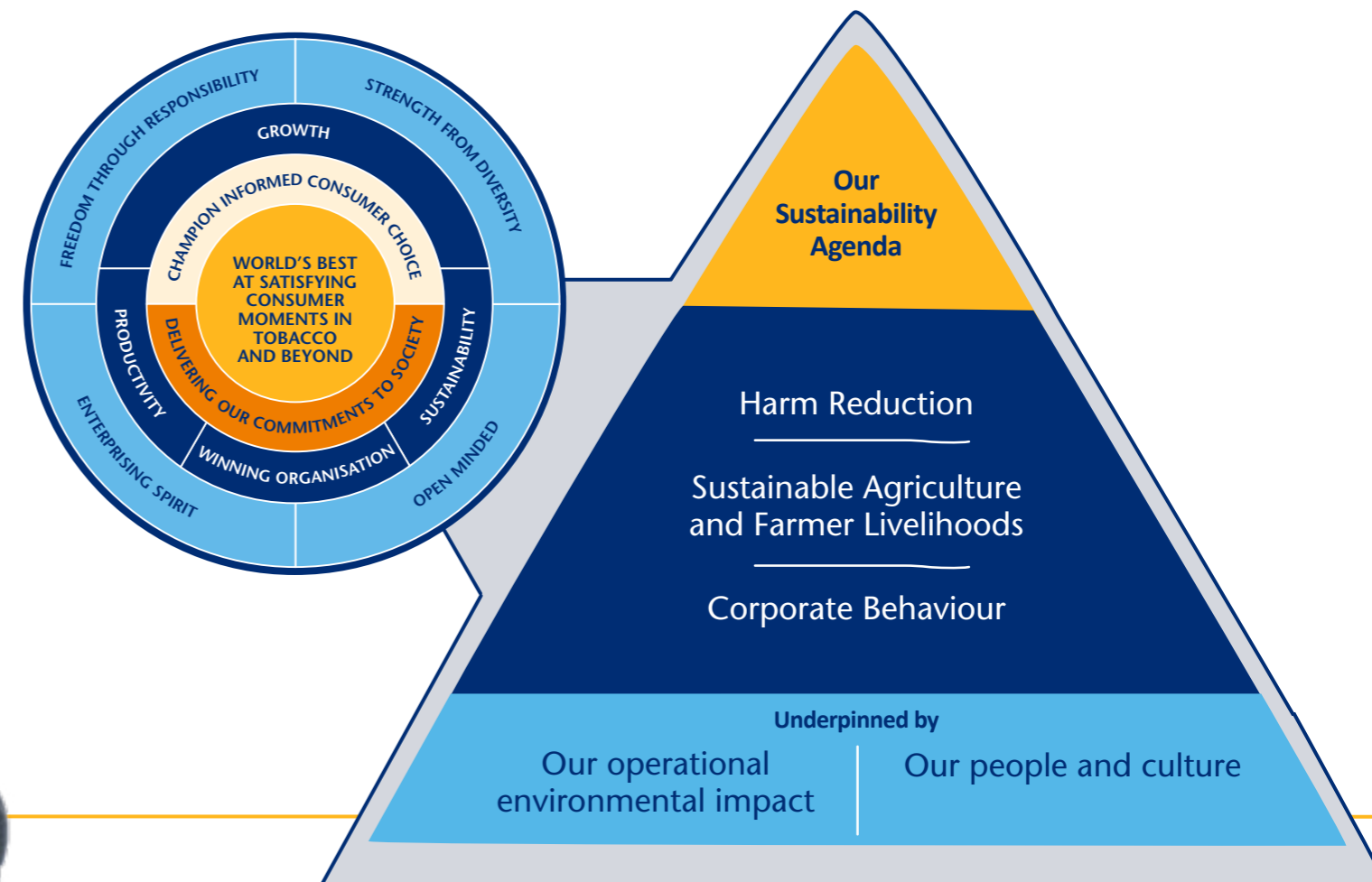
Future outlook

The tangible progress we’ve made to date gives us confidence to set clear ambitions for our future: by the end of 2018, our objective is to generate over £1 billion in revenue from NGPs and, by 2022, to have increased that figure fivefold to £5 billion. Taken together with the growing revenue from our oral tobacco business we fully expect that by 2030 a significant percentage of Group revenue will be generated by our portfolio of potentially reduced-risk products.

Transforming Tobacco is a journey we have been on for a long time. It is one we’re committed to lead.

Nicandro Durante

Chief Executive, March 2018



Our business and value chain

At the centre of our business is the manufacturing and marketing of high-quality combustible tobacco products and potentially reduced-risk products – comprising Next Generation Products (NGPs), like vapour products and tobacco heating products (THPs), alongside oral tobacco products like snus and moist snuff.

Our sustainable approach to sourcing, production, distribution and marketing helps us to create value for a wide group of stakeholders, from farmers to consumers.

We use our unique strengths, and employ our resources and relationships to deliver sustainable growth in earnings for our shareholders.

Our long-standing focus on sustainability and commitment to high standards has received notable independent recognition, including:



We were the tobacco industry leader in the 2017 Dow Jones Sustainability Indices (DJSI) and the only tobacco company to feature in both the Europe index and the prestigious World index.



For the second consecutive year, the Thomson Reuters Diversity & Inclusion Index ranked BAT as one of the most diverse and inclusive companies to work for.



BAT was just one of 13 companies to receive the prestigious Global Top Employer accreditation in February 2018. We were also recognised as a Top Employer in 35 countries.



In 2017, we received recognition from the PETA International Science Consortium Ltd for our significant contribution to help advance non-animal testing.

Our people and relationships

We employ over 55,000 people worldwide, to whom we paid over £2.6 billion in wages and benefits in 2017*.

Our workforce is diverse and multicultural, with 143 nationalities represented across the Group. We also have 31% female representation on our Board of Directors and 21% of our senior management positions are filled by women*.

Our business also supports thousands of people across our value chain, including farmers, suppliers, contractors, distributors and retailers, with whom we have excellent relationships as valued business partners.

Our companies have built close ties with the local communities where they operate and support a wide range of Corporate Social Investment (CSI) projects, often in partnership with external stakeholders including NGOs, governments, industry associations and peer companies. In 2017, we invested a total of £18.7 million in cash and a further £14.3 million in in-kind charitable contributions and CSI projects*.

We engage with a wide variety of stakeholders at local, regional and global levels, to understand their views and concerns, gain valuable feedback and respond appropriately. We also actively share our experience and expertise, and collaborate with others to develop joint solutions to common challenges. Recognising that all the engagement activities we undertake must be guided by high standards, all Group companies and employees are required to act in accordance with our Principles for Engagement.

* Including data from Reynolds American, to align with employee and financial reporting in our 2017 Annual Report.

Source

While the Group does not own tobacco farms, we buy more than 400,000 tonnes of tobacco leaf each year, grown by over 350,000 farmers in 34 countries, for our combustible tobacco products, our oral tobacco products and THPs.

The other materials used to make our products, such as cigarette paper and filters and NGP components and e-liquids, are sourced from nearly 1,500 direct materials suppliers. We also source other goods and services from over 30,000 indirect suppliers.

How we create value

- We invest over £60 million each year in our Leaf Research & Development (R&D) and in supporting over 90,000 farmers through our Extension Services of expert field technicians.
- The e-liquids used in our vapour products are made from medical grade nicotine sourced internally or from high-quality third-party manufacturers.
- Our Supplier Code of Conduct defines the minimum standards we expect, such as in relation to human rights, helping to raise standards across our supply chain, especially where our own standards exceed legal requirements.

Market

We offer adult consumers a range of products including cigarettes, fine cut tobacco, snus, moist snuff, vapour and THPs in a number of markets around the world.

How we create value

- By providing our consumers with a range of potentially reduced-risk products, we believe many millions of smokers will increasingly make the choice to switch and society could benefit from real progress in tobacco harm reduction.
- Our marketing is aimed at adult consumers only and we work with retailers to prevent underage access.
- We provide clear and meaningful information about the risk profiles of our different product categories, enabling consumers to make an informed choice.
- In 2017, the total tax contribution of the Group was £37.4 billion*, including tobacco excise, employee taxes, VAT and other sales taxes paid.

Produce

We manufacture high-quality tobacco products in manufacturing facilities all over the world. We also ensure these products and the tobacco leaf we purchase are in the right place at the right time. Our NGPs are manufactured in a mix of our own and third-party factories. We continue to work to ensure that we use natural resources as efficiently as possible, to reduce our environmental impacts.

How we create value

- In 2017, we had 45 factories across the globe producing cigarettes*. Environmental factors are a key consideration in the design of new factories and in making our existing factories more efficient, with a focus on CO₂e emissions, energy, water and waste.
- For our NGPs, we expect our contract manufacturers to comply with the same high standards that exist on our own sites.

Consumers

We place adult consumers at the heart of our business.

We invest in world-class research to understand changing consumer preferences and buying behaviour. This drives our leaf sourcing, product development, innovations, brands and trade activities.

We aim to satisfy consumers with a range of inspiring products across the risk spectrum, and address expectations about how we should market them.

Distribute

We distribute our products around the globe effectively and efficiently using a variety of different distribution models suited to local circumstances and conditions. Around half of our global cigarette volume is sold by retailers, supplied through our direct distribution capability or exclusive distributors. We continuously review our route to market for all our product categories, including our relationships with wholesalers, distributors and logistics providers.

How we create value

- Our global footprint and direct distribution capability enables our products and new innovations to be distributed to markets quickly and efficiently.
- Our driver safety and security programmes continue to focus on safeguarding the health and safety of our Trade Marketing and Distribution fleet.
- We're working to address the environmental impact of our fleet through standards for fuel efficiency, engine size and emissions, as well as optimising load capacity to reduce the number of journeys.

Resources for success

Innovation

We make significant investments in R&D to deliver innovations that satisfy or anticipate consumer preferences and generate growth for the business across all categories. The main focus of this investment is in our NGPs, such as vapour products and THPs.

Since 2012, we have invested approximately US\$2.5 billion* in the development and commercialisation of potentially reduced-risk alternatives to smoking. We also continue to develop innovations for our conventional cigarettes, such as capsule products, additive-free products and resealable pack technology.

World-class science

We have an extensive scientific research programme in a broad spectrum of scientific fields, and we actively engage with a wide range of scientific and public health stakeholders.

We're transparent about our science and publish details of our research programmes on our dedicated website, bat-science.com, and the results of our studies in peer-reviewed journals, as well as presenting widely at international scientific conferences.

We follow high standards and codes of conduct for all our research, collaborations, funding and clinical studies, detailed at bat-science.com/standards.

We welcome debate and scrutiny. The doors to our R&D centre are always open and we regularly host scientists, officials and journalists from across the world. You can also take a video tour inside our state-of-the-art labs and meet some of our scientists at bat.com/labtour.

Harm Reduction

We are committed to working to reduce the public health impact of smoking, through offering adult consumers a range of potentially reduced-risk products.

What are the issues and why are they important?

The key issue for our business is the real and serious health risks of smoking. So harm reduction is about providing adults, who continue to smoke, with a choice of less risky sources of nicotine.

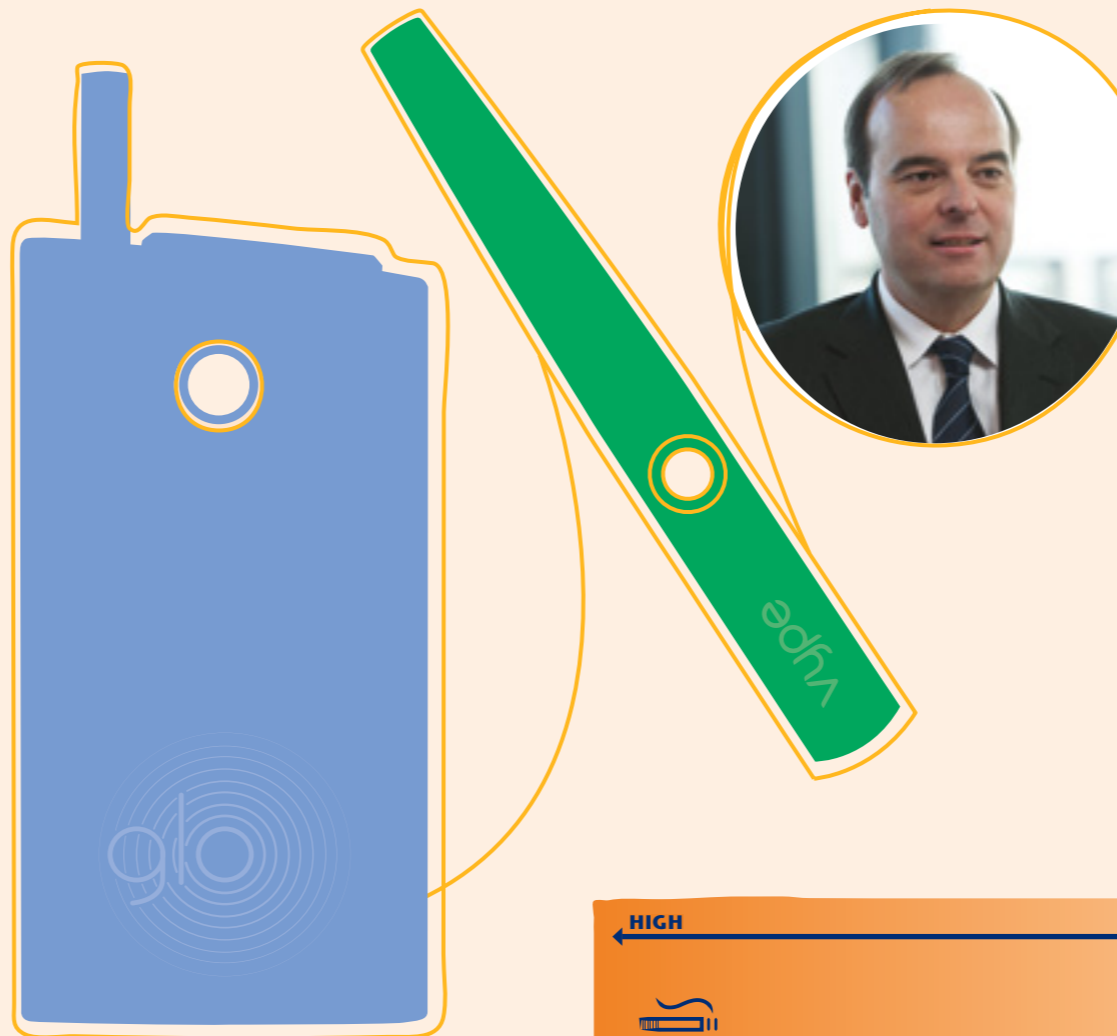
The advent of new and better consumer technologies has enabled the development of alternative Next Generation Products (NGPs), such as vapour products and tobacco heating products. In order to fully realise their harm reduction potential, sensible regulation is needed to enable growth and accessibility, as well as the objective and balanced support of public health bodies, politicians, media and academics in driving informed choice and consumer trust.

If we can all work successfully together, we can drive a triple-win scenario where our consumers will have a range of potentially safer choices; our shareholders will own an even more sustainable and profitable business; and society could benefit from real progress in tobacco harm reduction.

