



BRITISH AMERICAN
TOBACCO

BRITISH AMERICAN TOBACCO p.l.c.

(Registered in England and Wales under the UK Companies Act 1985 with no. 03407696)

Share Code on the JSE Limited: BTI

Share Code on the LSE: BATS ISIN: GB0002875804

("BAT" or "the Company")

PRE-LISTING STATEMENT

Prepared and issued in terms of the Listings Requirements of the JSE Limited ("JSE")

The definitions and interpretation set out on pages 7 to 10 of this Pre-listing statement apply mutatis mutandis to this page.

This Pre-listing statement is neither an invitation to the public to subscribe for, nor an offer to purchase, BAT Shares, but is issued in terms of the JSE Listings Requirements for the purpose of providing information to the public in regard to the secondary listing of the BAT Shares on the JSE.

The BAT Shares are listed on the Official List and traded on the main market of the London Stock Exchange for listed securities.

The JSE has granted a secondary listing by way of an introduction of all of the issued BAT Shares in the tobacco sector of the main board of the JSE under the abbreviated name BATS and trading code BTI, with effect from the commencement of trading on the JSE on Tuesday, 28 October 2008.

On the commencement of the Listing, the authorised share capital of BAT will be £775,000,000 divided into 2,858,265,349 ordinary shares and 241,734,651 convertible redeemable preference shares of 25 pence each. The issued share capital will, assuming that no options granted under the Share Schemes are exercised between the date of this Pre-listing statement and the date of Listing, be £506,255,453.50 divided into 2,025,021,814 ordinary shares of 25 pence each with a share premium of £56 000 000, all shares ranking pari passu.

The Directors whose names are given on page 33 of this Pre-listing statement collectively and individually accept full responsibility for the accuracy of the information contained in this Pre-listing statement and certify that to the best of their knowledge and belief there are no facts that have been omitted which would make any statement false or misleading, and that all reasonable enquiries to ascertain such facts have been made and that the Pre-listing statement contains all information required by the JSE Listings Requirements.

The BAT Shares will be traded on the JSE in electronic form only. Accordingly, any person who purchases BAT Shares and who elects to receive BAT Shares in certificated form will be required to dematerialise their interest in such certificated BAT Shares in order to be able to trade such BAT Shares on the JSE.

This Pre-listing statement is only available in English and copies thereof may be obtained during normal business hours from Tuesday, 21 October 2008 until Friday, 28 November 2008 from BAT's representative office in South Africa, Werksmans, J.P. Morgan and UBS South Africa at their respective physical addresses which appear on the inside front cover of this Pre-listing statement.

Joint sponsors



J.P. Morgan Equities Limited
(Registration number 1995/011815/06)



South African legal advisers to BAT



English legal advisers

Herbert Smith

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CRAVATH, SWAINE & MOORE

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Place of Incorporation

England and Wales

Date of Incorporation

23 July 1997

Date of registration as an external company in South Africa

13 October 2008

External company registration number

2008/023963/10

PRESENTATION OF INFORMATION

The definitions and interpretation set out on pages 7 to 10 of this Pre-listing statement apply *mutatis mutandis* to this section.

(i) Forward-looking statements

This Pre-listing statement may contain certain 'forward-looking statements' with respect to the plans, current goals and expectations relating to the future financial condition, performance, results strategy and objectives of BAT. Statements containing the words 'believes', 'intends', 'expects', 'plans', 'seeks', and 'anticipates', and words of similar meaning, are forward-looking. Save for those forward-looking statements required to be included in the document in accordance with the JSE Listings Requirements, such forward-looking statements involve risk and uncertainty because they relate to future events and circumstances which are beyond the control of BAT including amongst other things, UK domestic and global economic and business conditions, market related risks such as fluctuations in interest rates and exchange rates, and the performance of financial markets generally; the policies and actions of regulatory authorities, the impact of competition, inflation, and deflation; the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; and the impact of changes in capital, or accounting standards, and tax and other legislation and regulations in the jurisdictions in which BAT operates. This may for example result in changes to assumptions used for determining results of operations. As a result the actual future financial condition, performance and results of BAT may differ materially from the plans, goals and expectations set forth in such forward-looking statements. Except as required by the JSE Listings Requirements, BAT undertakes no obligation to update the forward-looking statements contained in this Pre-listing statement or any other forward-looking statements it may make.

(ii) Sources of information

Where third party information has been used in this Pre-listing statement, the source of such information has been identified. BAT confirms that information provided by third parties has been accurately reproduced. So far as BAT is aware, and has been able to ascertain from information published by such third parties, no facts have been omitted which would render the reproduced information inaccurate or misleading.

(iii) Presentation of financial information under IFRS

The historical financial information contained in Annexure I to this Pre-listing statement are the audited consolidated financial statements of the Group for the financial years ended 31 December 2007 and 31 December 2006 (including unaudited comparative information for the financial year ended 31 December 2005) and the unaudited consolidated financial statements of the Group for the six months ended 30 June 2008 (including unaudited comparative information for the six months ended 30 June 2007). The financial information for the financial years ended 31 December 2007, 31 December 2006 and 31 December 2005 and the six months ended 30 June 2008 and 30 June 2007 has been prepared in accordance with IFRS as adopted by the European Union.

The selected historical financial information set out in Part IV of this Pre-listing statement, other than sales volume, headline earnings per share, diluted headline earnings per share, net asset value per share and tangible net asset value per share, has been extracted, without adjustment to the numbers, from BAT's audited Annual Report and Accounts for the financial years ended 31 December 2007 and 31 December 2006 and BAT's Interim Report to 30 June 2008. The restated selected historical financial information for the financial year ended 31 December 2005 has been prepared on the basis of IFRS as adopted by the European Union and extracted from BAT's audited Annual Report and Accounts for the financial year ended 31 December 2006, but has not been audited. The selected historical financial information has been restated to reflect the adoption of the following:

- In December 2005, the International Accounting Standards Board issued an amendment to IAS21 on foreign exchange rates. The amendment to IAS21 allowed intercompany balances that form part of a reporting entity's net investment in a foreign operation to be denominated in a currency other than the functional currency of either the ultimate parent or the foreign operation itself. This means that certain exchange differences previously taken to the income statement are instead reflected directly in changes in total equity. However, as this amendment was only adopted by the European Union in 2006, the unaudited accounts for the six-month period 30 June 2006 were the first to contain financial information reflecting this change. The comparative information for the financial year ended 31 December 2005 has been restated in BAT's Annual Report and Accounts for the financial year ended 31 December 2006 and this has resulted in an increase in net finance costs of £4 million for the year ended 31 December 2005.
- In 2005, IAS32 and IAS39 on financial instruments were applied from 1 January 2005. This resulted in a £42 million reduction in the Group equity on 1 January 2005 and was shown as an adjustment to the opening balance of the Group equity in BAT's Annual Report and Accounts for the financial year ended 31 December 2005.
- The International Accounting Standards Board issued IFRIC Interpretation 4 which is applicable for annual reporting periods beginning on or after 1 January 2006. This interpretation is to determine whether an arrangement which is not in the legal form of a lease, is in substance a lease and should be accounted for in accordance with IAS17 (Leases). This has resulted in the recognition of certain arrangements as leases. The comparative balance sheet information for 2005 has been restated in BAT's Annual Report and Accounts for the financial year ended 31 December 2006 in respect of finance leases to increase property, plant and equipment by £4 million and borrowings by a similar amount but there was no impact on reported profit.

(iv) Non-IFRS measures

The selected financial information in Part IV of this Pre-listing statement include references to and discussion of other non-IFRS measures of the Group's operating performance, including "*gross turnover*", "*sales volume*", "*adjusted diluted earnings per share*", "*headline earnings per share*", "*net asset value per share*" and "*tangible net asset value per share*".

"*Gross turnover*" represents revenue earned from sales of cigarettes, cigars, leaf and other tobacco products, and includes duty, excise and other taxes payable in respect of such sales. Gross turnover is presented because BAT believes that it and similar measurements are widely used in its industry as a means of evaluating its performance. As such, gross turnover is not a replacement for measures such as revenue or any other performance measures derived in accordance with IFRS or any other body of generally accepted accounting principles, and should not be considered as a substitute for the information contained in the Group's audited financial statements.

"*Sales volume*" represents a key measure to evaluate the Group's performance. Sales volume is a non-IFRS unaudited operating measure of the number of cigarettes and StiX sold; it does not include cigars and other tobacco products such as roll-your-own tobacco or snus. Sales volume is calculated as the total global sales volume of Group's brands sold by the Group's subsidiaries. Sales volume serves as an additional indicator of the Group's performance and not as a replacement for measures such as revenue or any other performance measures derived in accordance with IFRS. The Company believes that sales volume is a measure commonly used by analysts and investors in its industry and, accordingly, has been used throughout the Pre-listing statement to permit a more complete analysis of the Group's operating performance.

"*Adjusted diluted earnings per share*" is reconciled to diluted earnings per share and is unaudited. The exceptional items that mainly drive the adjustments made are separately disclosed as memorandum information on the face of the Income Statement and the segmental analysis.

"*Headline earnings per share*" is an earnings per share number that is required to be reported by the JSE Listings Requirements and is unaudited. Headline earnings is an additional earnings number which is permitted by IAS33. Headline earnings is defined in Circular 8/2007 issued by the South African Institute of Chartered Accountants. It is calculated by starting with the basic earnings number in terms of IAS33 and then excluding certain re-measurements. A re-measurement is an amount recognised in the income statement relating to any change (whether realised or unrealised) in the carrying amount of an asset or liability that arose after the initial recognition of such asset or liability. These include, for

example, impairments/subsequent reversal of impairments and disposal gains/losses on property, plant and equipment. The main purpose of headline earnings is to ensure consistency of treatment by all companies listed on the JSE of the same or similar items. The headline earnings per share numbers are not audited and are not required under IFRS.

"Net asset value per share" and *"tangible net asset value per share"* are disclosed in accordance with the JSE Listings Requirements and is unaudited. *"Net asset value per share"* is defined as net assets divided by the combined number of shares in issue (retrospectively applied to the net assets of the combined and consolidated comparative balance sheet), less treasury shares held. *"Tangible net asset value per share"* is defined as the net assets less intangible assets divided by the combined number of shares in issue (retrospectively applied to the tangible assets of the combined and consolidated comparative balance sheet), less treasury shares held.

(v) References to percentage changes

All references in this Pre-listing statement to percentage changes have been rounded up or down to the nearest whole number (except where a percentage number would be rounded down to zero, in which case it is recorded to one decimal place).

(vi) Currencies

All references to "euro", "€" or euro cent(s) are to the lawful single currency of member states of the European Union that adopt or have adopted the euro as their currency in accordance with the legislation of the European Union relating to European Economic and Monetary Union. All references to "South African rand", "Rand", "R" or "ZAR" are to the lawful currency of South Africa. All references in this Pre-listing statement to "pounds sterling", "pounds", "sterling", "GBP", "£", "p" or "pence" are to the lawful currency of the United Kingdom. All references to "dollars", "US dollar(s)", "\$", "US\$" or "US cent(s)" are to the lawful currency of the United States. All references to "Canadian dollars" or "Canadian cent(s)" are to the lawful currency of Canada. All references in this Pre-listing statement to "DKK" are to the lawful currency of Denmark. The Group prepares its consolidated financial statements in sterling.

(vii) Definitions

Certain terms used in this Pre-listing statement, including capitalised terms, are defined and explained in the section entitled, "Definitions and Interpretation" on page 7 of this Pre-listing statement.

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DEFINITIONS AND INTERPRETATION

In this Pre-listing statement and the Annexures hereto, unless the context indicates otherwise, references to the singular include the plural and *vice versa*, words denoting one gender include others, expressions denoting natural persons include juristic persons and associations of persons and *vice versa*, and the words in the first column shall have the meanings stated opposite them in the second column, as follows:

"AGM"	annual general meeting
"Articles"	the articles of association of the Company, adopted by special resolution passed on 30 April 2008
"ASU30"	Adult Smokers Under 30
"Auditors, PricewaterhouseCoopers or PwC"	PricewaterhouseCoopers LLP
"Australia"	the Commonwealth of Australia, its states, territories and possessions
"B&W"	Brown & Williamson Holdings, Inc., formerly Brown & Williamson Tobacco Corporation
"BAT, British American Tobacco or the Company"	British American Tobacco p.l.c., a public company incorporated in England and Wales with registered number 03407696 and whose registered office is at Globe House, 4 Temple Place, London WC2R 2PG, United Kingdom
"BAT Ltd."	British-American Tobacco Company Ltd.
"Board"	the board of Directors of BAT being as at 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement), Jan du Plessis, Paul Adams, Ben Stevens, Nicandro Durante, Karen de Segundo, Robert Lerwill, Dr Ana Maria Llopis, Christine Morin-Postel, Anthony Ruys, Sir Nicholas Scheele and Matthys Visser
"business day"	a day (excluding Saturdays, Sundays and public holidays in England and Wales) on which banks generally are open for business in London
"Canada"	Canada, its provinces and territories and all areas subject to its jurisdiction and any political sub-division thereof
"certificated or in certificated form"	a share or other security which is in certificated form and for which a physical share certificate or other document of title has been issued
"Chairman"	Jan du Plessis
CMA	means the common monetary areas of Lesotho, Namibia, South Africa and Swaziland
"CREST"	the system for the paperless settlement of trades in securities and the holding of uncertificated securities operated by Euroclear UK & Ireland Limited in accordance with the Uncertificated Securities Regulations 2001 (SI 2001/375) (as amended)
"CREST Regulations"	the Uncertificated Securities Regulations 2001 (SI 2001 No. 3755), as amended
"CSDP"	Central Securities Depository Participant accepted as a participant in terms of the Securities Services Act
"Denmark"	the Kingdom of Denmark