The most important issues for our business and stakeholders

- Health impacts of our products
- Consumer information on product health risks, including the reduced-risk potential of NGPs
- Consumer accessibility to potentially reduced-risk products
- Ethics/credibility of industry scientific research

→ Find out how we identified these issues on page 36.



Andrew Gray, Chief Marketing Officer

“At BAT, we have been clear for many years that our business needs to be built on outstanding products, informed consumer choice and a drive towards a reduced-risk portfolio. More choice, more innovation, less risk.

Today we are entering the most dynamic period of change our industry has ever encountered. An unprecedented confluence of technology, societal change and public health awareness has created a unique opportunity: to make a quantum leap forward in our long-held ambition to provide our consumers with lower risk tobacco and nicotine choices.

We are fully committed to leading this transformation.”

Understanding the relative risks of our products

It is widely accepted that most of the harm associated with smoking is caused by inhaling the smoke produced by burning of tobacco. Our products that involve no combustion release far fewer and lower levels of toxicants compared to conventional cigarettes and have the potential to be significantly less harmful to health. That is why we are dedicated to the development and sale of products that provide the enjoyment of smoking without burning tobacco.



Our strategic approach

We're responding to these issues with a strategy focused on transforming tobacco by offering adult consumers a choice of products with potentially reduced risk.

Developing industry-leading potentially reduced-risk products and increasing their availability by expanding to new markets

Leading innovation
→ Page 8

Conducting scientific research to build the evidence needed to demonstrate the reduced-risk potential of our products

Cutting-edge science
→ Page 10

Engaging for, and collaborating on, the establishment of sensible regulation which promotes the growth of all types of reduced-risk products

Enabling responsible growth
→ Page 12

This approach is underpinned by well-established policies, standards and procedures:

- ✓ **NGP safety and quality standards – bat.com/productstandards**
- ✓ **Standards and Codes of Conduct for scientific collaborations and funding – bat-science.com/standards**
- ✓ **Information on the health risks of our products – bat.com/health**
- ✓ **Marketing Principles – bat.com/imp**

UN Sustainable Development Goals (SDGs)

We see a clear alignment between the SDGs and our own harm reduction priorities, specifically:

3 GOOD HEALTH AND WELL-BEING

Our *Transforming Tobacco* journey reflects our commitment to harm reduction and to offer consumers a choice of potentially less harmful tobacco and nicotine products.

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

We continue to push the boundaries of innovation with our Next Generation Products, based on sound science and leading technology.

17 PARTNERSHIPS FOR THE GOALS

We can only achieve real transformation through working together, and with the support of governments, public health bodies and other stakeholders.

¹ The positioning of products on this continuum is based on a number of published studies and is intended to provide an indication of the respective levels of harmful toxicants present in cigarette smoke, which the World Health Organization recommends to reduce. With the exception of nicotine replacement therapy products, which are widely accepted as being less harmful than conventional cigarettes, the respective positions of the product categories on this continuum is not intended to signify, and does not necessarily mean, that the relevant product is less harmful to health than another product on the continuum.

→ Find our goals and performance indicators on page 34.



Leading innovation

Consumer tastes in the tobacco and nicotine space are evolving. It is only by making available a wide range of innovative product choices that we can address these many and varied preferences and help millions of smokers to make the choice to switch to potentially reduced-risk products. We are continuing to push the boundaries of innovation, with new products based on sound science, leading technology and deep insights into societal trends and consumer thinking.

Product innovation

Since 2012, we have invested approximately US\$2.5 billion in developing and commercialising our range of Next Generation Products (NGPs), such as vapour products and tobacco heating products (THPs).



US\$2.5 billion invested in developing and commercialising NGPs since 2012

Following our 2017 acquisition of Reynolds American, not only have we become the world's largest vapour company, but we have also significantly increased the size of our existing oral tobacco business with the addition of leading snus and moist snuff brands in the US. In addition, we now have a nicotine replacement therapy gum, under the Zonnica brand, available in approximately 40,000 retail outlets across the US.

But to truly lead this transformation, we must win the technology race, so our research and development (R&D) investment, led by many hundreds of scientists across the world, is predominately focused on developing our pipeline of potentially reduced-risk products. As part of this, our R&D has undergone major changes in recent years, embracing new technology, methodologies and consumer trends. We've also recruited many new scientists, technologists and innovators from other sectors, blending this new expertise with 60 years' experience of tobacco research, as well as the skills and support of external partners.

We have a pipeline of innovative products including a new carbon tip THP, which we will consumer test in 2018. A new generation of our hybrid iFuse THP is in development, which will have a more authentic tobacco flavour, and our new Vype ePen will be launched in 2018.

In addition, one of our US subsidiaries has submitted applications to the US Food and Drug Administration (FDA) for the designation of Camel Snus as a 'Modified Risk Tobacco Product'; as well as an FDA 'substantial-equivalence application' for its improved Eclipse THP.

Growing our market reach

Simply developing potentially reduced-risk products isn't enough to realise our harm reduction objectives – we need to make them available to adult smokers in as many markets as possible, including emerging economies. By the end of 2017, in addition to our oral smokeless products in Sweden, Norway and the US, our NGPs were available in 16 markets worldwide, as well as airport duty-free shops. We plan to significantly increase our global reach in 2018. We are launching as fast and as sensibly as we can, and have prioritised markets with the right regulatory environments and where consumer awareness and demand are greatest.

To enable this, we're engaging with stakeholders around the world – from governments, regulators and public health bodies to consumers and the media – to help create appropriate regulatory and market conditions for the successful introduction of NGPs.

For example, to prepare for the launch of our glo tobacco heating product in South Korea in 2017, we worked to raise consumer and public health awareness through a wide range of channels. This included an interview with Dr Chuan Liu, one of BAT's leading scientists from our R&D in the UK, in a daily Korean newspaper to explain the results of our scientific research into glo; as well as features on a popular podcast channel, and engagement with regulators, journalists and key opinion leaders.

Growing our market reach means a lot of practicalities to work on too, such as establishing flagship stores, educating and training our existing retailers on the new products, and setting up websites for online sales with robust age verification in place to meet our digital marketing standards. We are also expanding some of our factories for NGP manufacturing, including the 2017 construction of two new facilities at our Sacheon factory in South Korea to manufacture Neostiks – the specially designed tobacco sticks for glo.



In 2018, our aim is to double our NGP revenue to £1bn and, by 2022, to have increased it to £5bn.



By the end of 2017, our potentially reduced-risk products were available in:

- Vapour products
- THPs
- Snus
- Moist snuff
- Nicotine replacement therapy

A selection of our potentially reduced-risk products:



Tobacco heating products

Smokeless oral tobacco

Vapour products

Largest vapour company in the world

If BAT is serious about harm reduction and transforming tobacco, why don't you stop selling cigarettes?

It is clear that conventional cigarettes will remain a key part of our business for many years to come and will continue to provide a vital source of investment in our NGPs.

We don't believe that stopping cigarette sales now would be commercially sensible or practical. The ongoing consumer demand for these products would either transfer straight to our competitors or, more worryingly, the black market; and, in many markets, there are still real regulatory obstacles to launching NGPs.

This is why, alongside our commitment to the transformation of our business, we also remain committed to our combustible tobacco business during this transformation.

Cutting-edge science

BAT and Reynolds American share a tradition of world-leading scientific research and, following the acquisition, we are at the forefront of developing a new generation of alternatives to cigarettes, and pioneering new scientific methods to evaluate their harm reduction potential.

**Dr David O'Reilly,
Group Scientific
and R&D Director**



“There's been a transformation in our research and development over the last five years, taking us from a fairly simple and stable product into a fast-moving consumer technology world. That's meant continually pushing the boundaries of our research to build the science base needed to determine reduced health risks. I'm confident in the credibility and quality of our science – we welcome open debate and scrutiny, and are passionate about working with others to take it forwards.”

We are using this framework to evaluate our NGPs, and have so far completed studies for both our Vype ePen and our glo tobacco heating product (THP). Our series of scientific papers for Vype ePen, published in 2017², is the most comprehensive published dossier of scientific data on a single vapour product to date. The results reveal the relatively simple composition of the vapour compared to cigarette smoke, with fewer and lower levels of toxicants. This vapour has little or no adverse impact on human cells in certain lab-based tests, and effectively delivers nicotine to consumers, indicating that it's a viable alternative to smoking.

Our studies on glo³ demonstrate similar results to Vype ePen and, in 2017, we also completed a short-term clinical study on glo in Japan, involving 180 participants. The results reveal that when smokers switch from cigarettes to glo, their exposure to smoke toxicants is significantly reduced and, in some cases, to levels comparable to those seen in people who quit smoking completely. We have submitted these results to a peer-reviewed journal and expect the article to be published in 2018.

While the results of our research are very encouraging, more is needed to understand the longer-term impact of using NGPs. That's why we're now embarking on one of our most ambitious and large-scale clinical studies, following hundreds of consumers in the UK for a full year, to look at whether switching to an NGP is as good as quitting smoking, in terms of reducing toxicant exposure and the potential impact on health.

Best practice standards for our scientific research

- All our clinical studies are approved by the relevant independent ethics committees before initiation.
- The majority of our product testing is through independent scientific laboratories and research organisations.
- We submit the results of our research to peer-reviewed scientific journals, irrespective of the findings, which involves an assessment by independent experts to determine whether it is of sufficient quality to be published.

For more information see
bat-science.com/standards

Scientific evaluation of risk reduction

No tobacco or nicotine product is 100% safe and, if you want to be totally risk free, you shouldn't use them. But the principle of harm reduction is that, compared to continued cigarette smoking, it is better to switch to a reduced-risk alternative. We think a consistent approach to evaluating new products is essential to demonstrating their reduced risk potential and to building trust and confidence among consumers, regulators and the public health community.

We use a wide range of analytical techniques, specialised laboratory technology and expertise to test our products to ensure high standards of consumer safety and product quality. We've also developed a framework of scientific tests to assess the reduced-risk potential of Next Generation Products (NGPs) relative to smoking cigarettes. This includes testing everything from how consumers use a product and the content of the vapour it produces, to the biological impact of the vapour on cells in laboratory tests and, ultimately, the likely impact of the availability of that product on consumer health.

Independent evidence

There have been strongly held views and much debate on the potential risks and benefits regarding these products, alongside a growing body of independent scientific evidence, much of which supports the findings of our own research.

Smokeless oral tobacco

Having been in use for decades, there is well-established epidemiological evidence to determine the long-term health risks of these type of products. A number of independent health studies have shown Swedish-style snus to be significantly less harmful than smoking. Moist snuff also demonstrates reduced risk compared to smoking, but can have a wider potential range of toxicant emissions compared to snus.

Vapour products

These products haven't been in use long enough to generate long-term epidemiological evidence, but there is a growing body of independent studies and reports by public health bodies that agree the evidence to date indicates a significant reduction in risk compared to continued cigarette smoking.

However, there continue to be concerns about long-term health risks, as well as the potential for alternative products to be a gateway into smoking, particularly for young people. Below you will find extracts from a selection of highly respected studies and reports that begin to examine these concerns, including:

The question of whether vapour products are safer than cigarettes

- A review by Public Health England (PHE), an executive body of the UK Department of Health, concluded that: “Based on current knowledge, stating that vaping is at least 95% less harmful than smoking remains a good way to communicate the large difference in relative risk unambiguously so that more smokers are encouraged to make the switch from smoking to vaping. It should be noted that this does not mean e-cigarettes are safe”⁴.
- Researchers working in a number of US-based universities reported in a study that replacing smoking with vapour products in the US could, over a period of 10 years, lead to 6.6 million fewer premature deaths⁵.
- A review by the National Academies of Sciences, Engineering and Medicine (NASEM), a US-based organisation of leading researchers which analysed the results of more than 800 identified peer-reviewed scientific studies, concluded that “while e-cigarettes are not without health risks, they are likely to be far less harmful” than conventional cigarettes⁶.

In understanding if they can help smokers to quit

- A study by the University of California found that a substantial increase in vapour product use among US adult smokers was associated with a statistically significant increase in the smoking cessation rate⁷.
- A study by University College London, that followed over 170,000 individuals in England, found that vapour products can increase success rates for smokers who are attempting to quit⁸.

To establish if they can be a gateway into smoking

The NASEM report raised the possibility that “e-cigarettes might cause youth who use them to transition to use of combustible tobacco products”⁹. The issue of youth tobacco and nicotine use is concerning and something we take very seriously. The NASEM conclusion is at odds with the research results of other highly respected studies, as detailed below. We do believe, however, that more research is needed in this area.

- A UK-based study led by Professor Linda Bauld at the University of Stirling, which analysed surveys involving thousands of teenagers, concluded that “most e-cigarette experimentation does not turn into regular use, and levels of regular use in young people who have never smoked remain very low”¹⁰.
- A systematic review by the University of Victoria in Canada found “no evidence of any gateway effect whereby youth who experiment with vapour devices are, as a result, more likely to take up tobacco use”¹¹.
- The UK Royal College of Physicians has stated: “All the UK evidence, and almost all the international evidence, on the use of e-cigarettes by children and young people to date indicates that concerns about e-cigarettes helping to recruit a new generation of tobacco smokers through a gateway effect are, at least to date, unfounded”¹².

Tobacco heating products

So far, the majority of research into THPs has been conducted by the industry. We encourage independent research into this area and so welcome the publication of a new independent study¹³, commissioned by the UK Department of Health, which found that people using these products are exposed to around 50–90% less of the ‘harmful and potentially harmful’ compounds compared with conventional cigarettes. This analysis is consistent with our own findings that toxicant levels in glo emissions are around 90% less than cigarette smoke.

The 2018 PHE report also examined the existing peer-reviewed evidence on THPs and, while acknowledging the need for more research, found that: “Compared with cigarettes, heated tobacco products are likely to expose users and bystanders to lower levels of particulate matter and harmful and potentially harmful compounds. The extent of the reduction found varies between studies”¹⁴.



² Assessing modified risk tobacco and nicotine products: Description of the scientific framework and assessment of a closed modular electronic cigarette, Murphy, J. et al., Regulatory Pharmacology and Toxicology, August 2017.

³ Glo Special Issue: Assessment of tobacco heating product THP1.0. (a series of nine published study papers), Proctor, C. et al., Regulatory Toxicology and Pharmacology, 2017.

⁴ Evidence review of e-cigarettes and heated tobacco products, a report commissioned by Public Health England, McNeill, A. et al., January 2018.

⁵ Potential deaths averted in USA by replacing cigarettes with e-cigarettes, Levy D.T. et al., Tobacco Control, October 2017.

⁶ Public Health Consequences of E-Cigarettes, National Academies of Sciences, Engineering, and Medicine (NASEM), Washington, DC: The National Academies Press, January 2018.

⁷ E-cigarette use and associated changes in population smoking cessation: evidence from US current population surveys, Zhu S-H. et al., BMJ, July 2017.

⁸ Association between electronic cigarette use and changes in quit attempts, success of quit attempts, use of smoking cessation pharmacotherapy, and use of stop smoking services in England: time series analysis of population trends, Beard, E. et al., BMJ, September 2016.

⁹ NASEM, op. cit.

¹⁰ Young People's Use of E-Cigarettes across the United Kingdom: Findings from Five Surveys 2015-2017, Bauld, L. et al., International Journal of Environmental Research and Public Health, August 2017.

¹¹ Clearing the Air: A systematic review on the harms and benefits of e-cigarettes and vapour devices, O'Leary, R. et al., University of Victoria, Centre for Addictions Research of BC, January 2017.

¹² Nicotine without smoke: Tobacco harm reduction, report by the Tobacco Advisory Group of the UK Royal College of Physicians, April 2016.

¹³ Statement on the toxicological evaluation of novel heat-not-burn tobacco products, The Committee on Toxicity of Chemicals in Food, Consumer Products and the Environment (COT), Department of Health UK, December 2017.

¹⁴ Public Health England, op. cit.

Enabling responsible growth

This transformation is larger than BAT. Lasting change can only be achieved by a combination of the commitment and product investment from companies like BAT, and the support of regulators through the establishment of regulation that promotes a spectrum of potentially reduced-risk products. We also need the objective and balanced support of public health bodies, politicians, media and academics in driving informed choice and consumer trust.

Supporting regulation

The Next Generation Products (NGPs) market is relatively new and regulation is still in its early stages. Globally, there is a mix of attitudes between those regulators who aim to encourage products that are potentially safer for smokers, and some regulators who view them with greater scepticism – including some countries where they are banned.

The UK is an example of what can happen with the support of regulators and public health bodies. Major reports on the reduced-risk of vapour products by the likes of Public Health England and the Royal College of Physicians, combined with a progressive approach to regulation, have helped the UK become the largest vaping market in Europe, as well as having the second-lowest rate of smoking.

There are many stakeholders involved in this area, and only by working together can regulations be developed that have clear aims and don't inadvertently create new problems once they're introduced.

Taxation is one such potential problem. Increased excise can lead to reductions in demands for legal vapour products, with punitive, higher taxes artificially driving up prices, and discouraging smokers to switch.

We are not against regulation. In fact, we believe it is critical for creating a fertile ground for the responsible growth of potentially reduced-risk products, and encouraging their take-up by more smokers. But while we can offer alternatives to conventional cigarettes, it is down to governments and regulators to 'open the door' and support their successful introduction into new markets.

This is why we continue to actively engage with stakeholders around the world to advocate for proportionate regulation, which takes account of the relative risks but doesn't treat these products in the same way as conventional cigarettes.

We also contribute to the wider harm reduction debate and growing evidence base for NGPs, through openly sharing and communicating our scientific research with governments, the media, and the scientific and public health communities. For example, in 2017, we presented at over 20 international conferences, including those of the Society of Research in Nicotine and Tobacco, National Academy of Sciences and Society of Toxicology.

As with any emerging area, views are evolving constantly. In July 2017, the US Food and Drug Administration (FDA) released its tobacco and nicotine plan which, for the first time, acknowledged the risk continuum. This was a significant milestone in suggesting that NGPs could play a role in harm reduction policies in a cigarette market as large as the US.

"We must acknowledge that there's a continuum of risk for nicotine delivery... and we must recognise the potential for innovation to lead to less harmful products. We need to envision a world where less harmful alternative forms, efficiently delivering satisfying levels of nicotine, are available for those adults who need or want them."

Scott Gottlieb, US FDA Commissioner

However, despite this, some markets still have restricted availability of NGPs. For example, in Australia and Japan vapour products containing nicotine are only available via a medicinal route which means they are not readily available to smokers. Today, this is also the case in Canada, but the Canadian Government is in the midst of putting together a new regulatory framework for vaping products. To inform this, we have been advocating our views on an effective regulatory framework, as described in the adjacent graphic.

This is a fast-moving area and setting regulations in such a dynamic market is not easy. That's why engagement with industry, public health bodies and consumers is so important for helping to ensure the regulations work and benefit public health.

Our view on an effective regulatory framework for NGPs



Leading the way on global standards

Ensuring high quality and consumer safety is at the heart of how we design, develop and manufacture our products. We would like to see these high standards become the benchmark for the industry and future regulation. It is only with such consistent, universal standards for NGPs that consumers and regulators will get the assurances they need.

That's why we've been openly sharing our approach, contributing our expertise and participating as part of multi-stakeholder groups and consultations in the development of robust, industry-wide quality and safety standards for NGPs. We are also actively encouraging the industry, vapers and public health communities to collaborate in this process. We do this through our work with taskforces, such as those of the Cooperation Centre for Scientific Research Relative to Tobacco (CORESTA), and our presentations on the global implications of product standards at conferences, such as those of the Food and Drug Law Institute, and the Global Tobacco and Nicotine Forum.



National

From 2014, we worked alongside a multi-stakeholder group with the British Standards Institute, as well as its French counterpart AFNOR, on the development of the first national standards for vapour products in the UK and France, that were published in 2015 and 2016, respectively. In 2017, we contributed to the publication of the world's first industry standard for tobacco heating products in Russia.



Regional

Since 2016, we have shared our technical and regulatory expertise in the EU Standards body (CEN) technical committee. This is a platform of 13 European national standards bodies working with vapers, regulators, industry and public health organisations to publish the first European standards on vapour products in 2018.



International

Building on our contribution to CEN's work at a regional level, we are also engaging with the International Organization for Standardization (ISO), alongside CEN and CORESTA, to introduce the first international technical standards on vapour products in 2018.



Sustainable Agriculture and Farmer Livelihoods

We are committed to working to enable prosperous livelihoods for all farmers who supply our tobacco leaf.

What are the issues and why are they important?

Tobacco leaf remains at the core of our products, even with the growth of our Next Generation Products (NGPs), so the farmers who grow it are crucial to the continued success of our business.

Agricultural supply chains are particularly vulnerable to a range of different risks and tobacco growing is no exception.

Understanding the challenges, finding solutions and mitigating these risks are central to BAT's approach to sourcing tobacco leaf. Not doing so could affect the livelihoods of the farmers we work with around the world and the security of our long-term supply of tobacco leaf.

These issues also affect agriculture more broadly and pose a threat to current farming practices being able to meet the demands of the world's growing population.

The most important issues for our business and stakeholders

- Farmer livelihoods, rural poverty and food security
- Child labour and forced labour
- Health and safety, and labour rights
- Ageing farmer populations
- Environmental and climate change impacts, including deforestation, soil degradation and water scarcity

→ Find out how we identified these issues on page 36.

Our strategic approach

We're responding to these issues with a strategy that helps us manage the risks and challenges they present, as well as embracing new opportunities to ensure a sustainable future for farmers and their communities.



Advancing sustainable agriculture and supporting our farmers

Supporting our farmers
→ Page 16



Managing and monitoring supply chain risks and opportunities

Setting standards, driving change
→ Page 18



Working in partnership to solve complex problems

Part of a bigger solution
→ Page 20

This approach is underpinned by well-established policies, standards and procedures:

- ✓ Supplier Code of Conduct – bat.com/principles
- ✓ Policies, standards, guidelines and due diligence for leaf operations, third-party suppliers and contracted farmers – bat.com/farmers
- ✓ Group Strategic Framework for Corporate Social Investment – bat.com/csi
- ✓ Environmental management – bat.com/environment

UN Sustainable Development Goals (SDGs)

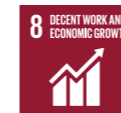
We see a clear alignment between the SDGs and our sustainable agriculture priorities, specifically:



We work together with our farmers and suppliers on enhancing farmer livelihoods.



We encourage our farmers to have diversified farms and crops, with over 90% of those we work with growing other crops alongside, or in rotation with, tobacco.



We're helping to improve farm working conditions, and to tackle child labour and forced labour.



We're working to protect and restore natural resources in farming communities.



Implementing long-term multi-stakeholder partnerships is central to our approach.



Alan Davy, Group Operations Director

BAT's commitment to leading and accelerating the transformation of the tobacco industry is demonstrated by the changes taking place across all areas of our business.

In our agricultural supply chain, this can be seen in how we're continually evolving our approach to respond to new challenges and opportunities, and building upon our experiences from over a century of working directly with farmers around the world.

Our investment in leaf research and development, our network of expert field technicians providing support to farmers, and our key programmes like Thrive help our farmers maximise the potential of their farms, and enhance the livelihoods and resilience of rural communities."

Our tobacco leaf supply chain

Traceability down to the farm level and centralised management of our tobacco leaf supply chain

400,000+ tonnes of tobacco leaf purchased each year



66% from 17 BAT leaf operations



34% from 20+ third-party suppliers

90,000+ farmers

260,000+ farmers

Reynolds American is included in the data as a third-party supplier for 2017 and will be integrated as a BAT leaf operation in 2018.



Find more detailed information in our Sustainable Agriculture and Farmer Livelihoods Focus Report
bat.com/sustainabilityfocus

→ Find our goals and performance indicators on page 34.

Supporting our farmers

We have a long and proud 100-year history in agriculture, working directly with farmers around the world to advance sustainable practices. While this undoubtedly brings benefits to our business in terms of securing our source of high-quality tobacco leaf, it also plays a significant role in protecting the environment and enhancing farmer livelihoods.

We invest over £60 million each year in our Leaf Research & Development (R&D) and supporting farmers through our Extension Services.

Leaf R&D and the science of agriculture

Through our global Leaf R&D, we develop new and innovative farming technologies and techniques which are rolled out to farmers as part of comprehensive agri-support packages.

For instance, by adapting and developing solutions and curing technologies to help farmers scale up production, we can help them increase their income, while at the same time reducing manual labour and minimising health and safety risks. This also helps to make farming more attractive to a younger generation, which is key for the long-term sustainability of agriculture.

This is also true of our work to develop new varieties of tobacco seeds, that offer greater yields and higher quality, as well as resistance to diseases. Currently, over 60% of tobacco leaf grown by our farmers is from these varieties, contributing to an increase in yields of up to 20% compared to traditional strains.

Increasingly, much of our work relates to wider, longer-term issues, particularly in relation to the effects of climate change, such as water scarcity or extreme weather events.

We've had success – in Mexico, for example – introducing technologies such as drip irrigation, which has been shown to increase water usage efficiency by up to 90%, as well as reducing soil erosion and salination, and ultimately boosting yields.

Deforestation, caused by farmers using virgin forest as a source of wood fuel for tobacco curing, is an issue we have been addressing for many years with great success. We are pleased to report that in 2017, 99% of farmers' wood fuel came from sustainable sources.

67,000+ farmers and rural community members benefited from our training and communications on human rights, child labour- and forced labour-related issues in 2017.

Extension Services and capacity building

We have a network of expert field technicians who provide on-the-ground Extension Services support, technical assistance and capacity building for all our 90,000+ directly contracted farmers.

They visit farms at every stage of the growing cycle, building trusted relationships and gaining unique insights into the challenges our farmers face, as well as the wider sustainability issues affecting the local community and landscape. This enables us to tailor our Extension Services to meet practical needs.

The services range from agreeing contracts at the beginning of each growing season, which mean a guaranteed income for farmers, to providing guidance and support around soil preparation, growing seedlings and cultivating other crops. Throughout the year we also run regular farmer training programmes focused on issues such as human rights, health and safety, soil and water management, and business and financial management skills.

For example, in Brazil, our Sustainable Farm programme provides business training focused on environmental, social and financial management issues. In Pakistan, our Farmer Loyalty programme is designed to support the strong relationship we have together and provide training on the latest thinking on good agricultural practices.

But this doesn't just apply to the 90,000 farmers we contract directly with. Our third-party suppliers use a similar model to provide guidance, technical assistance and capacity building for the 260,000+ farmers they contract.

Supporting farmers in this way helps to enhance their livelihoods and increases their resilience to the impacts of climate change, as well as other economic and social challenges.



"An efficient extension service system can reach smallholders with targeted, adapted advice that takes into account local environmental conditions, production practices and market access to help in decision-making and risk reduction. Extension service systems need to be adapted to local needs and build on farmer knowledge and exchange."

International Fund for Agricultural Development

Sustainable fuels for curing in Sri Lanka



Rasika Abeysekera, Leaf Area Manager

Our relationship with farming communities in Sri Lanka extends over a century and we currently source tobacco leaf from over 1,000 small-scale family farmers.

"Here in Sri Lanka, deforestation has long been a serious environmental issue."

Wood was often used as a fuel for curing tobacco, so in the early 90s we launched an initiative to find a sustainable alternative. The solution was rice paddy husks, which are readily available as a by-product from the rice industry.

We worked with local rice mills to secure a regular supply of husks, and provided training and demonstrations for farmers, successfully transitioning 100% to using husks, instead of wood, by 1997.

However, despite the environmental benefits of switching to the husks, the curing process itself for farmers was still very time-consuming and labour-intensive. So, since 2013, we have been working with farmers to upgrade their curing barns to an automated system, which, today, is used by over 70% of our farmers.

It's been great to see the positive benefits this has had for them: the barns are quicker and more efficient, reducing the amount of husks needed to cure 1kg of tobacco from 5.9kg to 4.4kg. We're currently working with the University of Moratuwa to research whether we can achieve even further efficiencies.

One issue with the barns is the amount of ash emissions they produce. In 2014, we established a partnership with a local inventor to develop a technology to trap the ash before it's released into the air. We worked with him on a prototype, which we tested with one of our farmers and then modified further with the addition of an advanced sprinkler system which uses 50% recycled water.

A pilot project has now been established, and initial testing has demonstrated a significant reduction in emission levels. Further testing and a validation study is now underway with the support of the Government's National Building Research Organisation, a leading R&D institute in Sri Lanka.

This initiative is a great example of collaborative working with local partners in order to find innovative and practical ways to protect the environment and make life easier for our farmers, as well as reduce their cost of production. It's something I feel very proud to have been involved with."

NGPs, tobacco leaf and farmer livelihoods

Although we are confident about the growth of our Next Generation Products (NGPs), for the foreseeable future we do not anticipate their success to immediately impact the farmers we work with for a number of reasons.

Our tobacco heating products, including our hybrid products like iFuse, use high-quality processed tobacco leaf, while our vapour products rely on the extraction of nicotine from tobacco plants. A significant proportion of our business will also remain in cigarettes for many years to come. Added to this, the farmers we work with already have highly diversified farms and crop production, with over 90% growing other crops alongside, or in rotation with, tobacco. This is something we have always encouraged as it helps farmers' resilience, enhances food security and preserves soil health.

If, at some stage in the future, we do find there is less overall demand for tobacco leaf, we have an established approach for working with impacted farmers to support a smooth transition into alternative agricultural livelihoods.



"Before we had barn automation, it was difficult and time-consuming to carry out curing with paddy husks. The new system saves money and, because I have less hassle with the process, I'm more confident about the final outcome too."

DP Wickramasinghe, BAT contracted tobacco farmer, Sri Lanka

Setting standards, driving change

Our tobacco leaf supply chain covers 34 different countries, involving 17 BAT leaf operations and over 20 third-party suppliers that together source from over 350,000 farmers. It is a truly global operation and one that, as with all crops, faces certain economic, environmental and social challenges.

We use two key programmes to ensure we effectively manage these risks, drive change and enhance farmer livelihoods.

Sustainable Tobacco Programme

We use the industry-wide Sustainable Tobacco Programme (STP) to conduct assessments and independent on-site reviews for all of our tier one tobacco leaf suppliers, including all our own leaf operations.