“Directors”	the directors of BAT, as listed on page 33 of this Pre-listing statement
“DSBS”	the British American Tobacco p.l.c. Deferred Annual Share Bonus Scheme
“EBITA”	earnings before deduction of interest, tax and amortisation
“EBITDA”	earnings before deduction of interest, tax, depreciation and amortisation
“EMTN Programme”	the Euro Medium Term Note Programme as described in paragraph 1.5 of Annexure V to this Pre-listing statement
“ESOP”	the British American Tobacco Employee Share Ownership Plan and the British American Tobacco International Employee Share Ownership Plan
“ESOS”	the British American Tobacco p.l.c. Share Option Scheme
“Executive Directors”	Paul Adams, Nicandro Durante and Ben Stevens
“Exchange Control Regulations”	the South African Exchange Control Regulations, 1961, as amended, made in terms of section 9 of the South African Currency and Exchanges Act, 1933, as amended
“FMSA or Financial Services and Markets Act”	the Financial Services and Markets Act 2000, as amended
“FSA”	Financial Services Authority in its capacity as competent authority under the Financial Services and Markets Act
“Global Drive Brands or GDBs”	the <i>Dunhill, Kent, Lucky Strike</i> and <i>Pall Mall</i> brands
“Group”	BAT, its subsidiaries and its subsidiary undertakings but not its associates and joint ventures
“HM Revenue & Customs or HMRC”	United Kingdom Revenue and Customs Department
“IFRS”	International Financial Reporting Standards as adopted by the European Union
“International Brands”	the Group’s international brands which include the <i>Vogue, Viceroy, Kool, Rothmans, Benson & Hedges, Peter Stuyvesant, Craven ‘A’</i> and <i>State Express 555</i> brands
“ITC”	ITC Limited
“Japan”	Japan, its provinces and territories and all areas subject to its jurisdiction and any political sub-division thereof
“J.P. Morgan”	J.P. Morgan Equities Limited
“JSE”	JSE Limited (registration number 2005/022939/06), a public company incorporated in accordance with the laws of South Africa, and a securities exchange licensed in terms of the Securities Services Act
“JSE Listings Requirements”	the JSE Listings Requirements, as amended from time to time, which will be generally applicable to BAT by virtue of its Shares being listed on the JSE
“Listing”	the listing of the Shares on the JSE
“London Stock Exchange or LSE”	London Stock Exchange p.l.c.
“London Stock Exchange’s Daily Official List or Daily Official List”	the daily official list of prices maintained by the London Stock Exchange
“LTIPs”	the British American Tobacco Long Term Incentive Plan and the British American Tobacco 2007 Long Term Incentive Plan

“Memorandum”	the memorandum of association of BAT adopted by special resolution passed on 14 May 1998, as amended
“Non Executive Directors”	the Directors other than the Executive Directors and, where the context requires, the Chairman
“Official List”	the official list of the UK Listing Authority
“Pre-listing statement”	this Pre-listing statement
“Proposals”	the proposals by the R&R Shareholders to restructure their shareholding in BAT, which are more fully described in the Remgro Circular and the Richemont Information Memoranda
“R&R”	R&R Holdings S.A.
“R&R Shareholders”	Richemont and Remgro
“Reinet”	Reinet Investments S.C.A, a soon to be listed Luxembourg investment company
“Rembrandt”	Rembrandt Group Limited
“Remgro”	Remgro Limited, a company incorporated in the Republic of South Africa with the registered number 1968/006415/06 and whose registered office is at Carpe Diem Office Park, Quantum Street, Techno Park, Stellenbosch 7600, South Africa
“Remgro Circular”	the circular to Remgro shareholders dated 15 August 2008
“Reynolds American”	Reynolds American Incorporated
“Richemont”	Compagnie Financière Richemont S.A., a company incorporated in Switzerland with the registered number CH-1703013862-4 and whose registered address is at 50 Chemin de la Chenaie, 1293 Bellevue, Geneva, Switzerland
“Richemont Information Memoranda”	the Richemont Information Memorandum dated 15 August 2008 and the Richemont Securities AG Supplementary Information Memorandum dated 15 August 2008
“Rothmans”	Rothmans International B.V.
“RJR”	R.J. Reynolds Tobacco Holdings, Inc.
“RJRT”	R.J. Reynolds Tobacco Company
“Securities Act”	the United States Securities Act 1933, as amended
“Securities Services Act”	the South African Securities Services Act, 2004, as amended
“Senior Managers”	Mark Cobben, John Daly, David Fell, Andrew Gray, Rudi Kindts, Jean-Marc Lévy, Michael Prideaux, Jimmi Rembiszewski, Peter Taylor and Neil Withington
“SENS”	the Securities Exchange News Service of the JSE
“Shareholders”	holders of Shares
“Shares” or “BAT Shares”	ordinary shares of 25 pence each in the capital of BAT
“Sharesave Scheme”	the British American Tobacco Sharesave Scheme
“Share Schemes”	the share schemes currently operated by BAT, namely, the DSBS, the ESOP, the ESOS, the LTIPs and the Sharesave Scheme, details of which are set out in Annexure VII to this Pre-listing statement
“South Africa”	the Republic of South Africa, its provinces and territories and all areas subject to its jurisdiction and any political sub-division thereof
“South African Transfer Secretaries”	Computershare Investor Services (Proprietary) Limited

“Strate”	Strate Limited (registration number 1998/022242/06), a public company incorporated in accordance with the laws of South Africa, which is a licensed central securities depository in terms of the Securities Services Act and which is responsible for the electronic clearing and settlement system used by the JSE
“ST”	Skandinavisk Tobakskompagni A/S
“UBS South Africa”	UBS South Africa (Proprietary) Limited
“uncertificated or in uncertificated form”	a Share recorded on BAT’s register as being held in uncertificated or immobilised form in CREST or Strate and title to which, by virtue of applicable regulations, may be transferred by means of CREST or Strate
“United Kingdom or UK”	the United Kingdom of Great Britain and Northern Ireland
“UK Companies Acts”	the UK Companies Act 1985 and the UK Companies Act 2006, in each case as amended
“United States or US”	the United States of America, its territories and possessions and any state of the United States of America and the District of Columbia
“Werksmans”	Werksmans Incorporated



**BRITISH AMERICAN
TOBACCO**

BRITISH AMERICAN TOBACCO p.l.c.

(Registered in England and Wales under the UK Companies Act 1985 with no. 03407696)

Share Code on the JSE Limited: BTI

Share Code on the LSE: BATS ISIN: GB0002875804

("BAT" or "the Company")

PRE-LISTING STATEMENT

PART I : INTRODUCTION

1. INTRODUCTION

The BAT Shares are listed on the Official List and traded on the main market of the London Stock Exchange for listed securities.

Richemont, which currently holds an indirect interest of approximately 19.4% in the Shares and Remgro, which currently holds an indirect interest of approximately 10.7% in the issued share capital of BAT, in both cases through R&R, have proposed various restructurings that will result in their respective shareholders becoming direct shareholders in BAT.

This will see 90% of their combined shareholding (or around 27% of the issued share capital of BAT) distributed to Richemont's and Remgro's shareholders, with the remaining 10% (or around 3% of the issued share capital of BAT) being retained by Reinet. The shareholders of Remgro will also receive depository receipts in Reinet in respect of certain BAT Shares contributed by Remgro to Reinet. The distributions will be followed by a rights issue by Reinet, which can be subscribed for by contributing BAT Shares.

The distributions are expected to take place in early November 2008 and the Reinet rights issue is likely to complete by the first half of December 2008. Based on the announcements made by Richemont and Remgro, BAT believes that, following completion of the distributions and the rights issue, the residual Reinet shareholding in BAT is likely to be less than 10%.

As previously announced, BAT agreed, if requested, to obtain a secondary listing for its Shares on the JSE in order to facilitate the restructurings. This request was made on 7 August 2008. BAT has therefore applied for a secondary listing on the JSE.

Shareholders are referred to the Remgro Circular and Richemont Information Memoranda for more details regarding the Proposals. Copies of these documents can be obtained from www.remgro.com and www.richemont.com.

2. LISTING AND TRADING

The JSE has granted a secondary listing by way of an introduction of all of the issued Shares in the tobacco sector of the main board of the JSE under the abbreviated name BATS and trading code BTI, with effect from the commencement of trading on the JSE on Tuesday, 28 October 2008.

The Shares will only be traded and settled on the JSE through Strate in electronic form. Accordingly, any person who acquires Shares, whether pursuant to the Proposals or otherwise, and who receives such Shares in certificated form will be required to dematerialise their interest in such certificated Shares in order to be able to trade such Shares on the JSE.

PART II : BUSINESS OVERVIEW

3. OVERVIEW

Since the Group's creation in 1902, the Group believes that it has become one of the world's most international tobacco groups and has the second largest global market share (excluding China and associates), selling over 300 brands in more than 180 markets. The Group is currently organised into five regions: Europe; Asia-Pacific; Latin America; Africa and Middle East; and America-Pacific (excluding the Group's associated companies, consisting primarily of Reynolds American in the United States, ITC in India and, until 2 July 2008, ST). As of 1 January 2009, the Group intends to reorganise its operations including the separation of the Group's European commercial operations into two separate units, *Western Europe* and *Eastern Europe*. Such reorganisation may result in further changes to the regions or compositions of the regions in which the Group's operations are currently organised. The Group holds significant market positions in each of these regions and has leadership positions in more than 50 markets.

The Group's products are distributed to retail outlets worldwide, including supermarkets, convenience stores, hotels, restaurants, cafes, tobacconists and duty free shops.

In 2007, the Group sold approximately 684 billion cigarettes (excluding the Group's associates) produced by forty-seven cigarette factories in 40 markets. In 2007, the Group's revenue was £10,018 million and its profit from operations before exceptional items was £3,003 million.

During 2007, the Group employed approximately 53,900 people worldwide. The Group's workforce is strongly multicultural and the Group has a decentralised structure, with each local company having a significant degree of autonomy and responsibility for its operations.

4. HISTORY

BAT was incorporated on 23 July 1997 under the laws of England and Wales as a public limited company and is domiciled in the United Kingdom. BAT is the parent holding company of a group of companies which manufacture, distribute or sell cigarettes and other tobacco products.

The Group has had a significant global presence for over one hundred years. BAT Ltd. was established in 1902, when the Imperial Tobacco Company and the American Tobacco Company agreed to form a joint venture company. BAT Ltd. inherited companies and quickly expanded into major markets including India and Ceylon, Egypt, Malaya, Northern Europe and East Africa. By 1912, BAT Ltd. had become one of the world's top dozen companies by market capitalisation. In 1927, BAT Ltd. expanded into the US market through its acquisition of B&W.

During the 1960s, 1970s and 1980s, the Group diversified its business under the umbrella of B.A.T Industries p.l.c., with acquisitions in the paper, cosmetics, retail and financial services industries. Various business reorganisations followed as the business was eventually refocused on BAT's core cigarette, cigars and tobacco products businesses with the creation in 1998 of British American Tobacco p.l.c. as a separately listed entity on the London Stock Exchange.

In 1999, as a result of BAT's merger with Rothmans, Compagnie Financière Richemont AG and Rembrandt acquired through R&R, a jointly owned company, an ownership interest of 35% of BAT's fully diluted ordinary share capital consisting of 25% in new ordinary shares and 10% in convertible redeemable preference shares. See "Major Shareholders" for additional information regarding BAT's relationship with Compagnie Financière Richemont AG (now Richemont) and Rembrandt (now Remgro).

The Group acquired Imperial Tobacco Canada in 2000, and in 2003, the Group acquired Ente Tabacchi Italiani S.p.A., Italy's state-owned tobacco company. Investments were made in Peru and Serbia in 2003.

In 2004, B&W completed the combination of the assets, liabilities and operations of its US tobacco business with RJRT, a wholly-owned subsidiary of RJR, pursuant to which Reynolds American was formed (the "**Business Combination**"). As part of the Business Combination, B&W contributed to RJRT all of the assets and liabilities of its US cigarette and tobacco business, subject to specified exceptions, in exchange for a 42% equity ownership interest in Reynolds American.

In connection with the Business Combination, BAT entered into a non-competition agreement with Reynolds American (the "**Non-Competition Agreement**") under which, subject to exceptions, the Group is prohibited from manufacturing and marketing certain tobacco products in the United States for a period of ten years and Reynolds American are prohibited from manufacturing and marketing certain tobacco products outside of the United States for a period of five years.

BAT, B&W and Reynolds American have also entered into a governance agreement (the “**Governance Agreement**”). In addition to agreeing not to take certain actions, including not seeking additional representation on the Reynolds American’s board of directors, BAT and B&W have agreed, with specific exceptions, not to acquire additional shares of Reynolds American if, as a result, the voting interest of the Group would exceed approximately 42% until the tenth anniversary of the completion of the Business Combination unless terminated in accordance with its provisions prior to such date. The Governance Agreement also restricts the Group’s ability to sell or transfer shares of Reynolds American during the term of the Governance Agreement, subject to certain exceptions.

The Group currently holds an approximately 42% ownership in Reynolds American, through B&W. The remaining 58% of the shares in Reynolds American are publicly traded and listed on the New York Stock Exchange.

BAT was registered as an external company in South Africa on 13 October 2008.

Save as disclosed in this Part II, there have been no material changes in the nature of the business or any trading objects of the Group in the past five years. There is no intention to effect any material changes to the business or trading objects of the Group in the immediate future.

5. SUBSIDIARIES AND ASSOCIATES

BAT is the parent company of the Group. The Group’s operations in the jurisdictions in which it operates are conducted through a number of subsidiaries and associates. The details of the principal subsidiaries and associates of BAT are set out in Annexure II to this Pre-listing statement. The following are the material trading subsidiaries of BAT:

Name of subsidiary	Place of incorporation	Date of incorporation	Registration number	Issued share capital	Percentage held by BAT	Main business	Date on which became subsidiary
British American Tobacco Australia Limited	Australia	28 April 1955	A.C.N. 000 151 100	16,238,474 Ordinary Shares of AU\$1.00	100%	Manufacture, sale, marketing and distribution of cigarettes, cigars and smoking tobacco	7 June 1999
British American Tobacco (Germany) GmbH	Germany	7 July 1926	HRB 1749	Euro 156,000,000	100%	Manufacture, sale, marketing and distribution of cigarettes, cigars and smoking tobacco	7 July 1926
British American Tobacco South Africa (Proprietary) Limited	South Africa	6 September 1995	1995/009509/07	1 Ordinary Share of ZAR1.00	100%	Marketing and distribution of tobacco and tobacco related products nationally and internationally	7 June 1999
Brown & Williamson Holdings, Inc. (direct holding company of Reynolds American Inc.)	Delaware, United States of America	16 March 1927	61-014470 (tax id)	1,000 shares of Common Stock of US\$100.00	100%	Holding company	16 March 1927
CJSC ‘International Tobacco Marketing Services’	Russia	21 December 1995	1027739152902	300,000,000 Ordinary Shares of 0.1 ruble each	100%	Sale, marketing and distribution of cigarettes, cigars and cigarillos	21 December 1995
Imperial Tobacco Canada Limited	Canada	1 February 2000	371414-4	184,174,156 Shares of Common Stock	100%	Manufacture, sale, marketing and distribution of cigarettes and smoking tobacco	1 February 2000
Souza Cruz S.A.	Brazil	25 April 1903	33.009.911/0001-39	R\$625,280,009.19 divided into 305,690,100 nonpar common shares	75,3%	Manufacturing, marketing, importation, and exportation of cigarettes, cigarillos, cigars, loose tobacco, matches and smoking articles	19 March 1914

In addition, BAT has a subsidiary, B.A.T. International Finance p.l.c. which is a party to a number of financial arrangements (see Annexure V to this Pre-listing statement for further detail on these arrangements).

6. SIGNIFICANT ACQUISITIONS AND DISPOSALS

The Group's growth strategy is to increase the Group's sales volume and value share of the global tobacco market through organic growth, mergers and acquisitions. In this regard, the Group believes that strategically important and financially attractive merger and acquisition opportunities combined with strategic disposals may provide the Group with growth opportunities.