STP was introduced in June 2016 to unify the industry under a single programme. It replaced our previous Social Responsibility in Tobacco Production programme, which from 2000 until 2015 set the standard for all our leaf suppliers worldwide. STP's criteria are aligned to international standards, such as those of the International Labour Organization (ILO) and the UN Guiding Principles on Business and Human Rights.

All our leaf operations and tier one suppliers complete a comprehensive annual self-assessment around four key pillars: crop, environment, people and facilities, which cover issues such as sustainable water, soil, biodiversity and forest management, safe working conditions, and preventing child and forced labour. They must also show that they have good governance underpinning all four pillars and must agree to assess, identify and mitigate any significant risks that arise.

AB Sustain, a supply chain management company, independently reviews the self-assessments each year, and conducts independent on-site reviews every three years. These include visits to tobacco farms and in-depth analyses of suppliers' policies, processes and practices. By the end of 2018, 100% of our leaf operations and suppliers will have had on-site reviews by AB Sustain.

While we always try to use the results to support our suppliers in improving their performance, if they are unwilling to engage with us, we will terminate the business relationship.

“As a smaller, family-run company, we have found that STP has made a big difference for us in now having one comprehensive programme for the whole industry. It helps us to better understand our customers' expectations, and provides a straightforward system with definitive criteria and tools to manage the long-term sustainability of our operations.”

Ali Baki, Senior Leaf Director of our supplier in Turkey, TTL Tütün Sanayi ve Dış Ticaret A.Ş.



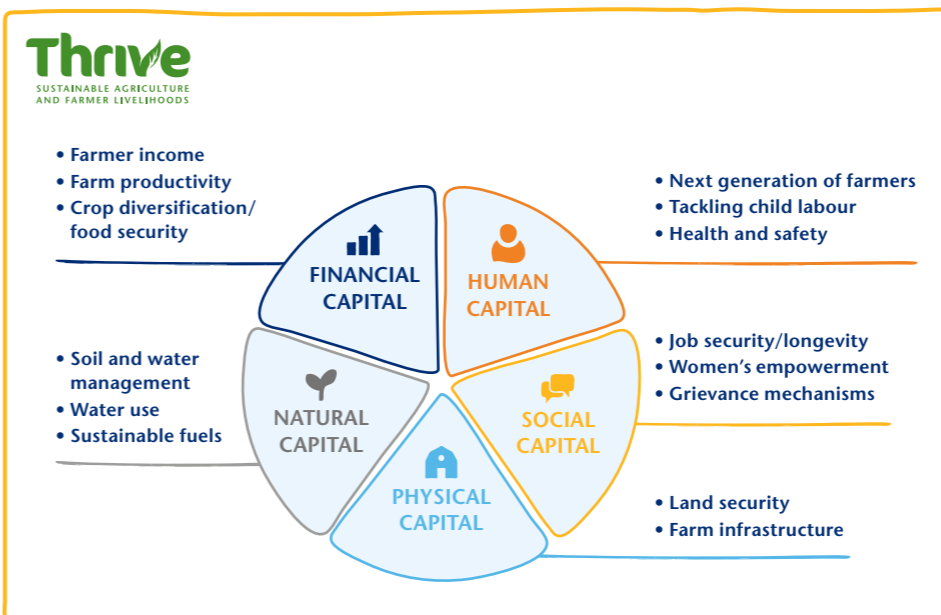
While supplier due diligence and assessments, as part of STP, are an important part of ensuring high standards and driving continuous improvement at supplier and farm level, we recognise that some of the challenges faced by farming communities are best addressed by a longer-term, collaborative approach.

Building on our history of working in multi-stakeholder partnerships, we have developed *Thrive*, a global programme which takes a more holistic approach to identifying and addressing root causes and long-term risks, such as rural poverty.

Thrive is based on the internationally recognised 'five capitals' framework, which works on the premise that to be sustainable, farming communities must be 'in credit' across five types of 'capital': financial, natural, physical, human and social. Strength in all five creates resilience and enables farmers and rural communities to prosper.

We have defined a set of 14 indicators to measure strength in each capital (see adjacent graphic), against which assessments have been completed for approximately 250,000+ farmers, covering nearly 80% of our total tobacco leaf purchases.

We are now using the results of these assessments to help us develop new partnerships and community-based projects, aligned with the five capitals, that will have a demonstrably positive impact for farmers and their communities.



Key insights from our Thrive assessments

- Tobacco is grown on an average of 40% of farmers' land, generating around 60% of their total farm income.
- 90% of our farmers grow other crops, including fruit, vegetables, wheat, maize, cotton and soy bean.
- Average farmer age is 43 years.
- Majority are small-scale family farms of one hectare or less.
- Approximately 130,000 school-age children live on the family farms.

Farm monitoring

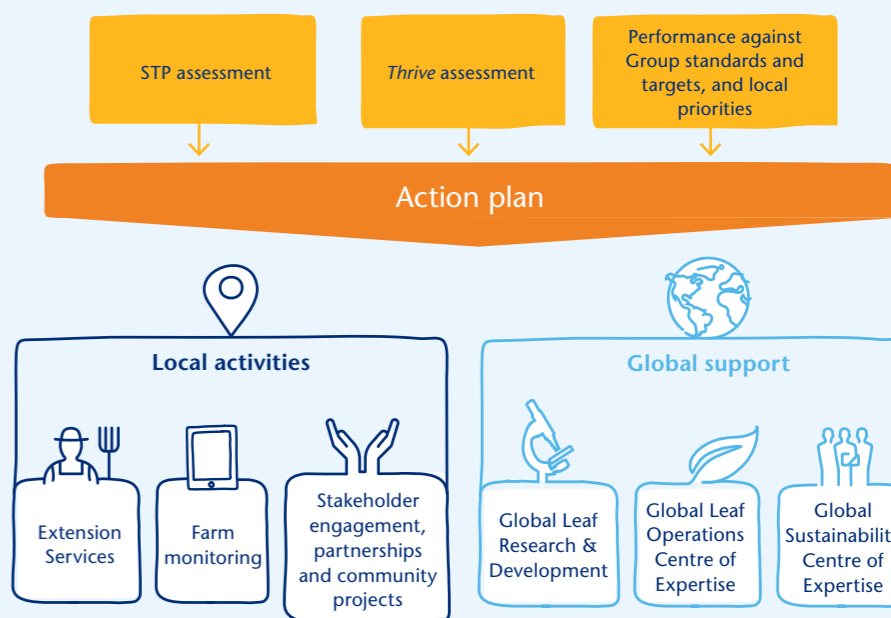
Farm monitoring is an important way of checking conditions on farms to ensure they're meeting our standards, as well as to gather data needed for STP and *Thrive* assessments. In the past, different methodologies have been used in different countries, so in 2017 we started piloting a new, more robust digital farm monitoring system.

This provides greater oversight and enables faster and more accurate reporting, so any issues can be quickly flagged up and addressed. Once the pilot is completed, we will review opportunities to roll out the system to our other leaf operations.

Taking action

The results of STP and *Thrive* assessments, together with insights gathered by our Extension Services through regular visits and farm monitoring, help us form a comprehensive picture of any immediate issues relating to our standards and performance, as well as longer-term challenges and opportunities affecting the sustainability of farming communities.

In response, each of our leaf operations, with support from our Leaf R&D and global experts, develop an overarching action plan.



26 independent on-site supplier reviews conducted by AB Sustain since STP was introduced, in **19** countries, covering **50%** of our total supply base.





Part of a bigger solution

We recognise that we are not experts in all areas and many of the wider, deep-rooted issues affecting the sustainability of farming can only be successfully addressed through collaborative, cross-sector solutions, involving all the community's stakeholders and covering the whole landscape.

For example, rural poverty and lack of easy access to basic services, such as clean water, electricity, schools and healthcare can lead to young people moving away from rural areas to find jobs in the cities. This could ultimately impact on the future of agriculture and, in turn, our supply chain, if fewer people choose farming as a career. But these are not issues which one company can address in isolation.

We already have a long history of working in partnerships and now our *Thrive* programme is helping to identify the most complex issues and inform the development of new long-term community-based, multi-stakeholder projects.

Local projects and partnerships

In 2017, we supported 121 community projects to promote sustainable agriculture and farmer livelihoods in 29 countries, including the US, through Reynolds American. These projects were focused on a range of issues such as child labour, afforestation, rural poverty, food security, clean water and sanitation.

For example, since 2001, our company in Mexico has partnered with the Government, the Rural Association of Collective Interest and local NGOs to prevent around 15,000 children of migrant farm labourers from being exposed to the risk of child labour.

Our afforestation programme in Kenya, in partnership with tobacco farmers, tree farmers and local government, has seen over 380,600 trees planted. We're also partnering with the County Government of Migori on a project to rehabilitate 42 hectares of the Agongo Hills, through planting 230,000 tree seedlings from a mixture of species.

In Pakistan, in partnership with provincial governments, we have provided over 6,000 people in remote rural villages with access to solar energy, and have also installed a new water irrigation system for farmers. Together with the local organisation Green Medical Services, our mobile doctor units provide free healthcare to over 70,000 rural people each year.

"I find it very encouraging to see how much more the industry is now working together, with such a strong focus on social, environmental, human rights and economic issues for farmers. We can't fix everything overnight, but I believe that by working together, continuous, incremental improvements can be achieved over time."

Clive Stewart, Head Agronomy Manager for our supplier, Mozambique Leaf Tobacco Ltda

A multi-stakeholder approach to encouraging the next generation of Brazilian farmers

Brazil is one of the largest tobacco growing countries in the world and around 30% of the total tobacco leaf purchased by the Group is from Souza Cruz, our Brazilian subsidiary, which directly contracts around 27,000 farmers. Souza Cruz has a long history of working in partnership with the industry, government, farmer associations and local NGOs, with a focus on increasing the prosperity of family farming and protecting the natural environment.

One such example is the *Growing Up Right* Institute, which was founded in 1998 as a partnership between the Interstate Tobacco Industry Union and associates, including Souza Cruz.

Alongside combating child labour, the Institute set out to address the issue of ageing farmer populations, by offering training and development opportunities to young people from rural areas.

In May 2016, it launched its Rural Professional Learning Programme, a year-long course delivered through partnerships with local municipalities, and certified by the Ministry of Labour.

Children from tobacco farms, aged between 14 and 18, take part as 'rural apprentices', and are selected on criteria based on social vulnerability and their risk of becoming involved in child labour. Regular school attendance is a prerequisite of the programme and apprentices are paid for a 20-hour week.

The programme is delivered locally in schools and on farms, with a focus on entrepreneurship and what it takes to run a farm sustainably. Alongside classroom studies, there are also seminars, which often involve apprentices' families and community partners too, and visits to other agro-industries, which give them the chance to see different types of agricultural enterprises and sustainable production models.

In 2016-17, the programme's pilot year, 100 young rural apprentices took part and are now acting as ambassadors in their farming communities.

"I'd heard a lot about child labour and it was something that worried me," explains apprentice Maira Carolina Petry. "But now, thanks to the Institute, I feel much more confident that I can go on and enjoy a successful career in agriculture."

Anelise Tornquist, another young apprentice, agrees. "Before the course, I wanted to leave the countryside and move to the city – staying on the farm just didn't seem like a realistic option."

"However, the course has shown me that I do have a future on the farm. I know it's going to be hard work, but it's an exciting challenge and I'm just so pleased I've got the opportunity to stay and work on the land where I was brought up."

Eliminating Child Labour in Tobacco Growing (ECLT) Foundation

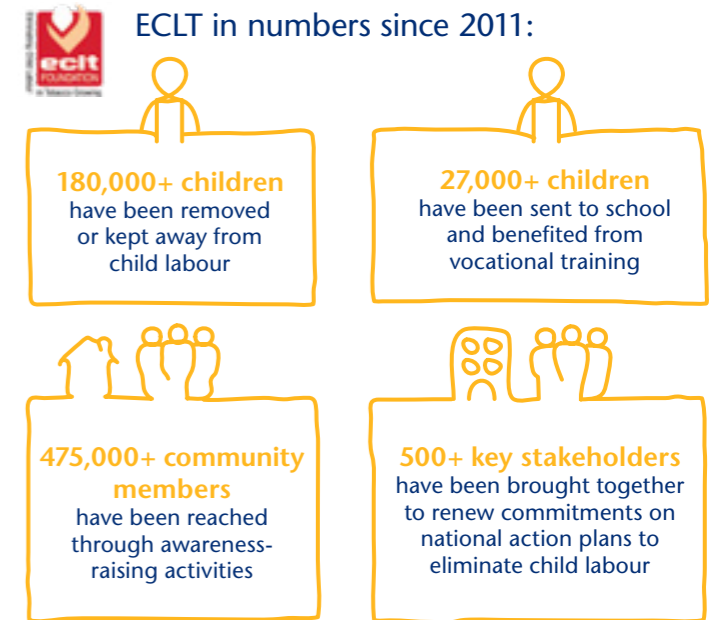
Agricultural supply chains are particularly susceptible to the risks of child labour and in 2000, as part of our long-running commitment to end the practice within tobacco farming, we became a founding board member of the ECLT Foundation.

We remain active members today, alongside other major tobacco companies, leaf suppliers and the International Tobacco Growers' Association. The International Labour Organization (ILO) serves as an advisor to ECLT's Board.

ECLT's independent status means it can call upon governments to take action, improve policies and advance research into child labour. It also carries out important work helping to strengthen communities and brings together key stakeholders to develop and implement local and national approaches to tackle child labour.

For example, in 2017 our company in Indonesia continued its work with ECLT on a multi-stakeholder project to address child labour in tobacco growing. This included developing a new collective strategy, involving national and local governments, farmers' associations, tobacco companies, civil society, international organisations and development agencies.

For more information visit eclt.org



Operational standard on child labour prevention

In 2017, we developed a new operational standard on child labour prevention, with important contributions from the ECLT Foundation and the ILO.

It is set to be rolled out across all our leaf operations in 2018 and will bring increased consistency and effectiveness to the way in which our long-standing Child Labour Policy is implemented.

For example, it provides clear guidelines and procedures for regular training and capacity building, farm monitoring and spot checks, and immediate reporting of any incidents of child labour. It also includes clearly defined steps for developing and implementing actions to prevent or remediate child labour, and to improve the situation of affected children and their communities.

"As issues such as water scarcity, child labour, biodiversity and rural development are not specific to a particular company, there is a huge potential to collaborate and align strategies to support the Sustainable Development Goals. The more competitors work together to address these challenges, the more can be achieved at a larger scale, for the mutual benefit of the companies and family farmers around the world."

Professor Dr Heiko Hosomi Spitzack, Director of the Center for Sustainability at Fundação Dom Cabral, Brazil

Corporate Behaviour

We are committed to operating to the highest standards of corporate conduct and transparency.

What are the issues and why are they important?

The actions and behaviour of any business are key to its long-term sustainability.

Businesses are expected to play a role in protecting human rights throughout their supply chains. For BAT, a major multinational operating in many diverse and challenging countries around the world, it is even more crucial to ensure we uphold high standards wherever we do business.

Through leveraging our global reach and influence, we can help to raise standards and create shared value for people across our value chain.

The most important issues for our business and stakeholders

- Regulatory environment and policy influence
- Anti-bribery and corruption
- Human rights impacts
- Marketing practices and preventing underage access for all product categories
- Illegal tobacco trade
- Corporate tax

→ Find out how we identified these issues on page 36.

Our strategic approach

We're responding to these issues with a strategy focused on upholding the highest standards of corporate conduct in all that we do.



Ensuring we never compromise our high standards of integrity for the sake of business results

Delivery with Integrity
→ Page 24



Respecting the rights of people across our business operations and supply chains

Protecting human rights
→ Page 26



Directing our marketing at adult consumers only and preventing youth access to our products

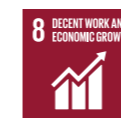
Marketing responsibly
→ Page 28

This approach is underpinned by well-established policies, standards and procedures:

- ✓ Standards of Business Conduct – bat.com/sobc
- ✓ Supplier Code of Conduct – bat.com/principles
- ✓ Regulatory environment and Principles for Engagement – bat.com/regulation
- ✓ Marketing Principles – bat.com/imp
- ✓ Youth Access Prevention Guidelines – bat.com/yap
- ✓ Corporate governance – bat.com/governance
- ✓ Guiding Principles – bat.com/guidingprinciples
- ✓ Anti-illicit trade – bat.com/ait
- ✓ Corporate tax strategy – bat.com/annualreport

UN Sustainable Development Goals (SDGs)

We see clear alignment between the SDGs and our own corporate behaviour priorities, specifically:



Our economic contribution stretches from a global to local level and we've long focused on respecting human rights.



We do not tolerate corruption anywhere in our business and we work to tackle the criminal black market in illegal tobacco.



We work in partnership with suppliers, retailers, governments, the industry and other stakeholders.



Jerry Abelman, Group Legal and External Affairs Director

“At BAT, we take great pride in our long tradition and culture of responsible corporate behaviour, which we express in our Guiding Principles and our Standards of Business Conduct.

These ethical values are even more relevant in the complex and challenging times we're all facing in today's world: from political changes and economic instability to increasing external expectations and legislation.

To successfully lead the transformation of the tobacco industry, we need to continually step up to respond to new challenges and embrace new opportunities – ultimately building an even more responsible, successful and sustainable business for the long term.”

Our Principles and Standards

Our **Guiding Principles** define the values that guide our behaviour, including freedom through responsibility and strength through diversity.

Our **Standards of Business Conduct (SoBC)** applies these values to our daily business lives and expresses the high standards of integrity we are committed to upholding. It includes our core policies for areas such as whistleblowing, bribery and corruption, illicit trade, respect in the workplace, human rights, and political and charitable contributions.

This is complemented by our Supplier Code of Conduct, Principles for Engagement and International Marketing Principles.

Main Board Audit Committee

Regional Audit and CSR Committees

Key audit controls

All business units worldwide complete an annual self-assessment against our key audit controls, in which they confirm they have adequate procedures in place to support SoBC compliance.

Annual training and sign-off

All staff working across the Group are required to complete training and an annual sign-off, confirming their commitment and adherence to the SoBC, and re-declare any personal conflicts of interest.

Speak Up channels

Anyone working for, or with, the Group can raise concerns or grievances in their local language, in confidence and without fear of reprisal, through our *Speak Up* hotlines and website. We investigate all reported incidents and allegations and strong action is taken where required.

→ Find our goals and performance indicators on page 34.



Delivery with Integrity

Responsible behaviour and ethical values are not new to BAT and are underpinned by the policies and standards contained in our Standards of Business Conduct (SoBC).

Caroline Ferland, Group Head of Business Conduct and Compliance



“For us, integrity and compliance are not simply ‘nice to have’ projects and boxes to be ticked – they’re fundamental ways of working that continue to form the basis of our culture and values.

Our employees all have a role to play and the way in which we deliver our business objectives is just as important as what we deliver.”

A culture of compliance

In 2017, we introduced our *Delivery with Integrity* programme focused on strengthening and driving a globally consistent approach to compliance across BAT, led by our newly established Business Conduct and Compliance department.

Delivery with Integrity is about re-emphasising our commitment to transforming tobacco in line with the highest ethical values. It’s an area in which we already have strong foundations, so while this is not new, we are further enhancing our compliance procedures.

The programme was launched in a two-day workshop held with 120 leaders from our Legal and External Affairs function and was opened by our Chief Executive. This was followed by a global communications campaign to all employees worldwide.

A key focus area of the programme has been to strengthen our long-standing procedures for the annual employee SoBC sign-off. A requirement for managers and office-based employees to undertake a new SoBC e-learning and assessment was introduced in 2017. This was completed by over 12,000 managers and an additional 6,000 non-management employees worldwide. Remaining employees, who may not have easy online access, received face-to-face training.

The programme also focused in 2017 on ensuring our policies and training, particularly in relation to anti-bribery and corruption, remain at the forefront of best business practice, as well as increasing the accessibility of our whistleblowing and *Speak Up* channels.

Anti-bribery and corruption

Our Anti-Bribery and Corruption Policy, as part of our SoBC, makes it clear that it is wholly unacceptable for Group companies, employees or our business partners to be involved or implicated, in any way, in corrupt practices. Our SoBC is fully aligned with the provisions of the UK Bribery Act 2010 and we’re also confident it meets the standards of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.

Our policies are continually kept under review and in July 2017, following our acquisition of Reynolds American, we updated the SoBC to reflect the requirements of the US Foreign and Corrupt Practices Act.

We’ve also developed a new e-learning course on anti-bribery and corruption targeted specifically at employees who conduct external engagement with key stakeholders, governments and regulators. This will be completed by over 3,000 employees in 2018.

Alongside this, a new mobile app will provide employees with ‘on-the-go’ guidance on how they should act in specific situations.

BAT is investigating, through external legal advisors, allegations of misconduct and have been liaising with the UK’s Serious Fraud Office (SFO) and other relevant authorities. It was announced in August 2017 that the SFO had opened an investigation in relation to the Company, its subsidiaries and associated persons. We are cooperating with the SFO’s investigation. A sub-committee of the Board has oversight of these matters, providing support for the investigation between Board meetings.

Speak Up channels

To increase the accessibility of, and strengthen, our long-standing whistleblowing policy and procedures, in early 2018, we launched a new third-party-managed *Speak Up* system, including a website available in multiple languages and local language hotlines in each country where we operate. The system enables global oversight of all reported issues in real time.

In 2017, 183 suspected violations of our SoBC were reported (2016: 174). In 75 cases, an investigation found no wrongdoing and in 30 cases the investigation continued at year-end. A total of 78 cases were established as breaches (2016: 77) and the appropriate action was taken, including dismissal, disciplinary measures and strengthening of our internal controls.



In the 2017 Dow Jones Sustainability Indices assessment, we achieved:



100% score
and **industry leader** in the *Policy Influence* category

93% score
in the *Codes of Business Conduct* category

84% score
and **industry leader** in the *Corporate Governance* category

Delivery with Integrity in Brazil



Sandra Miguez, Regional Head of Compliance, Americas and Sub-Saharan Africa

“In Brazil, since 2013, the country’s push to fight corruption has gained traction, with Brazilian people demanding more ethical behaviour and putting pressure on the Government to take stronger action – leading to a new local bribery law being enacted the following year.

This context, along with the UK Bribery Act’s extraterritorial reach, gave us the impetus to review and continue strengthening our local BAT compliance programme.

We started out by mapping the requirements of Brazilian legislation with the six pillars of the UK Act to ensure an aligned approach to both local and global standards. With clear commitment from our leadership team, we then updated our existing training, providing all employees with interactive scenarios to show how to make the right choices and decisions in difficult situations.

The message we put across was that this is about so much more than simple whistleblowing. It’s about choosing the right thing to do on a day-to-day basis, and while the ethical path may not always be the easiest one, it’s always the right one.

We also really benefited from the suite of Group-wide policies, tools and procedures, such as the Supplier Code of Conduct, introduced in early 2016. The Code includes specific requirements for our suppliers in relation to bribery and corruption, and has really helped us strengthen our due diligence processes as well as helping our suppliers better understand our expectations.

With the launch of the Group’s *Delivery with Integrity* programme, we now have an updated suite of training materials and tools reiterating our commitment to doing business responsibly. The newly established Group Business Conduct and Compliance department is always there to support us in continuing to make compliance part of the everyday culture of our business. And I’m very proud to now be leading this across the region.

Our work at Souza Cruz on *Delivery with Integrity* was also endorsed externally in 2017, through the prestigious Pro-Ethical Seal awarded by the Controladoria Geral da União – the Government body in Brazil that investigates fraud, corruption and bribery-related issues in the country. We were very pleased to receive this well-renowned ethical conduct award, which recognises the strength of measures implemented by companies in preventing, detecting and remediating potential acts of corruption and fraud.

It’s a long journey with new challenges arising all the time – but the long-term benefits are more than worth it.”

Protecting human rights

With operations and supply chains in many different diverse and challenging environments around the world, human rights are particularly important for our business and an area we've long focused on addressing.

In recent years, we have been strengthening our approach to further align to the UN Guiding Principles on Business and Human Rights (UNGPs). This began in 2012, with a review of our existing policies and approach to human rights management, informed by an independently facilitated stakeholder dialogue.

As a result, in 2014, we incorporated our Human Rights Policy into our Standards of Business Conduct (SoBC) – the core policy document that every Group employee must confirm compliance with. In early 2016, we complemented this with the introduction of our Supplier Code of Conduct, which defines the minimum standards expected of all our suppliers worldwide, including the respect of human rights.

Having established a strong policy base, we continued to focus in 2017 on enhancing due diligence across our business and supply chains.

Our supply chains

Arguably, the area of greatest risk for human rights abuses is in our tobacco leaf agricultural supply chain. We have extensive due diligence in place for all our tobacco leaf operations and third-party suppliers, including the industry-wide Sustainable Tobacco Programme, which you can read about on pages 18–19.

We have also long had due diligence processes in place for strategic suppliers of direct product materials, such as major suppliers of cigarette filters, paper and packaging. But to closer align with the UNGPs, and to better manage supply chain risks and opportunities, we extended the scope in 2016 to include all our direct materials suppliers worldwide, as well as strategic suppliers of indirect goods and professional services. All these suppliers are now assessed according to independent human rights indices and those with the highest risk exposure are prioritised for enhanced due diligence.

In 2017, on-site audits were conducted on a total of 65 direct suppliers in 29 countries, representing 20% of our total direct Procurement spend. The audits are conducted by Intertek – a highly respected global auditing company – and include criteria on forced labour, child labour, wages and hours, health and safety, environment and management systems. If any issues are identified, suppliers are required to implement corrective actions. Intertek verifies they have done so either through a desktop review, for moderate issues, or a follow-up audit for more serious issues.

For our indirect suppliers, 102 suppliers in 16 countries were identified as high risk and required to undergo a self-assessment in 2017. This provided us with information on the policies, procedures and practices the supplier has in place to effectively manage human rights risks. Where the assessments highlighted areas for improvement, we worked with the supplier to develop corrective actions.

In the event of serious and/or persistent non-compliance, or where suppliers fail to demonstrate a willingness to improve performance, we reserve the right to terminate the business relationship.

In 2018, we plan to extend the scope of our Intertek supplier audits to include tier two and three Next Generation Products (NGPs) material suppliers, and high-risk indirect suppliers of point-of-sale marketing materials and lighters.

Supporting our suppliers in driving continuous improvement



Maria Alice Tavares, Group Head of Direct Procurement

Ensuring the long-term sustainability of our non-agricultural direct supply chain is an essential part of my role. It's a pretty big remit, with around 1,500 direct first tier suppliers globally – covering everything from cigarette filters, paper and packaging, to batteries and components for our NGPs. Many are family businesses operating in countries where standards, such as for human rights and health and safety, aren't well developed. We've always expected our suppliers to align to international human rights standards, but in the last few years I've seen how the UNGPs are really helping to provide greater clarity for businesses. We've also seen a lot of changes internally with the growth of our NGPs, where we now have an electronics supply chain which has brought a whole raft of new risks and challenges.

I strongly believe we can make a positive impact by supporting our suppliers and not just walking away if issues are found – that helps no one. We need to work collaboratively together, leveraging our resources to change practices, increase awareness and capacity, and drive continuous improvement.

For example, last year we audited all our suppliers in Bangladesh, some of which performed below our expectations on health and safety criteria. The local team worked tirelessly in 2017 to support the suppliers' corrective action plans, and provide specialist training and advice. We also organised Intertek training for both our own and suppliers' employees.

I was reassured to see that when the suppliers were re-audited by Intertek, they achieved significant improvements in their audit scores, with one increasing from just 46% to 100%. Ultimately, this not only improved the working conditions for our suppliers' employees, but also made sound business sense in enabling us to maintain our existing supply base in the country and contribute to the local economy.

Now that we've increased the robustness and scope of our supplier audits, inevitably more issues are being identified. I look at this positively, though – knowing where the risks are helps us to focus our actions and raise standards across our supply chain."

Human rights risks in our business and supply chains



Tobacco leaf agricultural supply chain



Non-agricultural supply chain
Direct product materials Indirect goods and services



BAT subsidiary operations



92% score
and industry leader in the *Human Rights* category of the 2017 assessment for the Dow Jones Sustainability Indices



1,000+ managers
in our Procurement and Legal and External Affairs functions completed our **detailed human rights e-learning course** in 2017

Our own business operations

With the majority of our employees working in Trade Marketing and Distribution, managerial or manufacturing roles, where we have robust oversight and control, human rights risks in our own business operations are substantially avoided. The risks that do exist are also mitigated as a result of robust policies, practices, compliance and governance procedures in place across all our Group companies. However, we recognise the need to continually work to ensure these are effectively applied and to carefully monitor the situation in countries where local circumstances may mean a greater exposure to human rights risks.

So, in 2017, we worked with a specialist sustainability consultancy to further strengthen our approach, by developing a process for more focused monitoring of high-risk operations. This includes using independent human rights indices to assess the Group's risk exposure in all the countries where we operate, which is reviewed by our Board Audit Committee. Each high-risk country completes an assessment to confirm compliance with Group policies, standards and controls, and provides details of any additional local measures in place to enhance human rights management. Our regional audit and CSR committees then review the compliance status for each country and, if any areas for improvement are identified, request actions to be taken, with defined timescales.



Find out more in our second Modern Slavery Act statement at bat.com/msa





Marketing responsibly

Like any business, we want to grow our market share in a responsible way, through competitive and innovative product offers that encourage adult consumers to choose our products over those of our competitors. We have strict requirements in place that provide a globally consistent and responsible approach to marketing for all our products.

A global approach

We are committed to ensuring all our product marketing complies with local legislation and, since 2001, all our cigarette marketing, wherever these are sold, has been governed by our voluntary International Marketing Principles (IMP).

With our shift to a multicategory portfolio of different tobacco and nicotine products, we have subsequently introduced Snus Marketing Standards and Vapour Product Marketing Principles, and, in 2017, we developed our new principles for tobacco heating products. Alongside these, we have a digital marketing toolkit in place that includes in-depth guidance to help our markets apply our Marketing Principles online, covering content standards, use of social media and search engines, and ensuring robust age verification.

Some critics have suggested that we take the easy option and ignore our Marketing Principles in developing countries, or where regulation is less strict or the market is more challenging. This is not the case. These Principles are our minimum standards and are applied even when they are stricter than local laws.