In 2005, 2006, 2007 and 2008 the Group made a number of significant acquisitions and disposals as follows:

- On 25 November 2005, the Group acquired Restomat AG, the largest operator of cigarette vending machines in Switzerland, at a price of £25 million, resulting in goodwill of £7 million.
- On 10 March 2006, the Group's Italian subsidiary signed an agreement to sell its cigar business, Toscano, to Maccaferri for €95 million. The sale was subject to regulatory and governmental approval and the Group completed on 19 July 2006. This agreement resulted in the recognition of an impairment charge of £15 million.
- On 31 May 2006, the Group's associate, Reynolds American, completed the acquisition of Conwood, the second largest manufacturer of smokeless tobacco products in the United States, for \$3.5 billion. The acquisition was funded principally with debt, and the fair value of assets acquired and liabilities assumed was \$4.1 billion and \$600 million, respectively.
- From August 2006, the Group purchased minority interests in its subsidiary in Chile for a price of £91 million, raising the Group's ownership interest from 70.4% to 96.5%. The goodwill arising on these transactions was £80 million and the minority interests in the Group's equity were reduced by £11 million.
- On 20 February 2007, the Group announced that it had agreed to the sale of its pipe tobacco trademarks to the Danish company, Orlik Tobacco Company A/S, for €24 million. The sale was completed during the second quarter and resulted in a gain of £11 million. However, the Group retained the *Dunhill* and *Captain Black* pipe tobacco brands.
- On 3 September 2007, the Group completed the sale of the Group's Belgian cigar factory and associated brands to the cigar division of ST, which resulted in a gain on disposal of £45 million. The sale included a factory in Leuven as well as trademarks including *Corps Diplomatique*, *Schimmelpennick*, *Don Pablo* and *Mercator*.
- On 24 June 2008, the Group completed the acquisition of the cigarette assets of Tekel, the Turkish state owned tobacco company, for \$1,720 million. The assets principally comprise brands, which in 2007 accounted for approximately 32 billion cigarettes sold, five factories, one leased factory and tobacco leaf stocks. The acquisition did not include employees and the Group had directly employed the required workforce by the effective date of the transaction. The acquisition was funded with committed bank facilities.
- On 21 October 2005, the Group announced the exercise of its pre-emption rights over shares in ST, its Danish associate company, and the transaction was completed on 12 December 2005. This increased the Group's holding from 26.6% to 32.3% at a cost of £95 million. On 2 July 2008, the Group completed the acquisition of 100% of the cigarette and snus business of ST in exchange for the Group's 32.35% holding in ST and the payment of DKK11,598 million in cash, subject to finalisation of completion accounts. This transaction was approved by the European Commission on 27 June 2008, on the condition that the Group agrees to divest a small number of local brands, primarily in Norway. The sale of these brands should not materially affect the benefits the Group expects to derive from the enlarged business. The acquisition is expected to give the Group additional annual sales of approximately 30 billion cigarettes. The acquisition was funded with the proceeds of a bond offering under the Group's EMTN Programme.

7. STRENGTHS

The Directors believe that the Group's principal strengths are the following:

7.1 Geographic spread

The Group has operations in more than 180 markets around the world. The Group is currently organised into five regions: Europe; Asia-Pacific; Latin America; Africa and Middle East; and America-Pacific (excluding its associated companies, consisting primarily of Reynolds American in

the United States, ITC in India and, until 2 July 2008, ST). As of 1 January 2009, the Group intends to reorganise its operations including the separation of its European commercial operations into two separate units, *Western Europe* and *Eastern Europe*. Such reorganisation may result in further changes to the regions or composition of the regions in which the Group's operations are currently organised.

7.2 Brand portfolio

The Group has an internationally recognised portfolio of brands including its four GDBs and the Group's International Brands. The Group's product portfolio includes a wide range of cigarettes and other tobacco products including cigars, roll-your-own tobacco and snus.

7.3 Innovation pipeline

The Group focuses on developing new products that will meet consumers' needs as well as products that are recognised by scientific and regulatory authorities as reduced risk.

7.4 Global scale

The Group has an increasingly global approach to managing the Group's supply chain, covering direct agronomy services support to leaf growers, direct and indirect procurement, tobacco products manufacturing and distribution, with the aim of reducing complexity and rationalising manufacturing sites and suppliers (where appropriate) to leverage economies of scale while enhancing quality standards.

8. THE GROUP'S STRATEGY

The Group's vision is to achieve leadership in the global tobacco industry based on four factors: growth, productivity, responsibility and building a winning organisation.

The Group defines leadership in both a quantitative and qualitative sense. Quantitatively, the Group seeks volume leadership among international competitors. Qualitatively, the Group aims to lead the Group's industry as the preferred partner of key stakeholders and in demonstrating responsibility.

8.1 Growth

The Group aims to increase its sales volume and grow its value share of the global market through both organic growth and mergers and acquisitions.

Organic growth means growth achieved by increasing the Group's market share in existing markets, the migration of the Group's legacy brands to its GDBs and by entering new markets. To achieve organic growth, the Group focuses on what the Group considers to be the key segments of the market for tobacco products that offer the best long-term growth prospects. These include:

- the "*Premium*" market segment, which are products that are generally sold at a higher price in a market than competing products in that particular market;
- the "*Lights*" market segment, which are products that the Group considers to be lighter in taste; and
- the "*ASU30*" market segment, which are products that are developed to meet the preferences of adult smokers who are aged over 18 and under 30.

The Group believes that this segmentation will enable the Group to meet consumer preferences and will offer the best opportunity for organic growth. The Group also aims to optimise the performance of the Group's GDBs and seek opportunities for profitable sales volume growth in the value-for-money and low price market segments. The Group also believes that innovative products that offer consumers meaningful, value-added differentiation are key to organic growth.

To enhance the global scale of the Group's GDBs, the Group has used migrations to unlock the sales volume in some of the Group's older brands in its portfolio that have experienced a decline in their sales volume over the years. The Group refers to such brands as the Group's legacy brands. The brands the Group chose to migrate were underperforming assets with annual rates of decline in sales volume in the 3% to 5% range. The Group has now migrated consumers from underperforming assets to some of the Group's strongest corporate assets, its GDBs. The overall

reduction in the number of underperforming brands reduces operational complexity for the Group and its trading partners while at the same time offering consumers superior brand offerings. Over 4 billion cigarette sticks have been migrated to GDBs from legacy brands with approximately 90% of the migrations meeting the Group's expectations.

The Group aims to maintain or develop strong positions in its largest and most profitable markets. Strategically important and financially attractive mergers and acquisitions may also provide the Group with growth opportunities.

The Group believes that one of the Group's key strengths is its diversified GDB portfolio. The Group believes that the GDBs deliver tangible choices such as product, blend and price along with other perceived consumer benefits like strength and taste. The Group's growth strategy focuses on the success of its four GDBs. The Group focuses its resources on developing these brands in what it considers to be the key Premium, Lights and ASU30 market segments, where it expects both current and long-term growth opportunities.

The Group also continues to invest in its other internationally recognised, regional and local brands, where consumer preferences more closely align to a particular brand offer and where such brands play a strategic role for the Group's product portfolio in a particular market or region such as *Vogue*, its premium superslims cigarette product, *Kool*, its premium menthol cigarette product *Winfield*, a key brand in Australia and *Peter Stuyvesant* in South Africa.

8.2 Productivity

The Group's approach to productivity is to concentrate on cost management, marketing efficiency and capital effectiveness, and to deploy its global resources more effectively to increase profits and generate funds to reinvest in its business. This includes ensuring that the Group uses its marketing resources and capabilities in the most efficient way, reducing unnecessary complexity and effectively using its cash and other assets. The Group's strategy is to reduce costs by turning a multinational business into an integrated global enterprise that can take advantage of its scale.

Greater integration across the Group's supply chain has helped it to reduce costs, increase speed to market and improve effectiveness. Cost savings are predominantly the result of efficiencies within the manufacturing and logistics operations and initiatives regarding the specification, purchase and usage of packaging and leaf materials. The Group has also focused on reducing overheads and indirect costs through working capital benefits, better information technology throughout the supply chain and by reducing headcount. In 2008, the Group announced a new five-year productivity target of annualised cost savings in supply chain, overheads and indirect costs of £800 million by 2012.

The Group's Product Complexity Reduction Programme, which focused on ensuring that the Group uses resources efficiently, has eliminated, streamlined and optimised various specifications and practices in the Group's business. For example, the Group has reduced the number of specifications it uses by harmonising cigarette dimensions around the world, thereby increasing sourcing opportunities and allowing hub planning at reduced cost. The Group has also replaced cardboard cartons with clear film wrap, a type of cellophane material, as its standard packaging globally, delivering environmental and cost benefits. The Group has achieved a 35% reduction in the number of stock-keeping units and a 40% reduction in the number of input materials, leaving a more focused, consumer-relevant portfolio.

The Group expects that its Global Leaf Pooling Organisation, which commenced in December 2007, will reduce the need to hold multiple leaf stocks to cover local and regional contingencies, and deliver significant savings.

The Group is not the beneficiary of any material governmental protections, investment encouragement law or incentives which are not of general application.

8.3 Responsibility

The Group's companies manufacture and sell tobacco products whose use poses real and serious risks to health. The Group strongly believes that its business must demonstrate responsibility in everything it does. The Group aims to balance commercial objectives with the expectations of a broad range of stakeholders, thus ensuring a sustainable business.

The Group uses external benchmarks to assess its performance in terms of responsibility. The Group uses the DowJones Sustainability World Index (“**DJSI World**”) and the DowJones STOXX Sustainability Index (together with DJSI World, the “**DJSIs**”) as the primary business measures for assessing its performance in this area. The DJSIs are global indices tracking the performance, in terms of the responsibility of the leading companies worldwide. The results are based on a detailed assessment of a company’s economic, environmental and social performance, as well as how well it integrates sustainability strategies into its business. In 2008, the Group was, for the seventh year running, the only tobacco company included in the DJSIs. The Group scored a maximum 100% rating in four key areas, Environmental Performance, Environmental Reporting, Fuels for Tobacco Curing and Responsible Marketing. It also achieved outstanding ratings in strategic areas of concern, such as Social Reporting, Environmental Policy, Combating Smuggling, Human Capital Development and Labour Practice.

The Group supports tobacco regulation that balances the preferences of consumers and interest of its stakeholders with the interests of society and enables the Group’s businesses to continue to compete and prosper.

The Group believes that good environmental practice is good business practice and that businesses can enhance efficiency through environmentally sound technologies, optimising products and processes and conserving energy and natural resources. The Group is working to control and reduce its environmental impact through reduction, recovery and recycling. The Group believes that over time it has established a strong environmental record. In recent years, the Group has achieved significant reductions in its water use, energy use, waste sent to landfill and the associated carbon dioxide equivalent resulting from these.

8.4 Building a Winning Organisation

To achieve the Group’s vision of industry leadership, it recognises that it must continue to have the right people and the right working environment. The Group aims to develop leaders at all levels, to foster a confident culture that embraces change and innovation, to attract and retain talented people and to ensure continuous improvement throughout the Group.

8.5 Business segments

The Group sells its products in both developed and developing markets. In 2007, sales volume in developed markets accounted for 24% of the Group’s total sales volume, compared with 76% in developing markets. The Group is currently organised into five regions: Europe; Asia-Pacific; Latin America; Africa and Middle East; and America-Pacific (excluding the Group’s associated companies, consisting primarily of Reynolds American in the United States, ITC in India and, until 2 July 2008, ST). As of 1 January 2009, the Group intends to reorganise its operations including the separation of its European commercial operations into two separate units, *Western Europe* and *Eastern Europe*. Such reorganisation may result in further changes to the regions or compositions of the regions in which the Group’s operations are currently organised.

The European region encompasses over 50 markets in Western Europe, Central Europe and Eastern Europe, and extends from Portugal to Russia. In 2007, the sales volume for the European region was 245.0 billion cigarettes. In 2007, revenue from the European region was £3,655 million; which is 36.48% of the Group’s total consolidated revenue, and profit from operations, excluding exceptional items, was £842 million.

The Asia-Pacific region encompasses South Korea, China and the markets of South-East Asia, South Asia and Australasia. In 2007, the sales volume for the Asia-Pacific region was 145.2 billion cigarettes. In 2007, revenue from the Asia-Pacific region was £1,876 million, which is 18.73% of the Group’s total consolidated revenue, and profit from operations, excluding exceptional items, was £672 million.

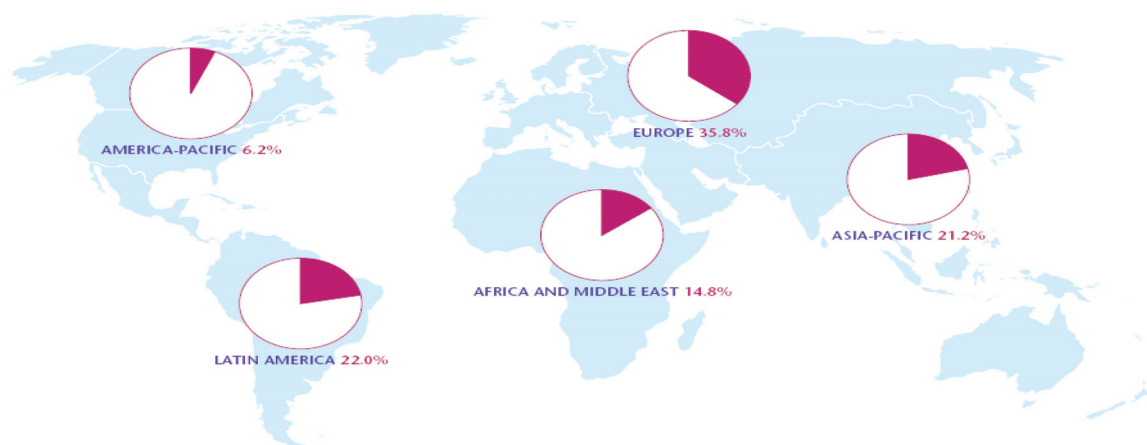
The Latin American region encompasses the markets of Central America and South America, the Caribbean and Mexico. In 2007, the sales volume for the Latin American region was 150.5 billion cigarettes. In 2007, revenue from the Latin American region was £1,983 million, which is 19.79% of the Group’s total consolidated revenue, and profit from operations, excluding exceptional items, was £680 million.

The Africa and Middle East region encompasses the Middle East, the Caucuses, Turkey and Africa. In 2007, the sales volume for the Africa and Middle East region was 101.0 billion cigarettes. In 2007, revenue from the Africa and Middle East region was £1,445 million, which is 14.42% of the Group's total consolidated revenue, and profit from operations, excluding exceptional items, was £470 million.