Upholding our Marketing Principles in Nigeria



Gbenga Hammed, Trade Marketing Representative

BB I'm responsible for executing our marketing activities across the South-West region in Nigeria, working with our trade partners and retail customers, distributing point-of-sale marketing communications, and managing stock, inventory and quality control of our products. Ensuring adherence to local laws and our IMP, as well as preventing youth access, is central to how we conduct our marketing activities.

It's an incredibly challenging environment with a highly fragmented marketplace that has many small traders and mobile street vendors, and some local competitors don't follow the same high standards. It's also still culturally acceptable for children to be sent to buy cigarettes on behalf of adults. As trade reps, we're in the front line every day, and I find our IMP and global guidelines really helpful in giving us a clear direction on how to act and overcome some of these challenges.

We engage with our trade partners and retail customers on the standards we expect of them, and regularly conduct spot checks. Monthly IMP audits are now also conducted by our Marketing team.

Regular training on the importance of compliance with our IMP is provided for all trade reps. These sessions are also a great opportunity to help us develop initiatives to ensure compliance. One such initiative has been introducing rewards for compliance to our Retail Loyalty Programme – so far this only reaches 50% of our retail base, but we hope to expand it over time.

We've also been running youth smoking prevention campaigns since 2011, focused on raising awareness among retailers and training them on how to check IDs, as well as reinforcing our requirement to not split packs and sell single cigarettes.

So, when the Tobacco Control Act was passed in 2015, which introduced a minimum age of 18 requirement for tobacco sales and also prohibited the sale of single cigarettes, our retailers were well-prepared to align with its requirements.

Although the Act went a long way to strengthen local laws in Nigeria, we're still working in a challenging environment and need to continually work in partnership with our trade partners and retail customers to ensure standards are upheld.

It's certainly no easy task, but this responsible approach is very much engrained into the culture of BAT – as well as being the right thing to do, anything less would be simply bad for business in the long term."

We are committed to aiming for 100% compliance with our global Marketing Principles worldwide. All our marketing materials have to be formally reviewed and approved by our Legal and External Affairs function and we provide training to our marketing employees and trade representatives, as well as any external agencies we work with, to ensure they are effectively applied.

In 2018, as part of the integration of Next Generation Products (NGPs) into our core business, we plan to develop a new set of consolidated Marketing Principles to cover all our product categories, including combustible cigarettes, smokeless tobacco and NGPs.

Youth access prevention

To proactively support our strict requirement to only direct the marketing of our products at adult consumers, we have long expected our markets to work with retailers to prevent underage access, by supporting proof-of-age schemes, and providing training and awareness raising to shop staff. We also engage with governments to establish a minimum age law of 18 where none exist, or to enforce tougher penalties for those that breach existing laws.

In 2017, we revised and strengthened our approach with the launch of our new Youth Access Prevention (YAP) Guidelines, which now cover all our different product categories – from conventional cigarettes to vapour and tobacco heating products. We have also broadened the scope to include markets where our products are distributed through third parties, and strengthened the governance process for ensuring compliance.

In 2017, we conducted youth smoking prevention activities based on our previous guidelines in all markets where we were able to do so. The YAP Guidelines came into effect in January 2018, and we will report our activities and adherence in our next Report.



Our environmental impact

A greener way of working

We are committed to reducing our environmental impact across our supply chain and operations. Evolving risks and opportunities around sustainable agriculture make the environmental impact of farming practices a key part of our approach to Sustainable Agriculture and Farmer Livelihoods (see pages 14–21). Reducing our operational environmental impact continues to be an important topic for our business, and is addressed separately in this section.

Our approach

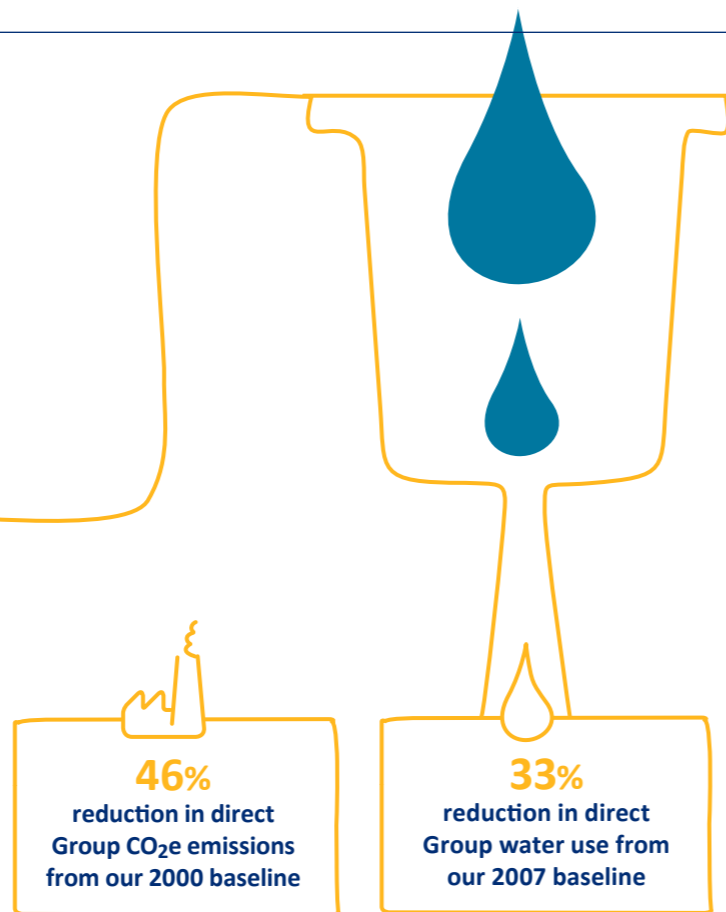
Our approach to reducing the environmental impacts of our operations is long established. We have a comprehensive Environment, Health and Safety (EHS) management system that is based on international standards, including ISO 14001, and we monitor our Group-wide environmental performance for all BAT sites worldwide.

We operate in diverse locations around the world, where environmental legislation, infrastructure, the availability of renewable energy technologies and levels of water scarcity can all vary significantly. Our approach is therefore to understand our impact in these environments, and then put plans in place to minimise it.

We have 45 cigarette factories and a further 16 green-leaf threshing sites worldwide which, along with a large distribution fleet, account for more than 60% of our direct impacts, so this is where we focus many of our initiatives.

In 2016, we developed a new set of environmental targets for 2025, as well as continuing to focus on our long-term goal to cut carbon dioxide equivalent (CO₂e) emissions by 80% by 2050 from our year 2000 baseline. Our focus in 2017 has been to identify opportunities for each of our business functions to play a role in achieving these targets, as well as adapting to changes in our business.

For instance, although the impact of the production and sales of our Next Generation Products (NGPs) still account for a small portion of our direct environmental impact, we have expanded the scope of our environmental reporting to include this, in light of our ambitious growth plan for our NGPs.



Detailed information on our environmental performance, including five-year data charts, can be found at bat.com/sustainability/data

Reducing our carbon emissions and energy use

Our efforts to reduce our carbon footprint across our operations includes investing in energy-efficient technologies, switching to low-carbon or renewable energy sources, and optimising our logistics and fleet with new standards for fuel efficiency, engine size and emissions. We have also optimised load capacity to reduce the number of journeys we need to make.

Having previously achieved significant reductions from baselines for our CO₂e and energy intensity metrics, performance in 2017 has remained relatively steady. This was primarily due to a fall in production volumes and the integration of new sites from 2016 acquisitions. We believe our new focus on increasing the ratio of renewable energy will help contribute towards achieving further reductions against our targets.

In 2018, we will be integrating data from our 2017 Reynolds American acquisition. We also plan to review the measurement and reporting of our Scope 3 emissions, and to conduct environmental life-cycle assessments across our products.

Our focus on renewables

We have committed to increase use of renewable energy across our operational sites to 25% by 2025. This may not seem like a stretching target, but the diverse geographies in which we operate present challenges, such as renewables infrastructure simply not being available in many of our markets. In 2017, we achieved a slight increase in our Group's energy use from renewable sources, now at 8.5%.

Historically, Western Europe has been one of our regions with the highest emissions, with many countries highly dependent on fossil fuels. However, in recent years, this region has seen a huge growth in renewables. We have actively looked to harness green electricity with Guarantees of Origin, where possible, as well as identifying opportunities for on-site renewables generation, to improve the energy mix across our operations. As a result, 45% of our manufacturing sites in the region now source green energy.

Worldwide, we have 14 sites that currently source electricity exclusively from renewable sources, including Augustów in Poland, Groningen in the Netherlands and Kanfanar in Croatia, as well as our global headquarters in London.

We are now reviewing other renewable energy opportunities across the Group to drive progress towards our target.



Reducing our water consumption

While our manufacturing processes are less water intensive than many industries, we understand the reality of increasing water scarcity in some parts of the world and this has led us to expand the scope of our water risk assessments. Previously only conducted at our strategic, high-risk sites, these assessments were completed by all our factories and green-leaf threshing sites in 2017.

Compared to the previous year, we have achieved a 5% decrease in water intensity, and we expect this to improve further, following the implementation of action plans resulting from the assessments.



Leading water efficiency in Chile



Chile is a country where water can be scarce, so our efforts to use it efficiently are all part of being a responsible business. We were one of the first operations across BAT to have conducted a water risk assessment, which helped identify opportunities to improve water efficiency.

At our Casablanca factory, we installed an online control system that monitors our water use, and this provides us with detailed data about where we can make savings. Take our vacuum pump, for instance, which is one of the main consumers of water. In late 2016, we developed a way to re-circulate the water it uses rather than discharging it to the on-site water treatment plant. This has enabled us to achieve a 17% reduction in water usage in the first year. We have a five-year reduction plan where we will implement similar saving initiatives to other high-water-consuming processes in our factory. The treatment plant provides huge benefits too, and this means we can reuse 46% of our water.

We've also implemented our Golden Rules initiative, an employee communication campaign on reducing water and energy consumption. Over the last year, this has helped us raise awareness about water efficiency, as well as other environmental topics, such as the importance of reporting spillages and leaks.

Here in Chile, our people have embraced saving water, and it's heart-warming to know that we're helping to create a better environment, both for our employees and the local communities that we're part of."

Reducing our waste impact

We recycle or reuse waste within our business, wherever possible. In 2017, we were pleased to achieve an 8% reduction in the amount of waste sent to landfill per million cigarettes equivalent, compared to 2016. We also recycled 93.2% of our waste in 2017.

Additionally, we have almost 25% of our manufacturing sites on zero waste to landfill status, and action plans in place to achieve this at 20 additional sites that already recycle over 90% of their waste.

Our people and culture

Valuing our people

We are focused on protecting the safety and wellbeing of our employees and building a culture where they can develop and thrive. Our emphasis on high performance, together with a commitment to help the next generation of leaders fulfil their potential, also means we make our organisation ready for the future as we transform tobacco, and stand out in an increasingly competitive international employment market.

Safeguarding the health and safety of our workforce

We are committed to providing a safe working environment for all our employees and contractors, and have a Group-wide goal of zero accidents.

Our approach is based on risk management and assessments, employee training and awareness, and specific initiatives for high-risk areas of our business. As the conditions in which we operate change, and new potential risks arise, our procedures evolve too.

We have well-established health and safety procedures in our manufacturing sites, and accidents in this area are comparably lower than those in Trade Marketing and Distribution (TM&D). With over 29,800 vehicles and motorcycles out on the road every day, TM&D is an area where the vast majority of accidents occur. Many of these are in challenging parts of the world with high levels of road traffic accidents and armed robberies.

Our driver safety and security programme continues to focus on addressing these risks, such as through the use of in-vehicle 'telematics' monitoring systems to analyse driver behaviour data, insights from which are used to tailor our training programmes to improve driving skills and hazard perception. Since 2014, all our vehicles are required to meet strict safety specifications, and we also continually assess threat levels to enhance security protocols and escorts in high-risk locations.



90%
of the world's fatalities on the roads occur in low- and middle-income countries, even though these countries have approximately 54% of the world's vehicles¹⁵.

Performance in 2017

In 2017, accidents to employees and contractors across the Group increased significantly, from 182 in 2016, up to 217. Sadly, this included an increase in fatalities, with the death of a contracting electrician in our factory in Bangladesh from contact with electricity; two TM&D contractors who died in road traffic accidents in Brazil; and one TM&D employee and eight TM&D security contractors who died in violent attacks in Brazil and South Africa. Eleven members of the public also lost their lives in road traffic accidents involving BAT vehicles in eight countries.

We deeply regret this loss of life and the suffering caused to friends, family and colleagues. We liaise closely with the relevant authorities and conduct our own detailed investigations to determine the root cause of each accident, identify any lessons that can be learned and implement action plans, the outcomes of which are reviewed at Board level.

For example, following the road traffic accidents, we reviewed telematics data to help identify the circumstances and cause of the accidents, as well as to refresh and reinforce our driver training programmes, and improve our route planning. Where the investigation found our driver to be at fault, we also took appropriate disciplinary action.

Overall, our driver and vehicle safety programmes have led to a decline in road traffic accidents in 2017 involving cars or vans, but this was offset by a rise in accidents involving motorcycles, which are increasingly used in markets where the high density of traffic means they are a more practical option. To address the increased risks, we have put in place motorcycle training programmes in all markets where motorcycles have been recently introduced, to provide practical techniques for different road conditions and types of traffic, safe speeds and distances, and how to spot a potential problem and take action to deal with it safely.

Responding to violent attacks on our people



Paul Oakley, Group Head of Environment, Health and Safety (EHS)

2017 has been one of the most challenging periods we have encountered in recent years. We've seen a doubling in the number of violent attacks on our TM&D representatives, accounting for nine of the twelve employee and contractor fatalities in the year.

These are happening in countries where the economic environment makes our trade reps particularly vulnerable to attacks from criminal gangs who want to steal their stock to sell on the black market. We have well-established security measures that have helped towards a steady downward trend in these types of incidents over recent years, so the rise in 2017 was of great concern to us.

The fatalities in Brazil and South Africa were concentrated in the first few months of the year and appeared to be planned and coordinated attacks involving high-grade weaponry – the scale of which we had not seen before. We immediately established comprehensive reviews and action plans in response, led by a cross-functional team involving Group Security, TM&D and EHS.

One issue identified was the high visibility of the security escorts, which drew a lot more attention, so we revised our approach. We reduced the amount of stock the reps carry to make it less valuable, and implemented extra security to our route planning and vehicle tracking systems to ensure the details couldn't be monitored by the gangs to plan attacks. These measures appeared to pay off, as we saw a significant reduction in armed robberies in the following months.

Unfortunately, though, at the very end of the year, one of our employees in Brazil got caught in a random shooting while driving, in which he lost his life. This makes the role of our ongoing training and awareness programmes even more important, to make sure our reps stick to approved routes and fully understand the changing risk environment.

I've seen for myself the level of BAT's commitment to keep all our people safe – right down from the Board level to the work of our teams on the ground. With a distribution network as large as BAT's, carrying high-value products in some of the most volatile countries in the world, I think we're unfortunately always going to encounter these types of incidents, but we're working tirelessly to prevent any future loss of life and making every effort to get closer to our goal of zero accidents."

A diverse and engaging culture

The quality of our people is a major reason why the Group continues to perform well and, as our business evolves and transforms, attracting and retaining a diverse talent base is even more important.

We focus on having a winning organisation by investing in our people, building and inspiring diverse teams, and creating a fulfilling, rewarding and responsible work environment.

Strength through diversity

This has long been one of our Guiding Principles, and it not only means a fulfilling workplace where we respect and value each other's differences, but also makes good commercial sense – having a diverse workforce enables us to better understand and meet the varied needs of our global consumers.

Operating in more than 200 markets, we already have a very diverse workforce in terms of nationality. In 2017, we had 143 nationalities working in management globally, and 20% of our senior management roles were filled by people from our focus nationalities.

Over the last few years, we have made significant progress with female representation at senior level. When we revised our focus on diversity in 2012, we started with a low base of 11% female representation in senior roles, due to the historical industry characteristics. In the last six years we've grown this significantly and now have 21% female representation at senior level.

This progress has been driven by a range of initiatives, including our highly regarded Women in Leadership programme, which supported 145 delegates on their development and career progression. Our regions and markets also work to progress the global diversity strategy through on-the-ground initiatives relevant to local cultures and contexts.

We've made good progress, but are not yet satisfied and will continue to press hard to improve our representation of senior women across the Group.

Strong employee engagement

In 2017, we ran the Group's global employee survey, known as 'Your Voice'. The survey had a response rate of 95% – 10 percentage points higher than the average for this type of survey. An 83% score was achieved in the Engagement Index, which measures employee satisfaction – 12 percentage points higher than the FMCG comparator norm of 71%. This conveys the pride which many employees have in working for us and is demonstrated by our employee turnover continuing to stay below comparator benchmarks.

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



Find more detailed information in our Gender Pay Report
bat.com/genderpayreport

¹⁵ who.int/mediacentre/factsheets/fs3358/en/ (accessed March 2018).

Performance summary

In response to our Stakeholder Panel's feedback from last year, we have introduced this section to present all our goals and accompanying performance in one consolidated table.

Performance against all our previously published goals and commitments can be found online on our Sustainability Performance Centre where you can also find five-year data charts and commentary for our key performance indicators.

Find out more at

bat.com/sustainability/data

Key

- Improvement or maximum performance
- ◆ Minimal (2% or less) or no change
- Decline

GOAL	INDICATOR	PERFORMANCE			TREND
		2015	2016	2017	
HARM REDUCTION					
Generate over £5 billion in Group revenue from our Next Generation Products (NGPs) by 2022	Amount of Group revenue generated from NGPs ¹⁶	–	–	£500 million	
SUSTAINABLE AGRICULTURE AND FARMER LIVELIHOODS					
Eliminate use of unsustainable wood sources by our contracted farmers	% of farmers' wood fuel from sustainable sources	98.8%	99%	99%	◆
Independent on-site reviews conducted on 100% of our leaf operations and suppliers every three years as part of the Sustainable Tobacco Programme (STP)	% of total leaf operations and suppliers reviewed in a three-year cycle ¹⁷	–	21%	50%	●
CORPORATE BEHAVIOUR					
100% adherence to our Standards of Business Conduct (SoBC)	Number of established breaches	29	77	78	◆
	% of employees who completed SoBC formal sign-offs	100%	100%	100%	●
100% of non-agricultural suppliers covered by our human rights supply chain due diligence (SCDD) programme	Suppliers assessed for human rights risks, as a % of total procurement spend ¹⁸	–	28%	46%	●
	Number of independent supplier audits conducted	–	23	65	●
100% adherence to our Marketing Principles	Number of established breaches	2	0	0	●
100% adherence to our global Youth Access Prevention (YAP) Guidelines	% of markets undertaking activities based on our global guidelines ¹⁹	100%	100%	100%	●

¹⁶ We began measuring performance against this metric in 2017, so data is not available for previous years. The figure includes data from Reynolds American on a full-year basis. Excluding Reynolds American, it was £397 million.

¹⁷ STP was introduced in June 2016, so data is not available for previous years.

¹⁸ We began implementing the SCDD programme in 2016, so data is not available for previous years.

¹⁹ Until the end of 2017, this was measured against our previous Youth Smoking Prevention guidelines. The 2017 figure includes Reynolds American. Markets that were unable to conduct activities are where there is political instability, where we only operate through a distributor, or where we are prevented from undertaking youth smoking prevention activities by local legislation – these represented less than 15% of our 2017 sales volumes. The YAP Guidelines came into effect in January 2018, and we will report our adherence to these and YAP activities in our next report.

GOAL	INDICATOR	PERFORMANCE			TREND
		2015	2016	2017	
ENVIRONMENT					
Reduce our CO ₂ e emissions by 55% to 0.68 tonnes per million cigarettes equivalent (MCE) produced by 2025, and by 80% to 0.30 tonnes per MCE by 2050 (against year 2000 baseline)	Tonnes carbon dioxide equivalent (CO ₂ e) per MCE ²⁰	0.80	0.84	0.82	◆
	Total % reduction from baseline ²⁰	47%	45%	46%	◆
Reduce our energy use by 25% to 9.17 gigajoules/MCE by 2025 (against year 2007 baseline)	Gigajoules per MCE ²⁰	9.98	10.41	10.48	◆
	Total % reduction from baseline ²⁰	16%	12%	11%	◆
Increase the amount of renewable energy we source to 25% by 2025	% of total energy use ²¹	–	8.2%	8.5%	◆
Reduce the total amount of water withdrawn by 35% to 3.17 cubic metres/MCE by 2025 (against year 2007 baseline)	Cubic metres per MCE ²⁰	3.56	3.44	3.27	●
	Total % reduction from baseline ²⁰	27%	29%	33%	●
Increase the total amount of water we recycle to 15% by 2025 (against year 2007 baseline)	% of total water recycled against baseline	9%	11%	11%	◆
Reduce our waste to landfill by 80% to 0.002 tonnes/MCE by 2025 (against year 2007 baseline)	Tonnes per MCE	0.0080	0.0084	0.0077	●
	Total % reduction from baseline	68%	66%	68%	●
Reduce the total volume of waste generated by 10% by 2025 (against year 2007 baseline)	Tonnes of total waste generated ('000)	131	131	132	◆
	Total % reduction from baseline	3%	3%	2%	◆
Recycle at least 95% of our total waste generated each year	% of waste recycled	92.8%	92.6%	93.2%	◆
PEOPLE					
Aim to achieve zero accidents Group-wide	Total reported accidents: employees and contractors ²²	181	182	217	■
	Lost Workday Case Incident Rate (LWCIR)	0.26	0.24	0.28	■
	Lost Workday Cases ²²	166	155	181	■
	Number of serious injuries: employees ²²	34	30	38	■
	Number of serious injuries: contractors ²²	8	20	24	■
	Number of fatalities: employees	0	2	1	■
	Number of fatalities: contractors	7	4	11	■
	Number of fatalities to members of the public involving BAT vehicles	6	2	11	■
	Significantly increase the representation of women and focus nationalities in senior management by 2020	% of women in senior management ²³	16%	16%	21%
	% of focus nationalities in senior management	18%	19%	20%	◆

²⁰ We have updated the following previously reported figures: CO₂e per MCE of 0.79 in 2015 and 0.81 in 2016; CO₂e % reduction from baseline of 48% in 2015 and 47% in 2016; energy use per MCE in 2015 of 9.75 in 2015 and 9.92 in 2016; energy use % reduction from baseline of 17.5% in 2015 and 16% in 2016; water use per MCE of 3.43 in 2016 and % reduction from baseline of 29% in 2016. This is broadly due to expanding the scope of recent and historical data to include three sites in one country for completeness, and correction of reported volume of MCEs in another site. Additionally, following the implementation of our new reporting system, we have taken steps to improve our calculation methodology, which has resulted in slight adjustments to overall historical data.

²¹ We began measuring performance against this metric systematically from 2016, so data is not available for previous years.

²² To include reportable injuries from our 2015 and 2016 acquisitions, we have updated the following previously reported figures: total accidents to employees and contractors of 175 for both 2015 and 2016; lost workday cases of 160 in 2015 and 151 in 2016; serious injuries to employees of 31 in 2015 and 33 in 2016; and serious injuries to contractors of 9 in 2015 and 16 in 2016. The latter two also include a reclassification of a 2015 serious injury from a contractor to an employee. Additionally, an internal audit identified three lost workday cases as incorrectly reported in 2016 under serious injuries – we have updated the 2016 data to reflect this reclassification.

²³ The 2017 figure includes data from Reynolds American, to ensure alignment with our gender diversity reporting in our 2017 Annual Report.

Materiality: identifying our sustainability priorities

The issues covered in our Group Sustainability Agenda are identified through a detailed materiality assessment as those which matter most to our stakeholders and our business.

We've been conducting materiality assessments since 2007, which we review on an annual basis and refresh through an in-depth process every three years. This enables us to evolve our strategy and report on it effectively. In 2017, we worked with Carnstone Partners, a highly respected sustainability consultancy, to conduct a new in-depth assessment, based on the following three-stage process:

Stage 1

Identifying a 'long list' of issues

A wide variety of stakeholder inputs were used to identify an initial long-list of issues. These included issues raised in our stakeholder engagement activities, at both a Group and local market level, with shareholders, investors, suppliers, farmers, local communities, employees, governments, non-governmental organisations (NGOs) and other key stakeholders.

In addition, we commissioned Kantar Media to conduct a global media review, and identified the key issues covered by industry and FMCG peer companies; relevant national and international regulation; international standards and frameworks, such as the UN Sustainable Development Goals; external reports and allegations regarding BAT or the tobacco industry; and risk monitoring and outlook reports, such as those of the World Economic Forum.

The external insights were complemented by internal BAT inputs, including Group and functional strategies; Group Risk Register; Main Board and regional meetings and committees; and Group policies, principles and standards.

Stage 2

Prioritising and refining

The issues were grouped under common themes and prioritised by mapping them onto the adjacent materiality matrix. This mapping used a defined scoring methodology, developed by Carnstone, to assess the level of importance to our stakeholders and the current or potential impact on the BAT Group.

Carnstone then carried out a series of interviews with BAT senior management, including our Group Legal and External Affairs Director, to gain feedback and refine the issues further.

Stage 3

Validation

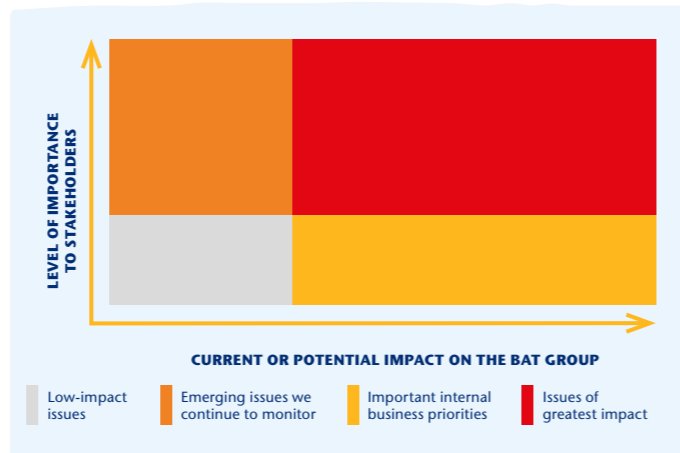
Our independent Stakeholder Panel of key opinion leaders (see page 38) reviewed the list of issues identified and details of each stage of the assessment, including the stakeholder inputs, scoring methodology and feedback from internal interviews. They then had the opportunity, via an independently facilitated meeting, to ask detailed questions and provide feedback.

Overall, the Panel supported the process followed and confirmed that the most material issues identified were aligned with their expectations.

Final results

The issues which have the highest level of importance to our stakeholders, and the greatest impact on the BAT Group, form our Sustainability Agenda under the three strategic areas of: Harm Reduction, Sustainable Agriculture and Farmer Livelihoods, and Corporate Behaviour (with the specific issues listed at the beginning of each section in this Report). These are underpinned by our ongoing focus on issues relating to the environmental impacts of our operations, and building a diverse and engaging culture for our people.

We also continue to focus on important internal business priorities, as well as to monitor emerging issues of high importance to our stakeholders.



Stakeholder engagement

We engage with a wide range of stakeholders at local, regional and global levels on the key sustainability issues covered in this Report.

Listening to stakeholders helps us better understand their views and concerns, and so respond to them appropriately. It gives us valuable inputs to, and feedback on, our strategic approach to sustainability, as well as our policies, procedures and ways of working. This helps us to continually improve and strengthen them and ensure we're meeting the expectations of our stakeholders.

For example, the development of our Human Rights Policy and approach to human rights management has been informed by an independently facilitated stakeholder dialogue session and subsequent work with external consultancies with expertise in this area. Our new operational standard on child labour prevention was also developed with important contributions from the Eliminating Child Labour in Tobacco Growing (ECLT) Foundation and the International Labour Organization (ILO).

We also participate in a wide range of multi-stakeholder partnerships and collaborations to develop joint solutions to common challenges. For example, to tackle the illegal tobacco trade, we work with industry groups and have cooperation agreements with governments, customs and law enforcement agencies. Our research and development (R&D) also has partnerships with highly respected academic and research institutions, which focus on scientific studies into the reduced-risk potential of next generation tobacco and nicotine products.

We continue to share the results of our peer-reviewed scientific research into Next Generation Products (NGPs) with regulators, public health bodies, the media and other key stakeholders to help inform the harm reduction debate and contribute to the evidence base.

We also actively share our experience and expertise with others, which can help to raise standards across the industry and make a valuable contribution to wider society. For example, openly sharing our scientific research and approach to product stewardship is helping to inform the development of industry-wide quality and safety standards for vapour and tobacco heating products.



Our ongoing dialogue and engagement with our business partners – including suppliers, farmers and retail customers – provides them with valuable support, such as in meeting international standards or new regulations, as well as helping us to understand the issues and challenges they face. We can then co-develop solutions to address them.

Around the world, our companies have also built close ties with the communities in which they operate and invest in Corporate Social Investment programmes, in partnership with local stakeholders, to support them.

How we engage with regulators

We engage with regulators around the world to support regulation that is based on robust evidence and thorough research, that respects legal rights and livelihoods, and delivers on the intended policy aims, while recognising unintended consequences.

Transparency is crucial to our approach. We're open about what we think, whether we're in favour of new proposals and regulations or not. And where we don't agree, we always try to be constructive and propose practical alternatives that can still achieve governments' regulatory aims and public health objectives.

We have long supported the OECD Principles for Transparency and Integrity in Lobbying, and the views and positions we advocate on key issues are openly available on our website at bat.com/regulation.

We recognise that, as a responsible company, all the engagement activities we undertake must be guided by high standards, which are set out in our Principles for Engagement. All Group companies and employees are required to act in accordance with these Principles. We support third parties on policy issues of mutual interest, but will never ask a third party to conduct itself in any way that contravenes our Principles.

Independent assurance

An independent review of our sustainability reporting is an important element of helping stakeholders place trust in our processes and in what we report, and supports our commitment to openness and transparency.

In 2017, we continued to engage Ernst & Young LLP to provide limited assurance of selected sustainability data. In addition, building on our long history of open engagement with our stakeholders, this is the second year we invited our Independent Stakeholder Panel, formed of key opinion leaders, to offer comment on the materiality of our Sustainability Report and a collective opinion on BAT's performance.