The America-Pacific region covers Canada and Japan. In 2007, the sales volume for the America-Pacific region was 42.3 billion cigarettes. In 2007, revenue from the America-Pacific region was £1,059 million, which is 10.57% of the Group's total consolidated revenue, and profit from operations, excluding exceptional items, was £446 million.

The Group believes that its geographic spread means that the Group is well represented in many of the developing markets where sales volume and profitability are expected to grow, and that the Group is not overly reliant on developed markets where sales volume is declining faster than the global average.

The following graphic sets forth the breakdown of the Group's sales volume by region in percentage terms in respect of the financial year ended 31 December 2007:



Source: 2007 Annual Report

9. BRANDS AND PRODUCTS

The Group's four Global Drive Brands are:

- *Dunhill*;
- *Kent*;
- *Lucky Strike*; and
- *Pall Mall*,

and International Brands include:

- *Vogue*;
- *Viceroy*;
- *Kool*;
- *Rothmans*;
- *Benson & Hedges*;
- *Peter Stuyvesant*;
- *Craven 'A'*; and
- *State Express 555*.

The Group's product portfolio includes cigarettes and other tobacco products including cigars, roll-your-own tobacco and snus.

The Group has focused its growth strategy on developing its GDBs in its key market segments (Premium, Lights and ASU30), where such brands are well represented. In 2007, GDBs represented 24% of the Group's overall sales volume. The Group will continue to focus on growing the GDBs.

9.1 Global Drive Brands

9.1.1 *Dunhill*

The *Dunhill* brand for tobacco products was launched in 1907. In 1999, as part of the Group's merger with Rothmans International, the Group acquired the *Dunhill* brand in respect of cigarettes, cigars and tobacco products. The *Dunhill* brand range includes a diverse range of premium and super premium cigars and cigarettes. The *Dunhill* brand is sold in more than 120 markets, with key markets in South Africa, Australia, Malaysia, South Korea and Taiwan. In 2007, total *Dunhill* sales volume was 35 billion cigarettes.

In recent years, the Group has enhanced *Dunhill's* position in the premium segment of its key markets with the roll-out of the *Dunhill Fine Cut* cigarettes, *Top Leaf*, *Essence (superslims)* and *Sense (menthol)* ranges. The roll-out of these new products has also helped the launch of *Dunhill* in other markets, particularly in Europe and the Middle East. In addition, the Group has successfully launched a number of key product innovations to consolidate *Dunhill's* position as a brand that can command premium or above premium prices.

The *Dunhill* range includes the *Dunhill Signed Range* cigars which received a top rating of 92 out of 100 in Cigar Aficionados' "Top 25 Cigars of 2007". In 2007, sales of the *Dunhill Signed Range* cigars increased 67% on 2006.

9.1.2 *Kent*

The Group considers *Kent* to be the Group's modern freestanding premium brand. *Kent* is sold in more than 70 markets, with its key markets in Russia, Eastern Europe and Chile. In 2007, total *Kent* sales volume was 54 billion cigarettes. The Group has increased the brand's global footprint through growth in existing markets, new market entries and migrations. *Kent* is available in countries throughout Western and Eastern Europe, Africa, Latin America and Asia.

In recent years, the Group has developed a number of innovations in respect of the *Kent* brand. These include the introduction of a new global pack and the core charcoal range's use of *3-Tek* filter technology. In 2007, innovations included the introduction of *Nanotek*, the king size super slim format with activated charcoal in the super premium segment, and *Mintek*, the king size format with menthol thread technology.

9.1.3 *Lucky Strike*

Lucky Strike was launched in 1871 and is one of the Group's oldest trademarks. *Lucky Strike* is among the Group's leading premium brands. The *Lucky Strike* brand comprises a range of cigarettes, including *Original Red*, *Original Silver*, *Madura*, *Fireleaf Silver* and *Mentha Piperita* variants, as well as the recently launched roll-your-own tobacco and snus, the smokeless product.

The *Lucky Strike* brand is sold in more than 90 markets, with key markets in Germany, Spain, Japan, France and Indonesia. In 2007, total *Lucky Strike* sales volume was 23 billion cigarettes. The ASU30 market segment accounts for more than 60% of the brand's franchise and the Group continues to focus on this market segment through consumer relevant innovation.

In recent years, *Lucky Strike* introduced new premium pack designs which, among other things, differentiate the Original Red from the Original Silver variant. The new range of *Madura*, *Fireleaf Silver* and *Mentha Piperita* variants were launched to deliver unique tobaccos and to provide a choice of rich tastes. In 2007, the Group launched limited edition *Window Pack*, *X-Pack* and *Fresh Pack* to complement the global roll-out of a premium pack design upgrade which began in 2006. Additionally, the Group launched new products in the menthol segment in Peru, France and Hong Kong.

9.1.4 *Pall Mall*

Pall Mall was introduced in 1899 and is the Group's leading global value-for-money brand. The House of *Pall Mall* range includes cigarettes and roll-your-own products. In 2007, total *Pall Mall* sales volume was 51 billion cigarettes.

Pall Mall is sold in more than 60 markets, with key markets in Germany, Italy, Russia and Uzbekistan.

The Group believes that *Pall Mall's* success is driven by the strong and consistent brand mix and consumer relevant innovations, including the launch in Russia of two aromatic superslims. In 2007, *Pall Mall's* good performance was driven by good organic sales volume growth in established markets such as Germany, Russia, Italy and Turkey, as well as successful launches across most regions.

Pall Mall is the Group's leading roll-your-own brand. The growth in roll-your-own is driven mainly by growth in sales volume and increases in market share in Germany and the Benelux region.

On a total tobacco basis (that is, including roll-your-own), *Pall Mall* total sales volume was 55 billion cigarettes in 2007.

9.2 Other International Brands

While the Group's GDBs remain central to its strategy, its International Brands are also growing, especially *Vogue* and *Viceroy*. In 2007, International Brand sales volume was 141 billion cigarettes, including total *Vogue* sales volume of 9 billion cigarettes and total *Viceroy* sales volume of 39.2 billion cigarettes.

Vogue is a super premium brand designed to meet the preferences of female consumers. Sales have been strong across Eastern Europe, including Russia, Romania and Ukraine. *Vogue* also has leading positions in France and Poland. The brand is well placed to grow where consumers are increasingly able to trade up to premium brands.

Viceroy is sold in over 40 markets, and its key markets include Romania, the Middle East, Turkey and Argentina. *Viceroy* is part of the Group's efforts to appeal to consumers who are choosing to trade down in price but still want an International Brand.

In 2007, various innovations were launched in relation to the Group's International Brands. In particular, *Vogue* launched the new *Vogue Arome* range in a number of markets. Additionally, in 2007 the Group introduced, in Japan, a new cigarette product, called *Kool Boost*, and received a positive response from consumers. The new product uses a menthol capsule in the filter which can be crushed at any point allowing the consumer to choose if and when to enhance the menthol experience.

9.3 Roll-your-own and Snus

In 2007, the Group's Canadian subsidiary began test marketing of Swedish-style snus, a smokeless tobacco product, in Canada under the *du Maurier* brand. The Group continued its snus test market in South Africa and ran a limited consumer trial in Japan. The Group also increased snus sales in Sweden and Norway. The Group continued to lobby for an amendment to EU regulations that ban the sale of snus in the EU except for Sweden.

10. PROCUREMENT

The Group purchases approximately 460,000 tons of tobacco leaf a year from approximately 280,000 farmers who grow tobacco leaf and other international suppliers from whom the Group buys other raw materials such as packaging and paper.

The Group runs leaf programmes that provide direct agronomy support to farmers if support is not otherwise available. The Group's agronomy support services involve providing seed and giving training, advice and support on all aspects of crop production and environmental best practice. In 2007, the Group ran agronomy services in 19 markets reaching approximately 193,000 growers and covering more than 220,000 hectares under cultivation. On average, the Group buys two thirds of its leaf under contract from growers who receive direct agronomy support from the Group.

The Group's major supply chain programs include its Business Enabler Survey Tool ("**BEST**") and its Social Responsibility in Tobacco Production ("**SRTP**") programme. BEST sets out in detail the standards the Group expects of its raw material suppliers, other than leaf suppliers. BEST assesses suppliers across 108 performance criteria, covering, for example, suppliers' business ethics, environment,

occupational health and safety management, employee rights and the supplier's ability to trace the sources of raw materials, including sourcing wood from sustainably managed forestry. SRTP addresses the social and environmental issues associated with leaf growing and processing, and reaches around 280,000 farmers who supply all the leaf the Group buys. SRTP covers farmers' standard of living and efforts to eliminate child labour (including access to schooling, the prevention of long working hours and hazardous work) while including a long-term programme of reviewing and examining suppliers' operations to stimulate good agricultural practices. SRTP also promotes afforestation initiatives, so that farmers who require wood for tobacco curing can obtain it from sustainable sources.

11. MANUFACTURING

In 2007, the Group sold approximately 684 billion cigarettes (excluding the Group's associates) produced by 47 cigarette factories in 40 markets. As of July 2008, the Group has an additional six operational factories following the acquisition of ST and Tekel. The Group's factory outputs and establishments vary significantly in size and production capacity. For example, the Group's site in Bayreuth, Germany, which has an annual output of about 50 billion cigarettes and over 1,000 employees versus one of its smallest factories in Fiji, which has an annual output of about 400 million cigarettes and approximately 50 employees. In addition, the Group has 18 green leaf threshing plants, where leaf is processed after being received from the farmers, and six factories (or factories within factories) that produce other tobacco products, such as roll-your-own tobacco and pipe tobacco. In total, approximately 22,000 employees work within the Group's manufacturing.

The technology employed in cigarette factories is sophisticated, especially in the area of cigarette making and packing where throughputs can reach over 12,000 cigarettes per minute. The Group can produce many different pack formats (e.g., the number of cigarettes per packet) and configurations (e.g., bevel edge, round corner, international) to suit marketing and consumer requirements. New technology machines are sourced from the leading machinery suppliers to the tobacco industry. Close cooperation with these organisations helps the Group support its marketing strategy by driving its product innovations, which are brought to the market on a regular basis. Supplier management is fulfilled in line with the procurement policies and BEST is used to assess the Group's suppliers.

To ensure the highest product quality levels, the Group utilises its quality standard called "*finished product inspection*", which measures many different parameters to ensure the Group's consumers receive their products in optimal conditions.

The Group has several improvement initiatives which it is currently managing. For example, the Manufacturing Excellence Programme is centrally led with an aim to improve the performance of the Group's factories globally by focusing on manufacturing standards, continuous improvement, assessment and benchmarking and organisational development. The Group also utilises a survey process in the factories with an aim to improve factory productivity and reduce costs in the manufacturing environment. This process is known as a 'Bulls Eye' process and has been in existence for a number of years which highlights productivity opportunities by benchmarking.

12. DISTRIBUTION AND SALES

The Group's products are distributed to retail outlets around the world, including supermarkets, convenience stores, hotels, restaurants, cafes, tobacconists and duty free shops. The Group recognises the importance of retail outlet distribution. As part of its trade communication and distribution strategy, the Group adopts a direct and exclusive distribution approach, or "direct store sales", by identifying and working with the retail outlets to develop a commercially based and strategic relationship. The Group believes that, where appropriate and possible, "direct stores sales" is the most effective way of serving the retail outlets. In 2007, the Group had several "direct stores sales" projects around the world, including in Canada, Nigeria, Malaysia, Vietnam, Turkey and New Zealand. The Group believes that by increasing its direct sales footprint in these markets, it will achieve new growth.

The Group has hundreds of local and regional wholesale customers and actively works with over a dozen key global corporate retailer partners. These very large businesses operate mainly in the grocery, convenience and petrol station convenience distribution channels. In addition, the Group has entered into long-term international partnering arrangements with Shell and Exxon Mobil.

13. MARKETING

The Group's marketing is based on understanding consumers and giving them relevant choices. The Group gathers insights into adult consumers' preferences and buying behaviour, before investing in developments across the marketing mix to deliver relevant choices for its consumers.

The Group is focused on delivering quality tobacco products to consumers. The Group's marketing strategy is driven by three principles:

- A portfolio of strong Global Drive Brands;
- Innovation; and
- World class trade marketing.

The Group has a diversified GDB portfolio, rather than a "one size fits all" model. Using insights into consumer lifestyles and values, the Group's GDBs – *Dunhill*, *Kent*, *Lucky Strike* and *Pall Mall* – deliver perceived consumer benefits through quality in product, blend, taste and price.

The Group's GDB approach offers consumers brand, format and style choices, drives the expansion of each brand's geographic footprint and improved margins for its business. The Group focuses resources to develop these brands in the *Premium*, *Lights* and *ASU30* market segments, where it expects both current and long-term growth opportunities to grow the Group's share in a particular market. The Group deploys and invests in the International Brands, regional and local brands in areas where they play a strategic role either in a product sector such as 'superslims' or in a particular market.

The Group believes there should be marketing restrictions for products which pose real and serious risks to health, such as tobacco products. In 2007, the Group revised its International Marketing Standards, which apply to all its companies and govern its tobacco marketing across print, billboards, electronic media, promotional events and sponsorship. They now include, for example, further procedures for adult verification and for the responsible use of new and emerging channels of consumer communication.

In some markets, the Group's International Marketing Standards are stricter than local laws. The Group set 30 June 2008 as its internal deadline for applying the updated standards in full.

14. INTELLECTUAL PROPERTY

The Group's trademarks, which include the brand names under which its products are sold, are key assets. The Group regards the protection and maintenance of the reputation of its brand names and trademarks as critical to its success. The Group relies on trademark laws together with copyright and design right laws in different jurisdictions around the world to protect its intellectual property rights.

The Group owns the trademarks to the vast majority of the brands that it uses in its business, including trademarks in relation to the Group's four GDBs and its International Brands in the Group's key markets. Generally, the Group's trademarks in relation to the Group's four GDBs and its International Brands are principally owned by its brand owning companies in the United Kingdom, United States, the Netherlands or Switzerland, which license the use of such trademarks to its relevant operating companies. Other brands tend to be locally owned. *Camel*, *Winston* and *Salem* are licensed to the Group by Japan Tobacco Inc. with respect to cigarettes in a number of markets in Latin America.

The Group also owns a number of brands and trademarks which it has licensed to third parties for use in particular jurisdictions. For example:

- *Benson & Hedges* and *State Express 555* trademarks are licensed to ITC for use in respect of cigarettes and tobacco products in India;
- *Dunhill* trademark is licensed to Reynolds American for use in respect of cigarettes, cigars and tobacco products in the United States; and
- *Dunhill* trademark is licensed to Rothmans, Benson & Hedges Inc. for use in respect of cigarettes and tobacco products in Canada.

The Group also seeks to protect its innovations by means of patents in key jurisdictions. The Group currently has over 4,000 patents which are the subject of either registration or applications.