The Stakeholder Panel's independent statement

Panel members

Philippa Foster Back CBE, Director of the Institute of Business Ethics (Panel chair) – an education charity whose purpose is to promote high standards of business behaviour based on ethical values.

Scott Ballin, Health Policy Adviser – Scott has spent more than 40 years involved in issues related to tobacco and health and is a key opinion leader on tobacco harm reduction.

Prof John Boardman, Emeritus Fellow, Environmental Change Institute, University of Oxford – John has published over 150 papers primarily focused on soil management and land degradation.

Peder Michael Pruzan-Jorgensen, Senior VP of Business for Social Responsibility – a global nonprofit organisation that works with its network of more than 250 member companies and other partners to build a just and sustainable world.

Process

This is the second year of the Panel's existence. Its aim is to understand the context BAT's business operates within, identify how it is meeting the various sustainability challenges, and offer comment on the materiality of the Report and a collective opinion on reporting performance. The Panel is independent of BAT and the comments which follow are based on the professional expertise and experiences of its members.

In this reporting cycle, the Panel held three meetings with BAT. The first, in October 2017, considered the process and outputs from the Company's materiality assessment (see page 36). The second meeting, in November 2017, was specifically requested by the Panel following its review of the 2016 Sustainability Report, to provide an opportunity to engage earlier in the reporting process. The meeting included a presentation from BAT on key business developments in 2017 and a discussion on the proposed structure and content of the Report.



Our Stakeholder Panel members meeting with Jerry Abelman, Group Legal and External Affairs Director

The third meeting, in February 2018, centred on a detailed scrutiny of a draft of the Report, for which:

- The Panel reviewed a draft in advance of the meeting;
- BAT presented details on how the Company had responded to the Panel's recommendations and feedback made in its statement in the 2016 Report, as well as those made during its November meeting;
- The Panel privately discussed the Report as a group to formulate their views and identify questions to ask BAT;
- The Panel met with senior BAT representatives to ask questions and provide initial feedback on the Report, including with Jerry Abelman, Group Legal and External Affairs Director, as well as senior experts from key areas of the business;
- The Panel made suggestions as to how the Report could be improved to best serve the needs of BAT's stakeholders – a number of these comments were addressed in the Report prior to publication; and
- Drafted this statement independently of BAT and presented it to the Company's representatives.

Throughout the three meetings, the Panel appreciated BAT's willingness to share information and discuss the issues and challenges it faces as a business openly and constructively. The Panel's comments on the Report, together with recommendations as to how future reports could be improved, are summarised below. The Panel acknowledges the progress made from last year's Report which reflects many of the recommendations made by the Panel. The specific details of how these recommendations have been addressed are included below.

Materiality and performance

As in previous years, the BAT Sustainability Report 2017 reads well, covers the Group's most material issues in a meaningful and balanced way, and strikes a good balance between narrative reporting and performance reporting, not least when read in context of the rich information – qualitative and quantitative – accessible on BAT's websites and in other, thematically more focused reports.

The Company's commitment to reporting is underpinned by the annual materiality refresh and a more thorough review every three years. Nonetheless, and surprisingly, we call out the opportunity for defining meaningful and measurable objectives, including long-term targets for Harm Reduction and Sustainable Agriculture and Farmer Livelihoods. As mentioned in last year's Statement, we believe that it would be useful to define outcome indicators for the most material issues noting, as a positive development, that the recently commenced *Thrive* programme may yield a stronger evidence base for outcomes related to Sustainable Agriculture and Farmer Livelihoods.

In line with our recommendation for improved clarity on objectives and targets in key performance areas, the Report would benefit from greater clarity on what the Company considers the priorities for transforming tobacco, including milestones and key performance indicators for successful transformation. Moreover, as the BAT business model evolves with greater focus on Next Generation Products (NGPs), we expect that the broader sustainability profile of BAT will evolve, including what constitutes material issues, something we would expect to see covered in future reporting.

Harm Reduction

BAT continues to show progress in advancing its NGP portfolio and harm reduction strategies on multiple fronts. It responded to a number of the Panel's recommendations made in last year's Statement, including providing more detail on what a regulatory framework for NGPs might entail. The Panel notes that BAT recognises the serious harm caused by the use of cigarettes and the need to provide smokers with consumer acceptable, affordable alternative products, something that the Panel believes should be given the highest of priorities.

Even as BAT continues its efforts in the NGP area, we strongly encourage it to step-up efforts to provide existing, more affordable harm reduction products (such as snus, vapour and other nicotine products) to the one billion smokers living in low- to middle-income countries. The existing 'smoking' marketplace, made up of many of BAT's consumers, provides the Company with significant opportunities to demonstrate its commitment to harm reduction as part of its *Transforming Tobacco* strategy.

The Panel also encourages BAT to continue to expand its efforts to engage with regulators, the scientific and research community, policy makers, public health NGOs, consumers and the media, and to participate in meetings and conferences where productive engagement between stakeholders can be achieved. Transparency remains a key element in the transformation of the tobacco and nicotine space.

Finally, in this area as elsewhere, the Panel hopes that BAT will in future reports provide more measurable, detailed and articulated performance objectives. We note that this year's draft Report was critically lacking in this area, even when compared to the 2016 Report. It was noted, for example, that BAT has invested US\$2.5 billion since 2012 on NGPs, but how does that compare to other activities of BAT including its annual revenue? One way to highlight and provide these details would be through one of its prominently featured websites, such as bat-science.com.

→ Continued on the next page

Sustainable Agriculture and Farmer Livelihoods

The Panel welcomed the presentation of data on BAT's Extension Services to farmers and information on how the *Thrive* programme is developing. We look forward to seeing more output next year in this area. Similarly, we would welcome more disclosure on the use of short-term hired labour by BAT's directly contracted farmers. We accept that there are practical difficulties related to the frequent and rigorous monitoring of these types of employment relationships, especially in less developed countries. However, we believe it is important that sufficient information is available for us to form a view as to whether this is a material issue. We note that the Sustainable Tobacco Programme deals only with tier one suppliers.

In the area of climate change, we encourage BAT to develop a robust analysis of the risks of climate change in their major tobacco growing regions. As a first step, this could be done by use of Intergovernmental Panel on Climate Change predictions for specific regions in terms of temperature and precipitation changes. Uncertainties should be acknowledged. Following from this, an analysis of the risks to production (particularly to smallholder farmers) is needed. Finally, the resilience to these risks should be assessed. We encourage BAT to produce something along the lines of a Focus Report on climate change. It may well be that the risks are minimal but, at present, except for some mention of extreme events and water scarcity, we feel they are not being given sufficient prominence.

Corporate Behaviour

The Panel commends the approach taken by BAT in response to comments made in last year's Statement. The approach is clear and we were pleased to see in the sections of Delivery with Integrity, Protecting Human Rights and Marketing Responsibly some detail of how BAT's approach is delivering tangible benefits through the highlighted case studies.

An omission is a description of the Company's values, seen as a commitment to stakeholders, and how they are integrated in Corporate Behaviour – it is implicit but the Panel feels they should be more explicit. Likewise, providing more detail on the Standards of Business Conduct would be beneficial to the reader.

The detail given on *Speak Up* channels was welcome as this is a key area for all organisations. It is suggested that next year's reporting on these matters follows best practice being developed by comparable-sized companies.

In discussion, the Panel learnt of BAT's global approach to Corporate Behaviour, yet we are aware it operates in countries with weaker enforcement and governance mechanisms. This might be an area to develop in this section, so the reader might understand how BAT's overall approach is applied within the context of different national regulatory regimes.

Other observations

The Panel welcomes the Report's inclusion of information on occupational health and safety. In addition to the increase in the number of fatalities, which is well covered, we note with concern that overall health and safety performance seems to be on a negative trajectory. During interviews with senior BAT

representatives we took comfort from the attention given to the topic, and we encourage continued attention to reversing the trend, as well as to report in greater detail in the future on steps taken to improving performance.

In addition to our observations on climate change stated earlier, we welcome BAT's commitment to expand its understanding and measurement of its Scope 3 CO₂e emissions with a view to improve its overall performance. However, we note that while BAT's Scope 1 and 2 CO₂e emissions have reduced, the rate of progress seems to have stalled, raising questions about the trajectory to meeting its existing 2025 targets, an issue not fully clarified in the Report. We also note that as the Company's business model evolves with greater sales coming from NGPs, emissions may increase. In future reporting, we expect BAT to clarify how the evolving business model may influence its carbon footprint, including Scope 3 emissions.

Concluding remarks

As a general comment, the 2017 Report takes BAT forward and again helps the reader to get a picture of BAT's approach to sustainability and its most significant issues identified by its materiality process.

Transforming Tobacco is a key development for BAT and the Panel is interested to learn how this will be integrated into the 2018 Report. This is made more complex given the multiple audiences of BAT's sustainability reporting. Given the difficulty of providing clarity to all audiences the Panel suggests the nature of this Report is revisited, particularly in the light of the Performance Summary data feeling disconnected from what is said in the Report on some matters.

The Panel is grateful for the cooperation of BAT's Group Sustainability team and senior management involvement.

Stakeholder Panel members

March 2018



Assurance of performance data

Ernst & Young LLP has performed a limited assurance engagement on selected sustainability data presented in this Report and at our Sustainability Performance Centre at bat.com/sustainability/data

Read Ernst & Young's full statement, including the scope of work and conclusions, which is available at bat.com/assurance

Our response to the Panel's statement

The Panel's insights, challenge and constructive feedback are invaluable in helping to ensure our reporting meets the needs of our stakeholders. They have highlighted both strengths in our reporting and where improvements could be made, and we are committed to openly responding to their feedback.

Process

This year, we welcomed the opportunity to engage with the Panel earlier and more frequently in the reporting process. The initial drafting of the Report benefited greatly from the Panel's input and we were able to apply many of their suggestions prior to publication. We're also carefully considering further recommendations for future reports.

Materiality and performance

We're pleased the Panel found our material issues are reported in a meaningful and balanced way. We recognise the need to define more measurable long-term targets, particularly for Harm Reduction and Sustainable Agriculture and Farmer Livelihoods.

We have published our new target to generate over £5 billion in Group revenue from Next Generation Products by 2022 and believe this financial metric demonstrates our commitment to harm reduction and the transformation of our business. As this area develops, we will work to define further targets and indicators to support this.

We agree with the Panel's observation that the development of our *Thrive* programme will help us to better quantify outcomes and impacts for our farmers and rural communities, and are committed to reporting on this in the future.

Harm Reduction

We appreciate the Panel's recognition of our progress in this area and how we've responded to their recommendations. We understand their concerns regarding the availability of affordable, alternative products for smokers in low- to middle-income countries. However, in many of these countries, there are still real regulatory and marketplace obstacles to launching alternative products, so we welcome the Panel's recommendation to continue to expand our efforts for productive engagement between key stakeholders. If we can all work successfully together, we believe real progress in tobacco harm reduction can be achieved.

Sustainable Agriculture and Farmer Livelihoods

We note the Panel's recommendation for more information on the use of short-term hired labour by our contracted farmers. The extent to which hired labour is used differs according to location and scale of the farm. In many locations, the use of short-term casual labour is common, with workers hired for one or two days' work at a time. This is a reflection of how the informal economy operates in many parts of the world and one over which we have limited direct control. However, we are clear on the labour standards we expect

our contracted farmers to uphold with their own hired workers and monitor practices via our farm monitoring and the industry's Sustainable Tobacco Programme, both of which include specific criteria relating to the use of hired labour. We will consider how we can better reflect this important part of our supply chain in future reports.

We're also carefully considering the Panel's suggestion to conduct a new analysis on climate change impacts in tobacco growing, and to provide more detail in future reports on how we're working to understand, mitigate and increase farmers' resilience to these impacts.

Corporate Behaviour

We're pleased the Panel found our reporting in this area to be clear and that the use of case studies to demonstrate how we're delivering tangible benefits was a useful addition. We're also grateful to the Panel for highlighting the gap regarding the role of our Guiding Principles and Standards of Business Conduct – which we were able to address prior to publication (see page 23). In addition, we're committed to including data from our *Speak Up* channels in future reports.

We recognise the importance of clearly explaining how our global approach to Corporate Behaviour is applied, particularly in the context of different local circumstances. We adhere to our policies, principles and standards even when they are stricter than local laws, and prioritise countries with a higher risk exposure for enhanced monitoring, such as where regulation or enforcement is weak, or there are high levels of corruption, criminality or unrest. We will work to further clarify our reporting on this in the future.

Other observations

We share the Panel's concerns regarding our health and safety performance in 2017, but are pleased they were reassured by the high level of attention this is given, including regular monitoring and oversight by our Board Audit Committee.

With the majority of incidents concentrated in the first half of the year, we have already seen an improvement in performance for the second half of 2017, as a result of the targeted programmes and initiatives we've put in place to respond to increased risks. We will endeavour to include more detail on this in next year's Report.

We recognise that performance in 2017 against our CO₂e and energy intensity metrics has remained relatively steady. In response to the Panel's feedback, we have provided more clarity in this Report (see page 30). We're currently working on identifying opportunities for achieving further reductions against our targets and believe our new focus on increasing the ratio of renewable energy will help contribute towards this.

Concluding remarks

We would like to thank the Panel for their time and thorough review of our Report and look forward to continuing this open and constructive dialogue.

British American Tobacco

March 2018

bat.com/sustainability

More detailed information on our Sustainability Agenda and initiatives.



PERFORMANCE CENTRE

Progress against our goals, performance charts, Global Reporting Initiative (GRI) G4 reporting, independent assurance statement and our response to assurance.

 bat.com/sustainability/data



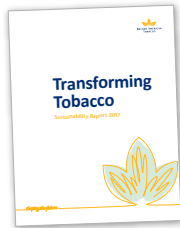
GET IN TOUCH

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SUSTAINABILITY REPORT

Our sustainability strategy and the three key areas of Harm Reduction, Sustainable Agriculture and Farmer Livelihoods, and Corporate Behaviour.

 bat.com/sustainabilityreport



FOCUS REPORTS

More in-depth information on a specific area of our Group Sustainability Agenda.

 bat.com/sustainabilityfocus



ANNUAL REPORT

Our Group vision, strategy, business model, governance, principal risk factors and financial reporting.

 bat.com/annualreport

 [@BATPress](https://twitter.com/BATPress)
[@BAT_Sci](https://twitter.com/BAT_Sci)

 [youtube.com/welcometobat](https://www.youtube.com/welcometobat)

 [flickr.com/welcometobat](https://www.flickr.com/welcometobat)

About this Report

This is a report by British American Tobacco p.l.c. Associate companies are excluded. All Group data relates to the calendar year 2017. Data from Reynolds American Inc., our US business that we acquired in July 2017, is excluded from the Report unless stated otherwise, as we continue the integration. References to 'British American Tobacco', 'BAT', 'we', 'us' and 'our' when denoting opinion refer to British American Tobacco p.l.c. (the Company), and when denoting tobacco business activity refer to Group operating companies, collectively or individually as the case may be. This Report contains forward-looking statements that are subject to risk factors associated with, among other things, the economic and business circumstances occurring in the countries 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.

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