15. RESEARCH AND DEVELOPMENT

The Group focuses its research and development activities on both creating new products and new processes and maintaining and improving the quality of existing products. In a competitive market, the Group believes that innovation is key to continued organic growth. As such, the Group's research and development focuses on developing new products that meet the preferences of adult consumers. Research is carried out on risk characterisation, building a framework to assess the relative risk of novel and conventional products and a better understanding of consumer behaviour. The Group focuses its research and development of a potentially reduced-risk cigarette on addressing three scientific challenges:

- Determining which toxicants in smoke are significant for disease and developing tools to measure smokers' exposure to them;
- Developing products that may reduce exposure to these toxicants and, through clinical testing, demonstrating that they do; and
- Assessing whether this reduction in exposure can reasonably be predicted to reduce the risks of tobacco-related diseases.

In April 2008, the Group launched its research and development website *bat-science.com*. The website is written by scientists for scientists and covers tobacco science and an overview of the Group's research into potentially reduced-risk products. As the challenges in understanding and in working to reduce the health risks posed by tobacco products are complex and span many scientific disciplines, its goal is to create a forum where the Group can share its scientific research and findings with other scientists in order to better understand means of reducing tobacco-related health risks. For non-scientists, there is a summary of its research on health and science at *bat.com/science*.

The Group will also continue to publish research findings in peer-reviewed journals, present its findings and views at scientific conferences and seek constructive discussions about harm reduction with scientific and public health stakeholders.

The Group is also researching the science and behavioural science related to smoking and it continues to fund related independent studies.

16. EMPLOYEES

During 2007, the Group's workforce amounted to 53,907 employees worldwide. The Group believes that its labour relations are good. The average number of persons employed by the Group and its associates during 2007, including the Directors, was 97,696 worldwide (compared to 97,431 worldwide in 2006).

The following table sets forth the number of the Group's employees by region and that of its associates in 2007, 2006 and 2005.

Region	Year Ended 31 December		
	<i>(number of employees worldwide)</i>		
	2007	2006	2005
Europe	18,913	18,953	19,479
Asia-Pacific	10,334	10,128	10,407
Latin America	15,009	14,941	13,969
Africa and Middle East	7,807	8,993	9,247
America-Pacific	1,844	2,130	2,262
Subsidiary undertakings	53,907	55,145	55,364
Associates	43,789	42,286	41,588
Total Employees	97,696	97,431	96,952

Included within the employee numbers for Europe are certain employees in the UK in respect of central functions. Some of the costs relating to these employees are allocated or charged to the Group's various regional and national operations.

17. INDUSTRY AND COMPETITIVE ENVIRONMENT

The world market for cigarette sales has exceeded five trillion per year over the last two decades. This is predominantly due to the year on year growth in China which has offset the reducing sales volume of cigarettes in the rest of the world, especially in developed markets such as America-Pacific and Western Europe. The Group expects this trend to continue into the next decade. Additionally, the Group believes that the strongly increasing global population suggests that, although the proportion of adults who smoke is likely to continue to decline, in ten years' time there will still be as many, or more, tobacco consumers globally, as there are today.

China accounts for approximately 40% of global cigarette sales volume and is the world's largest cigarette market. The international tobacco companies have a very small presence in the Chinese market, where the industry is state-owned. The four biggest international manufacturers, which the Group estimates, in 2007, were Philip Morris International with a global market share of 15.7%, BAT (excluding associates) with 13.6%, Japan Tobacco with 11.0% and the combined Imperial Tobacco and Altadis with 6%, collectively held around 52% of the global market.

In 2007 and 2008, the tobacco industry has seen significant consolidation and corporate activity. Japan Tobacco acquired Gallaher, Imperial Tobacco acquired Altadis while Altria spun off Philip Morris International as an independently listed tobacco business. The Group believes that further major industry consolidation and further acquisitions by the major market participants are likely to be smaller regional or country-specific deals. The Group believes that the recent industry consolidation has increased the competitive position of the Group's major global competitors. However, the Group also believes that it has the geographic spread, brand portfolio, innovation pipeline, trade marketing capabilities and global scale to continue to compete with its major competitors.

The global tobacco industry operates in a challenging environment. The size of the global cigarette market is impacted by a number of factors, including increased regulation, rising excise rates on its products and illicit trade.

Regulation of the tobacco industry continues to increase. This includes, in certain jurisdictions, the requirement for graphic health warnings on packaging, severe restrictions on advertising and tougher restrictions on smoking in enclosed public places and workplaces. Further tobacco-control regulation is inevitable, and will at least in part be driven by the outcome of the Framework Convention on Tobacco Control ("**FCTC**") process, as well as domestic regulation. As national regulations increasingly reflect global influences, the scope of areas regulated will likely further expand, particularly in relation to the design features of cigarettes, such as setting ceilings for tar and nicotine content and increasing restrictions on advertising and promotion.

Illicit trade in tobacco products includes the trade in counterfeit products, smuggled genuine products and locally manufactured products on which applicable taxes are evaded. Illicit trade remains a key challenge for the legitimate tobacco industry. Illicit trade is driven by many factors including: tax driven price increases, poor enforcement of border control, weak laws, loosely regulated free trade zones, a less rigorous approach to intellectual property rights protection and the growth of the internet as a medium of trading. The Group estimates that approximately 330 billion cigarettes per year are smuggled, manufactured illegally or counterfeited. The Group is liaising with governments and law enforcement agencies around the world to combat illicit trade. The Group also undertakes a range of measures to protect its trademarks and strengthen the security of its supply chain, such as, the use of covert authentication devices to distinguish genuine from counterfeit products, the destruction of all old machinery and spares and cooperation with suppliers and customers.

Tobacco products are subject to substantial duty, excise and other taxes in most markets in which the Group operates. Increases to duty, excise and other taxes affect the size of the markets in which the Group operates. Increased taxes in markets where tobacco prices are already high are leading consumers to switch to cheaper brands. This is likely to lead to the growth in sales of lower margin products and decreases in sales of higher margin products. Additionally, increases in tobacco taxes can lead to consumers rejecting legitimate tax paid products for products from illicit sources.

18. REGULATION

The Group's businesses operate under increasingly stringent regulatory regimes worldwide. Regulation of the tobacco industry and its products has increased in recent years, including graphic health warnings on packs, advertising and promotion restrictions and restrictions on smoking in enclosed public places. Regulation of the tobacco industry generally covers a variety of aspects of product design, packaging, promotion, sales and pricing. In particular, product regulations may restrict product design and attributes (for example, ISO-measured tar, nicotine and carbon monoxide ceilings), as well as requiring product disclosures such as ingredients, additives and emissions. Packaging regulations may include the requirements to include pictorial health warnings and rotating health warnings, as well as restrictions on the use of colours and font size. Promotional regulations may include restrictions on communications regarding the Group's products at both retail and trade levels. Sales and pricing regulations include restrictions on how cigarettes are sold and the price the Group can charge for its products. Regulations may also restrict the places where adults can and cannot smoke tobacco products.

Regulation is expected to increase and can be summarised as follows:

- *Place*: regulations and restrictions on smoking in public and work places (e.g., smoking bans);
- *Product*: regulation on product design and attributes (e.g., ceilings regarding tar, nicotine and carbon monoxide yields), as well as product disclosures (e.g., ingredients and emissions);
- *Packaging and labeling*: regulation on pictorial health warnings, rotating health warnings, use of descriptors, size of warnings and other government mandated messages, and possible consequential implications for the ability to fully utilise trademarks and other intellectual property rights;
- *Promotion and advertising*: regulation on communications to consumers regarding tobacco products;
- *Purchase*: regulation on the manner in which tobacco products are sold, such as type of outlet (e.g., supermarkets and vending machines) and how they are sold (e.g., above the counter versus beneath the counter); and
- *Price*: regulations which have implications on the prices which manufacturers can charge for their tobacco products (e.g., by excise or minimum prices).

The Group supports tobacco regulation that balances the preferences of consumers and interests of its stakeholders with the interests of society and enables its business to compete and prosper.

The Group believes that as a responsible tobacco business, it can contribute through information, ideas and practical steps, to help regulators address the key issues regarding its products, including under-age access, illicit trade, product information, product design, involuntary exposure to smoke and the development of potentially less harmful products, while maintaining a competitive market that accommodates the significant percentage of adults who choose to be tobacco consumers. The Group is committed to work with national governments and multilateral organisations and welcomes opportunities to participate in good faith to achieve sensible and balanced regulation of tobacco products.

19. ENVIRONMENTAL MATTERS

The Group is subject to extensive environmental laws and regulations with respect to water and air quality, solid waste disposal and odour and noise control. The Group conducts an on-going programme designed to comply with these environmental laws and regulations. The Group believes that it is in compliance with substantially all applicable environmental laws and regulations. However, the Group cannot predict whether future changes in environmental laws or regulations might increase the cost of operating its Group's facilities and conducting its business. Any such changes could have adverse consequences on the Group's business, financial condition and results of operations.

The Group's Environment, Health and Safety policy ("**EHS policy**") sets out detailed requirements for all of the Group's operating companies, designed to achieve the Group's aim of applying the best international standards in environmental, occupational health and safety management, and to ensure that its companies give the necessary activities a high priority. Unless local law is more exacting, all of the Group's operating companies must comply with EHS policy.

20. CURRENT TRADING, TRENDS AND PROSPECTS

Shareholders are referred to the Group's most recent trading update dated 9 October 2008 which is attached hereto as Annexure X.

21. RISK FACTORS

Any investment in the Shares is subject to a number of risks and uncertainties. Before making an investment decision, investors should carefully consider these factors and risks associated with any investments in the Shares, BAT's business and the industry in which it operates, together with all the information that is included in this Pre-listing statement and should form their own view.

In particular, investors should evaluate the uncertainties and risks referred to or described below. If any of the events contemplated by the following risks actually materialise, BAT's business, financial condition, prospects and share price could be materially and adversely affected to the detriment of BAT and investors may lose all or part of their investment.

The below describes all risks the Group considers to be material. However, there may be additional risks that the Group currently considers immaterial or of which it is currently unaware, and any of these risks could have the effects set forth above.

21.1 Risks related to the tobacco industry and the Group's business

21.1.1 Significant increases in tobacco-related taxes have been proposed or enacted and are likely to continue to be proposed or enacted in numerous jurisdictions. These tax increases may result in a decline in overall sales volume for the Group's products or may alter the Group's sales mix in favour of value-for-money brands

Tobacco products are subject to high levels of taxation, including excise taxes, sales taxes and import duties in most markets in which the Group operates. In many of these markets, taxes are generally increasing but the rate of increase varies between markets and between different types of tobacco products. Increased tobacco taxes, laws establishing minimum retail selling prices, changes in relative tax rates for different tobacco products or adjustments to excise structures, may result in a decline in overall sales volume for the Group's products or may alter its sales mix in favour of value-for-money brands. Increases in tobacco-related taxes can limit the Group's ability to increase the prices on tobacco products and can also lead to consumers rejecting legitimate tax-paid products for products from illicit sources.

21.1.2 Competition from illicit sources may have an adverse effect on the Group's overall sales volume, restricting the ability to increase selling prices and damaging brand equity

Illicit trade in the form of counterfeit products, smuggled genuine products, and locally manufactured products on which applicable taxes are evaded, represents a significant and growing threat to the legitimate tobacco industry. Increasing tax regimes are encouraging more consumers to switch to illegal cheaper tobacco products and providing greater rewards for smugglers. Illicit trade can have an adverse effect on the Group's overall sales volume, restrict the ability to increase selling prices and damage brand equity.

21.1.3 The Group's business faces increasing government tobacco-control and tobacco-related regulation which may have an impact on the Group's overall sales volume

Regulation, combined with the generally diminishing social acceptance of smoking, has resulted in reduced industry volume in many of the Group's markets. In addition, further tobacco-control and tobacco-related regulation is inevitable over the next few years in most of the Group's markets, driven both by guidelines and protocols deriving from the Framework Convention on Tobacco Control ("**FCTC**"), as well as by tobacco-control activities emanating outside the FCTC (e.g., European Union and domestic regulation). The FCTC is an international public health treaty and its objective is to establish a global agenda for tobacco regulation with the purpose of reducing initiation of tobacco use and encouraging cessation. Over 150 governments worldwide have ratified the FCTC. The FCTC has led to increased efforts by tobacco-control advocates and public health organisations in various markets to

reduce the supply and demand of tobacco products to adult consumers, and to encourage government consideration of judicial processes for the purpose of tobacco-control. Many of the measures outlined in the FCTC have been or are being implemented into national legislation in many markets. Most regulation or potential regulatory initiatives can be categorised as follows:

- *Place*: regulations and restrictions on smoking in public and work places (e.g. smoking bans);
- *Product*: regulation on product design and attributes (e.g., ceilings regarding tar, nicotine and carbon monoxide yields), as well as product disclosures (e.g., ingredients and emissions);
- *Packaging and labeling*: regulation on pictorial health warnings, rotating health warnings, use of descriptors, size of warnings and other government mandated messages, and possible consequential implications for the ability to fully utilise trademarks and other intellectual property rights;
- *Promotion and advertising*: regulation on communications to consumers regarding tobacco products;
- *Purchase*: regulation on the manner in which tobacco products are sold, such as type of outlet (e.g., supermarkets and vending machines) and how they are sold (e.g., above the counter versus beneath the counter); and
- *Price*: regulations which have implications on the prices which manufacturers can charge for their tobacco products (e.g., by excise or minimum prices).

These types of tobacco-control regulations may have an impact on the Group's overall sales volume, as well as increasing its costs of doing business.

Further, taking into account the significant number of regulations applying to the Group's businesses across the world, it is possible that there may be allegations of breaches of regulations. Even when such allegations are proven untrue, there is often a reputational impact and financial cost in defending such allegations.

21.1.4 The Group's business faces significant tobacco-related litigation that could substantially reduce its profitability and could severely impair its liquidity

There are legal and regulatory proceedings related to tobacco products pending in a number of jurisdictions. These proceedings may be characterised as covering smoking and health issues and include claims for personal injury and claims for economic loss arising from the treatment of smoking and health related diseases.

In the United States, B&W, BAT's wholly-owned subsidiary, is a defendant in a number of product liability cases. In a number of cases, the amounts of compensatory and punitive damages sought may range into the millions and, in some cases, billions of dollars. Although the Group has the benefit of an indemnity from RJRT, a subsidiary of Reynolds American, its associate company in which it holds an approximately 42% ownership interest through B&W, with respect to a broad range of US tobacco-related litigation concerning B&W, if RJRT is unable or unwilling under any particular circumstances to settle or honour the indemnity, the Group is at risk to the extent that the costs related to any liability cannot be recouped through the indemnity.

In the ordinary course of business, the Group anticipates that new legal claims may arise while existing claims will be settled or resolved in the applicable courts of law. Certain rulings in respect of existing cases, if considered favourable to plaintiffs, may give rise to further litigation by others. The Group's consolidated results of operations, cash flows and financial position could be materially affected in a particular fiscal quarter or fiscal year by an unfavourable outcome or settlement of certain pending or future litigation, including through exposure to substantial liabilities as a result of such outcomes or settlements.

See further Note 30 to the Group's consolidated financial information for the financial year ended 31 December 2007 and the details of material litigation set out in Annexure IX to this Pre-listing statement.

21.1.5 The Group is exposed to funding and liquidity, foreign exchange rate, interest rate, and counterparty risks

Funding and liquidity risks expose the Group to shortages of cash and cash equivalents needed in its operations and for refinancing its existing debt. The Group cannot be certain that it will have access to bank finance and capital markets at all times and that the failure to achieve such access will not have an adverse effect on its funding and liquidity position, its credit ratings or its ability to finance acquisitions.

The Group is exposed to changes in currency rates on the translation of the net assets of overseas subsidiaries into its reporting currency, the pound sterling. The Group is also exposed to currency changes from the translation of profits earned in overseas subsidiaries; these exposures are not normally hedged. Exposures also arise from the foreign currency denominated trading transactions undertaken by subsidiaries and dividend flows. The Group maintains both floating and fixed rate debt. Where appropriate, the Group also uses derivatives, primarily interest rate swaps, to vary the fixed to floating mix. Changes in currency values and interest rates could have an adverse impact on the Group's financial condition or operations.

Cash deposits and other financial instruments give rise to credit risk on the amounts due from counterparties. The failure of any counterparty to meet its obligations to the Group could have an adverse effect on its financial condition or operations.

21.1.6 The Group is exposed to risks inherent in operating in a global market

The Group operates in over 180 markets. The Group's results of operations and financial condition are influenced by the economic, regulatory and political situations in the markets and regions in which it has operations, which are often unpredictable and outside its control. Some markets in which the Group operates face the threat of increasing civil unrest and can be subject to frequent changes in regime. In others, terrorism, conflict and the threat of war may have a significant impact on the business environment. Some markets maintain trade barriers or adopt policies that favour domestic producers, preventing or restricting the Group's sales. Political, social, legal, economic, trade or other developments, as well as theft and fraud, may have an adverse impact on the Group's investments and businesses or on its consolidated results of operations.

The Group's results are also impacted by factors such as the prevailing economic climate, levels of employment, inflation, governmental action to increase minimum wages, interest rates, increase in raw material costs, consumer confidence and consumer perception of economic conditions, and any change to such factors in any of the markets in which it operates could have a particular impact on its revenue and margins.

21.1.7 The Group's business may be significantly impacted by constantly changing tax laws and tax rates from around the world

The Group operates in over 180 markets and pay tax in accordance with the tax legislation of those markets. Tax laws and tax rates around the world are constantly changing and these changes may have a significant impact on the taxes the Group must pay and may have an impact on its net profits, which could be material.

21.1.8 The Group may be faced with potentially onerous liabilities in the event that it breaches environmental laws of the jurisdictions in which it operates

If the Group fails to manage properly the environmental risks to which its business is subject, this could result in additional and potentially significant remedial costs and have a negative impact on the Group's reputation. In addition, changes to local regulations or of the legal environment in which the Group operates may result in additional costs which could adversely affect its operations and financial condition.

21.1.9 The Group's licenses to use certain brands and trademarks may be terminated or not renewed

Some of the brands and trademarks under which the Group's products are sold are licensed to it for a fixed period of time in respect of specified markets, such as the right to use the *Camel*, *Winston* and *Salem* brands and trademarks in various markets in Latin America. In

the event that the licence to use any of such brands and trademarks is terminated or is not renewed after the end of the term of the relevant licence, the Group will no longer have the right to use, and to sell products under, such brand(s) and trademark(s) in the relevant markets and this could have an adverse effect on its business, results of operations and financial condition.

21.1.10 The Group is exposed to intellectual property rights infringements as a result of limitations in judicial protection and/or inadequate enforceability

The Group's brand names under which its products are sold are key assets of its business. Investments over a period of time have led to many of the Group's brands having significant brand equity and a global appeal to consumers, essential to delivering sustainable profit growth into the future. The protection and maintenance of the reputation of these brands is important to the Group's success. In some of the markets in which the Group operates the risk of intellectual property rights infringement remains high as a result of limitations in judicial protection and/or inadequate enforceability. Any substantial erosion in the value of the brands could have a material adverse effect on the Group's business, results of operations and financial condition. The Group's strategy or its execution may not maintain the value in any product brand.

21.1.11 The Group's market share and profitability may be adversely affected by competitive actions and pricing pressures in the marketplace

The Group operates in highly competitive businesses and geographical markets, which are experiencing increased industry consolidation. To maintain a competitive advantage the Group must anticipate and respond to new consumer trends through continuous innovation. The Group also seeks to develop and market new products, packaging and technologies, including products which potentially have reduced risk. Competitors' speed-to-market in branding changes, new product launches, or changes in product mix, could have an adverse effect on the Group's operations and results.

From time to time, the Group reviews its organisational structure across all levels of the business to continue to manage costs, improve competitive advantage and ensure continued relevance to business needs. This involves changes to management structures, processes and personnel which, if executed inefficiently, could initially lead to increased costs and reduced market share.

21.1.12 The Group's business is vulnerable to the effects of price wars in a tough competitive environment

In tough competitive environments, where the price burden on consumers is high because of taxation or limited purchasing power, the Group is vulnerable to competitors aggressively taking market share through price repositioning, which generally has the impact of reducing the overall profit pool of the market and therefore its profits.

21.1.13 The Group may lose market share and profit due to the loss of production capacity or key suppliers, distribution interruption or commodity risk

There are some product categories in respect of which the Group does not have over capacity or where substitution between different production plants is very difficult. The Group may lose market share and profit in the event of loss of production capacity needed to supply its products. The Group has an increasingly global approach to managing its supply chain, covering direct agronomy services support to leaf growers, direct and indirect procurement, tobacco products manufacturing and distribution, with the aim of reducing complexity and rationalising manufacturing sites and suppliers (where appropriate) to leverage economies of scale while maintaining quality standards. Supply chain rationalisation projects, including the factory footprint, require significant project management. Severe disruption to any aspect of the Group's supply chain or suppliers' operations could have an adverse impact on its ability to produce and deliver to customer demands. In certain markets, distribution of the Group's products is through channels managed by third parties, and is often licensed by governments. In these instances, the Group's sales volume may be adversely affected by the loss of such distributions.

Further, raw materials used in the Group's businesses are commodities that are subject to price volatility caused by factors including weather conditions, growing conditions, local planting decisions, market fluctuations and changes in agricultural regulations. The Group's access to raw materials may be adversely affected by a significant event occurring in one or more major leaf growing areas. Commodity price changes beyond the Group's control may result in unexpected increases in raw materials and packaging costs for its products. The Group may not be able to increase its prices to offset these increased costs without suffering reduced sales volume and income.

The Group has operations in geographic areas where full insurance coverage against damage resulting from natural disasters may not be obtainable or coverage may be subject to other limitations. The Group may be unable to recover any damages covered by its insurance or obtain certain types of insurances in the future.

21.1.14 Contamination of the Group's products could adversely impact sales volume, market share and profitability

The Group's market position may be affected through the contamination of its products, either by accident during the manufacturing process or deliberately with malicious intent. In these instances, significant costs may be incurred in recalling products from the market. In addition, consumers may lose confidence in the specific brand affected by the contamination, resulting in a loss of sales volume which may take a long time to recover. During this time the Group's competitors may increase substantially their market share which would subsequently be difficult and costly to regain.

21.1.15 Failure to meet targeted costs savings may reduce profitability

The Group's strategy is to improve profitability through productivity and efficiency. These improvements aim to be delivered by reducing costs throughout the supply chain including back-office integration and management structures, as well as the targeted £800 million annualised savings in indirect and overhead costs by 2012. Unexpected increases in direct or indirect costs could arise, especially given the increasingly competitive costs of communicating with consumers in a limited number of available channels. The Group's ability to gain additional efficiencies may become more difficult over time, including as synergies from business combinations and acquisitions are fully realised. In addition, objectives and limitations could be imposed over the scope of savings programs by relevant stakeholders, which may adversely jeopardise future savings programs.

21.1.16 The Group may be exposed to reduced trading performance in key markets

A substantial majority of the Group's profit from operations is based on its operations in 12 markets. The Group's reported profits may be adversely affected by a significant downturn in one or more of these larger markets.

21.1.17 The Group may be adversely affected by its leading market position in certain markets

The Group has leading market shares in certain markets in which it operates. As a result the Group may be subject to investigation for alleged abuse of its position in markets in which it has significant market shares, which could result in adverse regulatory action by the authorities, including monetary fines and negative publicity.

21.1.18 The Group may not be able to expand its portfolio through successful mergers or acquisitions and may become liable for claims arising prior to the mergers or acquisition of those businesses

The Group's growth strategy includes a combination of organic growth as well as mergers and acquisitions. The Group may not be able to successfully integrate the businesses that it acquires or obtain the appropriate regulatory approvals for such acquisitions. The integration of businesses involves risks, including the risk that the integration may divert the Group's focus and resources from its goals and the risk that the integration may take longer and be more expensive than expected. Any of the foregoing risks could result in increased costs, decreased revenues or a loss of opportunities for the Group and have a material adverse affect on its business, results of operations and financial condition.

In addition, the Group may become liable for claims arising in respect of conduct prior to the merger or acquisition of the businesses in the event that it is deemed to be a successor to the liabilities of the acquired company. An adverse judgment against the Group may adversely affect its business.

21.1.19 The Group may be unsuccessful in its attempts to develop tobacco products with the potential to reduce the risks of tobacco-related diseases or to respond to changes in tobacco product technology

The Group devotes considerable resources into the research and development of products that may be identified as potentially reducing risks of tobacco-related diseases. Given the challenges in achieving consumer, regulatory and scientific acceptance of these products, there is a risk that these investments may incur significant costs without achieving financial success. There is also the risk of deterioration in the Group's competitive position if its competitors are successful in this area.

21.1.20 Loss of key personnel could have a negative impact on the Group's operations

The Group relies on a number of highly experienced employees with detailed knowledge of tobacco and other business-related issues. Unanticipated losses of key employees or the inability to identify, attract and retain qualified personnel in the future could adversely affect the Group's business operations.

21.1.21 Reliance on information technology means that a significant disruption could affect the Group's communications and operations

The Group increasingly relies on information technology systems for its internal communications, controls, reporting and relations with customers and suppliers. A significant disruption due to computer viruses, malicious intrusions, the setting up of shared services centres or the installation of new systems could affect the Group's communications and operations.

21.1.22 The Group has net liabilities under its retirement benefit schemes which may increase in the future due to a number of factors

The Group operates approximately 160 retirement benefit arrangements worldwide. These arrangements have been developed in accordance with local practices in the markets concerned. The majority of the Group's scheme members belong to defined benefit schemes, most of which are funded externally, although it operates an increasing number of defined contribution schemes. The contributions to the Group's defined benefit schemes and their valuations are determined in accordance with the advice of independent, professionally qualified actuaries. Changes in asset returns, salary increases, inflation, long-term interest rates and other actuarial assumptions could have an adverse impact on the Group's financial condition and operations.

21.1.23 The Group may be adversely affected by the performance of the Group's associates

Although the Group owns an approximately 42% interest in Reynolds American, its associate company in the United States and the parent of RJRT, and a 32% ownership interest in ITC, its associate company in India, the Group does not have control over either of these associates. The Group's ownership interest in Reynolds American and ITC means it may be affected by their businesses and respective financial performances, as they are subject to tobacco-related industry and business risk factors similar to those the Group faces.

21.2 Risks related to the Shares

21.2.1 Investments in listed securities are subject to changes in the broader market for such securities

Prospective investors should be aware that the value of an investment in BAT may go down as well as up. The market value of the Shares can fluctuate and may not always reflect the underlying asset value. A number of factors outside the control of the Group may impact

on its performance and the price of the Shares, including: (i) the operating and share price performance of other companies in the industries and markets in which the Group operates; (ii) speculation about the Group's business in the media or investment community; (iii) strategic actions by competitors, such as acquisitions and restructurings; (iv) the publication of research reports by analysts; and (v) changes in general market conditions.

21.2.2 Dividend payments are dependent on BAT's earnings

The ability of BAT to pay dividends on the Shares is dependent upon the availability of distributable reserves and upon receipt by BAT of dividends and other distributions of value from its subsidiaries, associates and companies in which it has an investment.

21.2.3 Any dividends will be declared in pounds sterling and any investor whose principal currency is not pounds sterling will be subject to risks relating to currency conversions

The Shares are denominated in pounds sterling. Dividends paid in respect of Shares will be declared in pounds sterling and paid in pounds sterling, other than in respect of South African resident Shareholders who will receive dividends in Rand, converted at an exchange rate determined on or around the dividend declaration date. An investment in the Shares by an investor whose principal currency is not pounds sterling exposes the investor to foreign currency exchange rate risk. Any depreciation of sterling in relation to such foreign currency will reduce the value of the investment in the Shares or any dividends in foreign currency terms and any appreciation of sterling will increase the value in foreign currency terms.

21.2.4 Future share issues and sales of Shares by major Shareholders may decrease the price of Shares

BAT has no current plans for a subsequent offering of Shares. However, it is possible that BAT may decide to offer additional Shares in the future. An additional offering or significant sale of Shares by any of BAT's major Shareholders could have an adverse effect on the market price of the Shares.

21.2.5 There has been no prior public market for the Shares in South Africa and an active public market for the Shares in South Africa may not develop or be sustained

Prior to the Listing, there will have been no public trading market for the Shares in South Africa. Although the Company is currently listed on the London Stock Exchange, the Directors can give no assurance that an active trading market for the Shares will develop on the JSE or, if it develops, will be sustained. If an active trading market does not develop or is not maintained, the liquidity on the JSE and trading price of the Shares could be adversely affected and investors may have difficulty selling their Shares.

21.2.6 The holding of Shares by certain South African residents and emigrants will be subject to South African exchange control restrictions on the holding and trading of Shares

Certain South African residents will be subject to various restrictions on their holding and trading of Shares, which restrictions may affect the price and liquidity of the Shares on the JSE. The details of these restrictions are set out in paragraph 52 in Part VI of this Pre-listing statement. In addition, the South African Government may change these restrictions or impose further restrictions in the future.

21.2.7 Dividends received by South African resident Shareholders in respect of the Shares may become subject to tax

On the basis of current law, dividends received by South African resident Shareholders will be exempt from South African taxation only if BAT remains dual-listed on the LSE (or other non-South African exchange recognised for this purpose) and JSE, and provided that such dividends are not distributed from reserves created by a reduction in BAT's share capital or share premium account.

PART III : DIRECTORS AND SENIOR MANAGEMENT OF THE GROUP

22. DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

22.1 Directors of BAT

The names, business address and functions of the Directors are set out below.

Name	Function
Executive	
Paul Adams	Chief Executive
Ben Stevens	Finance Director
Nicandro Durante	Chief Operating Officer; Director, America-Pacific
Non-Executive	
Jan du Plessis	Chairman
Karen de Segundo	Independent Non-Executive Director; Chair of the Corporate Social Responsibility Committee
Robert Lerwill	Independent Non-Executive Director; Chairman of Audit Committee
Dr Ana Maria Llopis	Independent Non-Executive Director
Christine Morin-Postel	Independent Non-Executive Director
Anthony Ruys	Independent Non-Executive Director; Chairman of the Remuneration Committee
Sir Nicholas Scheele	Senior Independent Non-Executive Director
Matthys Visser	Non-Executive Director

The business address of the Directors is Globe House, 4 Temple Place, London WC2R 2PG, United Kingdom.

22.2 Biographical details of the Directors

Summaries of the biographical details of the Directors are set out below.

Chairman

Jan Petrus du Plessis (54) (British/South African) – Chairman

Mr du Plessis was appointed Chairman in July 2004, having been a Non-Executive Director since his appointment to the Board of Directors in 1999. He was previously Group Finance Director of Richemont. He is Chairman of the Nominations Committee. He is a Non-Executive Director of Lloyds TSB Group plc, Rio Tinto plc and Rio Tinto Limited.

Executive Directors

Paul Nicholas Adams (55) (British) – Chief Executive

Mr Adams was appointed a Director in March 2001 and Chief Executive in January 2004. He joined the Group in July 1991 and held senior appointments as Regional Director, Asia-Pacific and Regional Director, Europe prior to becoming Deputy Managing Director in June 2001 and Managing Director in January 2002.

John Benedict (Ben) Stevens (49) (British) – Finance Director

Mr Stevens was appointed a Director in March 2008 and has been the Finance Director since 30 April 2008. He previously held the position of Director, Europe having joined the Management Board in 2001 as Development Director. Since joining the Group in 1989, he has covered a number of senior marketing, finance and management roles, particularly in Europe, South Asia and Russia and was Head of Merger Integration following the merger with Rothmans in 1999 and Head of Corporate Affairs.

Nicandro Durante (52) (Brazilian/Italian) – Chief Operating Officer and Director, America-Pacific

Mr Durante was appointed a Director and Chief Operating Officer in January 2008. He previously held senior financial and general management roles in Brazil (including President of Souza Cruz) and also in the United Kingdom and Hong Kong. He joined Souza Cruz in December 1981 and prior to his appointment as a Director and Chief Operating Officer he was Regional Director for Africa and Middle East.

Non-Executive Directors

Karen Maria Alida de Segundo (61) (Dutch) – Independent Non-Executive Director

Mrs de Segundo was appointed as a Director in October 2007. She is currently a Non-Executive Director of Lonmin plc, Blackrock New Energy Investment Trust PLC, Ensus Holdings Limited, Pöyry Oyj and Ahold NV and is also a member of General Electric's Eco Advisory Board and a Council Member of the Anglo Netherlands Society. Previously, she was Chief Executive Officer of Renewables and President of Hydrogen of Shell International. She is Chair of the Corporate Social Responsibility Committee and a member of the Nominations and Remuneration Committees.

Robert Earl Lerwill (56) (British) – Independent Non-Executive Director

Mr Lerwill was appointed a Director in 2005. He has been Chief Executive of Aegis Group plc since 2005 and was formerly a Director of Cable & Wireless plc and WPP Group PLC. He is also a Non-Executive Director of Synergy Health PLC. He is Chairman of the Audit Committee and a member of the Nominations and Remuneration Committees.

Dr Ana Maria Llopis (58) (Spanish) – Independent Non-Executive Director

Dr. Llopis was appointed a Director in 2003. She is Executive Deputy Chairman of the J F Llopis Foundation and a Non-Executive Director of ABN AMRO Bank. Previously, she was the Executive Vice-President, financial and insurance markets, at Indra, a leading Spanish IT Consultancy and Chief Executive of OpenBank, the Santander Group online bank. She was also a member of the Good Governance Working Group for Spanish listed companies. She is a member of the Nominations, Remuneration and Corporate Social Responsibility Committees.

Christine Jacqueline Michelle Morin-Postel (62) (French) – Independent Non-Executive Director

Mrs Morin-Postel was appointed as a Director in October 2007. She is a Non-Executive Director of Royal Dutch Shell PLC and 3i Group plc and is also a Senior Advisor to Arlington Capital. Previously, she was Chief Executive of Société Générale de Belgique, Executive Vice-President and member of the Executive Committee of Suez and Chairman and Chief Executive Officer of Crédisuez S.A. She is a member of the Audit, Nominations and Remuneration Committees.

Anthony Ruys (61) (Dutch) – Independent Non-Executive Director

Mr Ruys was appointed a Director in March 2006. He joined Heineken N.V. in 1993, becoming Chairman in 2002. He is a member of the Supervisory Boards of ABN AMRO Bank and Schiphol Airport N.V. and a Director of Lottomatica S.p.A. (Italy). He is Chairman of the Remuneration Committee and a member of the Audit and Nominations Committees.

Sir Nicholas Scheele (64) (British/US) – Senior Independent Non-Executive Director

Sir Nicholas was appointed a Director in 2005. Formerly, he was President and Chief Operating Officer of Ford Motor Company. He is Chancellor of the University of Warwick. He is Chairman of The Cambridge-MIT Institute and Key Safety Systems, Inc. (U.S.A.) and a Director of Pegasus Holdings Group (U.S.A.), Grupo Proeza (Mexico) and Caparo plc. He is a member of the Audit, Nominations, Remuneration and Corporate Social Responsibility Committees.

Matthys Hendrik Visser (54) (South African) – Non-Executive Director

Mr Visser was appointed a Director in 2001. He is Chief Executive Officer of Remgro Limited, having held senior management positions with Rembrandt since 1980. He is Chairman of Rainbow Chicken Ltd and is a Non-Executive Director of Medi-Clinic Corporation Limited, Nampak Limited

and Distell Group Limited. He is a member of the Nominations and Corporate Social Responsibility Committees. As Chief Executive Officer of Remgro, an indirect shareholder of BAT and as a director of R&R, a direct shareholder of BAT, there may be situations where it is not possible for him to simultaneously act in the best interests of BAT and Remgro or R&R.

Except as disclosed in this section, none of the Directors listed above perform activities outside the Group which are significant with respect to the Group.

22.3 Directors of material subsidiaries of BAT

The details of the directors of material subsidiaries of BAT are set out in Annexure XI to this Pre-listing statement.

Senior Managers

In addition to the executive management on the Board of the Company, the Senior Managers are considered relevant to establishing that the Company has the appropriate expertise and experience for the management of its business.

The names, business address and functions of the Senior Managers are set out below.

Name	Function
Mark Cobben	Director, Latin America and Caribbean
John Daly	Director, Asia-Pacific
David Fell	Director, Eastern Europe
Andrew Gray	Director, Africa and Middle East
Rudi Kindts	Director, Human Resources
Jean-Marc Lévy	Director, Western Europe
Michael Prideaux	Director, Corporate and Regulatory Affairs
Jimmi Rembiszewski	Group Marketing Director
Peter Taylor	Global Operations Director
Neil Withington	Director, Legal and Security and General Counsel

The business address of the Senior Managers is Globe House, 4 Temple Place, London WC2R 2PG, United Kingdom.

22.5 Biographical details of the Senior Managers

Summaries of the biographical details of the Senior Managers are set out below.

Mark Cobben (51), (Dutch) – Director, Latin America and Caribbean

Mr Cobben joined the Management Board as Director, Latin America and Caribbean in October 2007. After a career in marketing at Unilever and Colgate he joined the Group in 1993 and has been General Manager in Switzerland, Argentina, Russia and most recently Germany. He was appointed chairman of Souza Cruz S.A. in March 2008.

John Daly (52), (Irish) – Director, Asia-Pacific

Mr Daly joined the Management Board as Regional Director for Asia-Pacific in October 2004. He held a number of senior management roles for Rothmans International in Europe and the Far East before becoming Area Director for the Middle East and North Africa in 2001.

David Fell (48), (British) – Director, Eastern Europe

Mr Fell joined the Management Board as Director, Eastern Europe in May 2008. He joined the Group in 1989 and, since then, has held a variety of marketing positions in Europe and South East Asia. He was appointed President of American Tobacco Japan in 2000 before being made Area Director, BAT Australasia and Managing Director, BAT Australia in 2004.

Andrew Gray (43), (Brazilian/British) – Director, Africa and Middle East

Mr Gray joined the Management Board as Director, Africa and the Middle East in January 2008. Joining Souza Cruz as an intern in 1986, he went on to hold a number of senior management positions in South America (including President of Souza Cruz S.A.) and also in Central America, the Caribbean and Malaysia.

Rudi Kindts (51), (Belgian) – Director, Human Resources

Mr Kindts joined the Management Board as the Director, Human Resources in July 2004. He joined British American Tobacco in 1988 and has held a number of senior human resources roles in the Group. His responsibilities have covered Europe, Africa, the Middle East and Central and South Asia.

Jean-Marc Lévy (45), (Swiss) – Director, Western Europe

Mr Lévy joined the Management Board as Director, Western Europe, in May 2008. After beginning his career with the Kraft-Jacobs-Suchard Group he joined the Group in 1994 as Marketing Director in Switzerland. He went on to hold a variety of marketing and general management roles in Europe and South East Asia.

Michael Prideaux (57), (British) – Director, Corporate and Regulatory Affairs

Mr Prideaux joined the Management Board as Corporate and Regulatory Affairs Director in 1998 following the demerger of B.A.T Industries. He had joined B.A.T Industries in 1989 from Charles Barker, a leading financial and corporate public relations, advertising and design agency, where he was Chief Executive.

Jimmi Rembiszewski (57), (German) – Group Marketing Director

Mr Rembiszewski joined the Group as a Marketing Director and as a Territorial Director in 1991. He has been a member of the Management Board since 1996. He had previously held various senior marketing and business appointments in Procter & Gamble and Jacobs Suchard.

Peter Taylor (56), (British) – Global Operations Director

Mr Taylor was appointed Operations Director in 2003. He joined British American Tobacco in 1980 and worked in a variety of operational and general management roles across the Group.

Neil Withington (52), (British) – Director, Legal and Security and General Counsel

Mr Withington was appointed Legal Director and General Counsel of British American Tobacco in 2000, having previously been the Group's Deputy General Counsel. He joined the Group in 1993 after a career at the Bar and in the chemical and pharmaceutical industries with ICI. He has been a Director of Reynolds American Inc. since July 2004.

Except as disclosed in this section, none of the Senior Managers listed above perform activities outside the Group which are significant with respect to the Group.

22.6 Other directorships and partnerships held by the Directors and Senior Management

The names of all other companies and partnerships in which the Directors and Senior Management have been a director or a partner in the five years preceding the date of this Pre-listing statement are set out in Annexure III to this Pre-listing statement, excluding the subsidiaries of a company of which the person is also a director.

23. Service contracts, emoluments and terms of office

23.1 Executive Directors

23.1.1 Service Contracts

The following Executive Directors have entered into service contracts with BAT, the details of which are as follows:

Director	Notice Period (from Director)	Date of contract
P N Adams	12 months	27 February 2007
N Durante	12 months	28 January 2008
J B Stevens	12 months	26 March 2008

23.1.2 Terms of appointment

Each of the three Executive Directors has a one year rolling contract, executed at the time of each Director's original appointment. The contract may be re-executed during the term of such Director's employment to take account of variations in terms and conditions as well as changes in best practice. The contractual term will continue to be of a one year rolling period. In addition, the Remuneration Committee may, when appropriate, offer a contract with an initial period of longer than one year to those future directors who may be recruited externally or from overseas, reducing its duration to a one year rolling contract after the expiry of the initial period. It is the Group's policy that an Executive Director's one year rolling contract incorporates a provision for a termination payment in lieu of notice.

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

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

Nicandro Durante, who was appointed Chief Operating Officer with effect from 1 January 2008, has a service contract with the Company in the form outlined above. In addition, as a result of the application of local labour laws in Brazil, he retains certain termination or compensation rights in respect of his former employment with Souza Cruz SA. In the event of any compensation being payable to him pursuant to his service contract with the Company, these Souza Cruz SA rights will be taken into account first in arriving at a final compensation amount.

Executive Directors are able to accept one substantive external board appointment provided that permission is sought from the Board. Since 1 January 2006, the fees from such appointments have been retained for a Director's own account.

22.1.3 Remuneration

The table below sets out the remuneration of the Executive Directors for the year ended 31 December 2007:

Director	Salary £	Performance related pay: annual cash bonus £	Performance related pay: deferred share bonus² £	Benefits in kind³ £	Total £
P N Adams	1,076,641	487,230	528,386	137,016	2,229,273
N Durante ¹	–	–	–	–	–
J B Stevens ¹	–	–	–	–	–
Total	1,076,641	487,230	528,386	137,016	2,229,273

Notes:

1. Both Nicandro Durante (from 1 January 2008) and Ben Stevens (from 3 March 2008) were appointed as Executive Directors after the year ended 31 December 2007 and therefore neither of them received remuneration as Executive Directors up to and including that date.

2. The deferred share bonus payments include cash sums equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the awards held by participants (including any Executive Directors) in the DSBS at each dividend record date. For the year ended 31 December 2007, these payments for Paul Adams totalled £41,156.
3. Benefits in kind include: (a) a car or a car allowance; (b) use of a driver; (c) travel and other expenses incurred in connection with accompanied attendance at business functions.

23.1.4 *Salary*

The Executive Directors' salary is a fixed cash sum, payable monthly half in arrears and half in advance. Salaries are reviewed annually in the light of individual performance and market comparisons for similar jobs. Factors taken into account for comparison purposes include company type and sector, measures of company size (market capitalisation, turnover and employee numbers) and degree of international scope.

Base salary has been, and continues to be, the only element of remuneration that is pensionable.

The remuneration of the Executive Directors is reviewed in February each year. With effect from 1 April 2008, the base salary for Paul Adams (Chief Executive) was £1,180,000 (2007: £1,090,000) and for Nicandro Durante (Chief Operating Officer) was £600,000 (Appointed Chief Operating Officer from 1 January 2008 at a salary of £600,000). Ben Stevens was appointed to the Board with effect from 3 March 2008 at which point his base salary was £425,000. With effect from 1 April 2008 and until 29 April 2008, his base salary was £450,000. Upon becoming Finance Director on 30 April 2008, Mr Stevens' base salary was increased to £560,000.

23.1.5 *Benefits*

In addition to their basic salary, the Executive Directors are entitled to certain benefits in kind which comprise private medical and personal accident insurance, a car (or cash allowance in lieu) and the use of a driver. Mr Durante receives certain additional benefits under his service contract: (i) an accommodation allowance of £60,000 net per annum payable monthly until 31 March 2009; and (ii) the provision of four first class airline return tickets to Brazil for each of himself and his spouse in the calendar years 2008 and 2009.

23.1.6 *Bonus scheme*

The British American Tobacco International Executive Incentive Scheme ("**IEIS**") provides for annual, non-pensionable payments and awards, being 50% cash and 50% shares (i.e. the DSBS) for the Executive Directors. DSBS shares are held in trust for three years and participants receive a cash sum equivalent to the dividend on the after-tax position of all unvested shares held in the DSBS at the dividend record date. The bonus entitlements and awards depend upon the performance of the business against targets reflecting five common business measures: underlying operating profit, market share of key players, Global Drive Brand volume, net revenue and cash flow. The 'on-target' and maximum bonus opportunities for the Executive Directors for 2008 as a percentage of base salary are: Chief Executive: 100/200; Chief Operating Officer: 90/180; and Finance Director: 90/180.

23.1.7 *Pensions*

Pension entitlements are dealt with in accordance with the terms and conditions of the applicable pension scheme and do not form part of the contractual compensation payment.

As Executive Directors, both Paul Adams and Ben Stevens are, like other employees, eligible for membership of the British American Tobacco UK Pension Fund (the "**UK Pension Fund**"). The UK Pension Fund, for members who joined before 1 April 2005 (both Paul Adams and Ben Stevens joined before this date) is a non-contributory defined benefit scheme with a normal pensionable age of 60. Pension accrual rates may differ according to individual circumstances but do not exceed 1/40 of pensionable salary for each year of pensionable service. The maximum pension payable will not exceed 2/3 of base salary averaged over the preceding twelve months. The UK Pension Fund retains a scheme-specific cap following the introduction of the new UK pension regime in April 2006. In

addition, Paul Adams and Ben Stevens each have an unfunded pension promise from the Company in respect of earnings above the cap on an equivalent basis to the benefits provided by the UK Pension Fund. This is provided through the membership of an unfunded unapproved retirement benefit scheme.

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

23.2 Non-Executive Directors

23.2.1 Terms of appointment

The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment. For Non-Executive Directors appointed before 1 October 2007, the terms of appointment of each such Director provide that he or she is appointed for a specified term, being an initial period to the next Annual General Meeting after appointment and, subject to reappointment at that meeting, for a further period ending at the Annual General Meeting held three years thereafter. Subsequent reappointment is subject to endorsement by the Board and the approval of Shareholders. Following the implementation of the relevant provisions of the Companies Act 2006, an appointment of a Non-Executive Director made by the Company from 1 October 2007 is made on the basis of a two year term; such appointment being subject to approval by Shareholders in accordance with the terms of the provisions of the Articles relating to the rotation of Directors. Under the terms of their appointment letters, each of Robert Lerwill, Dr. Ana Maria Llopis, Christine Morin-Postel, Anthony Ruys, Sir Nicholas Scheele, Karen de Segundo and Matthys Visser have agreed to act as Non-Executive Directors. On termination, at any time, a Non-Executive Director is entitled to any accrued but unpaid Director's fees but not to any other compensation.

They will each receive reasonable expenses and an annual fee set out below (in each case subject to annual review).

Non-Executive Director	Date of original appointment	Date of last reappointment at an Annual General Meeting
K M A de Segundo	1 October 2007	30 April 2008
R E Lerwill	1 January 2005	26 April 2007
A M Llopis	24 February 2003	30 April 2008
C J M Morin-Postel	1 October 2007	30 April 2008
A Ruys	1 March 2006	30 April 2008
Sir Nicholas Scheele	28 February 2005	26 April 2007
M H Visser	1 April 2001	26 April 2007

23.2.2 Remuneration

The table below sets out the remuneration of the Non-Executive Directors during the year ended 31 December 2007:

Non-Executive Director	Fees £	Performance related pay: annual cash bonus £	Performance related pay: deferred share bonus £	Benefits in kind¹ £	Total £
K M A de Segundo	18,750	–	–	46	18,796
R E Lerwill	95,000	–	–	515	95,515
A M Llopis	75,000	–	–	–	75,000
C J M Morin-Postel	18,750	–	–	–	18,750
A Ruys	75,000	–	–	562	75,562
Sir Nicholas Scheele	75,000	–	–	887	75,887
M H Visser	75,000	–	–	6,879	81,879
Total	432,500	–	–	8,889	441,389

Notes:

1. Benefits in kind include travel and other expenses incurred in connection with accompanied attendance at business functions.

23.2.3 Fees

The Company's policy for Non-Executive Directors' remuneration is that fees are determined in the light of market best practice and with reference to the time commitment and responsibilities associated with the roles.

23.2.4 Incentives

Non-Executive Directors will not receive any remuneration other than their fees. They are not, therefore, eligible for performance related bonuses and do not participate in any Group employee benefit plans or participate in any of the Share Schemes.

23.3 Chairman's terms of appointment

23.3.1 Terms of appointment

The Chairman was originally appointed a Non-Executive Director on 7 June 1999 and he became Chairman of the Company on 1 July 2004. His date of last reappointment as a director at an Annual General Meeting was 30 April 2008. His current terms of appointment provide that he holds that office of Chairman with effect from 1 July 2007 for a period of three years unless terminated earlier by: (i) the Company giving three months' notice or a discretionary compensation payment in lieu of notice; or (ii) by Mr du Plessis giving one month's written notice, in which case the Company will have discretion to make a compensation payment in lieu of such notice. This is limited to any fees which are payable for such part of the relevant notice period as the Board does not require the Chairman to perform his duties. The Chairman is subject to the reappointment of Directors' provisions contained in the Articles. As a result he will not ordinarily serve as a director for more than two years before seeking reappointment. The Chairman's terms of appointment also provide for private medical insurance and personal accident insurance.

23.3.2 Fees and Incentives

During the year ended 31 December 2007, the Chairman received fees pursuant to his terms of appointment of £561,250. In addition he received benefits in kind of £85,224 which comprised the use of a driver and included travel and other expenses incurred in connection with accompanied attendance at business functions. In common with the Non-Executive Directors, he does not participate in any of the Share Schemes, bonus schemes or incentive plans and is not a member of any Group pension plan.

23.4 General

The Directors' emoluments set out above were all paid by BAT, and no Director received emoluments from (i) BAT's subsidiaries; (ii) associates of BAT and its subsidiaries; (iii) joint ventures of BAT, its subsidiaries or associates; or (iv) entities that provide management or advisory services to any of (i) to (iii).

There were no fees paid or accrued as payable to a third party in lieu of Directors' fees during the last financial period of BAT.

It is not expected that there will be any variation in the remuneration receivable by any of the Directors as a consequence of the Listing.

No business of BAT or any of its subsidiaries or any part thereof is managed or is proposed to be managed by a third party under a contract or arrangement.

No payment had been made, either in cash or securities or otherwise, or is proposed to be made, to any director of BAT or to any company in which he is beneficially interested, directly or indirectly, or of which he is a director or to any partnership, syndicate or other association of which he is a member, as an inducement for that director to become a Director.

24. DIRECTORS' INTERESTS

24.1 Directors' shareholdings

As at 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement) the direct and indirect share interests of the Directors in the share capital of BAT are as follows:

Director	Number of Shares as at 8 October 2008			Percentage of issued equity share capital as at 8 October 2008	Number of Shares as at 31 December 2007			Change in shareholding since 31 December 2007
	Direct	Indirect	Total		Direct	Indirect	Total	
Executive Director								
P N Adams	–	144,132	144,132	0.007%	–	143,743	143,743	389
N Durante	100,910	349	101,259	0.005%	97,391	203	97,594	3665
J B Stevens	30,110	5086	35,196	0.002%	14,631	5,308	19,939	15,257
Non-Executive Director								
J P du Plessis	–	50,000	50,000	0.002%	50,000	–	50,000	–
K M A de Segundo	–	4,050	4,050	0.0002%	–	5,000	5,000	–950
R E Lerwill	–	3,000	3,000	0.0001%	–	3,000	3,000	–
A M Llopis	–	2,200	2,200	0.0001%	–	2,200	2,200	–
C J M Morin-Postel	–	4,700	4,700	0.0002%	–	4,700	4,700	–
A Ruys	–	3,000	3,000	0.0001%	–	3,000	3,000	–
N Scheele	5,000	–	5,000	0.0002%	–	–	–	5,000
M H Visser	–	–	–	–	–	–	–	–

J P du Plessis and M H Visser hold interests in the R&R Shareholders, and, accordingly, will receive Shares pursuant to the Proposals.

As at 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement), the Executive Directors had the following interests in the Shares which are held in trust pursuant to the DSBS:

Executive Director	Number of Shares as at 31 December 2007	Number of Shares as at 8 October 2008
P N Adams	118,683	106,544
N Durante	10,566*	16,594**
J B Stevens	32,192	28,487

* In addition, as at 31 December 2007, Mr Durante held cash-based awards on equivalent terms to the DSBS with a value equivalent to 11,983 Deferred Shares. These awards will be cash settled by Souza Cruz SA (a Group subsidiary company).

** In addition, as at 8 October 2008, Mr Durante held cash-based award on equivalent terms to the DSBS with a value equivalent to 5,380 Deferred Shares. This award will be cash settled by Souza Cruz SA (a Group subsidiary company).

As at 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement), the Executive Directors held conditional awards over Shares made under the LTIPs as set out below:

Executive Director	Date of award	Number of Shares	Vesting date
P N Adams	15 March 2006	113,493	15 March 2009
	15 May 2007	159,337	15 May 2010
	15 May 2008	163,418	15 May 2011
N Durante*	15 May 2008	74,962	15 May 2011
J B Stevens	15 March 2006	33,124	15 March 2009
	15 May 2007	38,240	15 May 2010
	15 May 2008	53,098	15 May 2011

* In addition, Mr Durante has received cash-based awards granted by the Company in 2006 and 2007, equivalent in value to 31,380 and 34,416 shares respectively. These awards are subject to the same performance conditions and vesting terms as awards made under the LTIPs.

24.2 Directors' options

The following table sets out the Executive Directors' options over Shares:

Option holder	Share Plan/Scheme	Number of Shares as at 31 December 2007	Exercise price	Date awarded	Date from which exercisable	Expiry date	Change in option holding since 31 December 2007
P N Adams	Sharesave	2,492	663p	Nov 2004	Jan 2010	Jun 2010	–
N Durante	Sharesave	1,421	1,152p	Nov 2006	Jan 2012	Jun 2012	–
J B Stevens	Sharesave	2,492	663p	Nov 2004	Jan 2010	Jun 2010	–

No options have been issued to the Chairman or the Non-Executive Directors.

As at 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement), no Shares were allotted to Directors in terms of a share purchase/option scheme for employees, or any other scheme or structure affected outside of BAT which achieves substantially the same objectives as a share purchase/option scheme, which have not been fully paid for.

24.3 Directors' interest in transactions and assets

No Director had any material beneficial interest, whether direct or indirect, in transactions effected by BAT during the current or immediately preceding financial year or any earlier financial year which remain in any respect outstanding or unperformed.

No Director has, or within three years of the date of this Pre-listing statement had, any material beneficial interest, whether direct or indirect, in any material asset or property acquired or disposed of by, or leased to BAT or in the promotion of BAT.

24.4 Directors' loans

No loans have been made by the Group to any of its Directors or Senior Managers or any of their associates and no security has been furnished by the Group on behalf of any of its Directors or Senior Managers or any of their associates.

25. DIRECTORS' AND SENIOR MANAGERS' DECLARATIONS

As at the date of this Pre-listing statement, no Director, Senior Manager or person acting as a Senior Manager:

- (i) has ever been adjudged bankrupt, insolvent or sequestrated in any jurisdiction or been party to a scheme of arrangement or other form of compromise with his or her creditors;
- (ii) has ever been found guilty in disciplinary proceedings, by an employer or regulatory body due to dishonest activities;
- (iii) has ever been barred from entry into any profession or occupation;

- (iv) has been a director with an executive function of a company at the time of or within the twelve months preceding any of the following events in relation to such company: any receiverships, compulsory liquidations, creditors voluntary liquidations, administrations, company voluntary arrangements or any compromise or arrangement with creditors generally or any class of creditors;
- (v) has been a partner in a partnership at the time of or within the twelve months preceding any of the following events in relation to such partnership: compulsory liquidations, administrations or partnership voluntary arrangements;
- (vi) has been involved in a receivership in respect of his assets or in respect of the assets of a partnership in which he or she was a partner at the time of or within the twelve months preceding such event;
- (vii) has ever received any official public criticism by any statutory or regulatory authorities, including recognised professional bodies;
- (viii) has ever been disqualified by a court from acting as a director of a company or from acting in the management or conduct of the affairs of any company;
- (ix) has ever had any convictions in relation to any offence resulting from dishonesty, fraud or embezzlement; or
- (x) ever been convicted in any jurisdiction of any criminal offence or an offence under legislation relating to the South African Companies Act nor has any company of which he or she was a director or alternate director been so convicted.

26. PROVISIONS OF THE ARTICLES RELATING TO DIRECTORS

The relevant provisions in the Articles relating to Directors are summarised in Annexure IV to this Pre-listing statement.

27. BOARD PRACTICES

The Board is responsible to the Shareholders for the success of the Group and for its overall strategic direction, its values and its governance. Among the key matters on which the Board alone may make decisions are the Group's business strategy, its annual budget, dividends and major corporate activities. It is also responsible for reviewing the Company's internal control and governance system and for approving its "Standards of Business Conduct". The Board held eight meetings in 2007. Responsibility for overseeing the implementation by the Group's operating subsidiaries of the policies and strategy which it sets and for creating the conditions for their successful day-to-day operation is delegated to the Management Board, which met a scheduled nine times in 2007. The Management Board is chaired by the Chief Executive and comprises the other Executive Directors together with the Senior Managers.

The Board is also responsible for the overall system of internal control for the Company and its subsidiaries and for reviewing the effectiveness of the system. It carries out such a review annually, covering all material controls including financial, operational and compliance controls and risk management systems, and it reports to Shareholders that it has done so. The system is designed to identify, evaluate and manage risk that may impede the achievement of the Company's business objectives rather than to eliminate these risks. As a result, the internal control system can therefore provide only reasonable, not absolute, assurance against material misstatement or loss.

28. CORPORATE GOVERNANCE

28.1 General

BAT is committed to maintaining high standards of corporate governance. Its corporate governance framework is directed towards achieving its business objectives in a manner which is responsible and in accordance with high standards of honesty, transparency and accountability.

These principles are reflected in its Standards of Business Conduct, which are kept under continual review and were updated with effect from 1 January 2008 in order to ensure that they remain at the forefront of best business practice. Every Group company and every employee worldwide is expected to live up to them.

The Standards require all staff to act with high standards of business integrity, to comply with all laws and regulations wherever the Group's companies operate and to ensure that business standards are never compromised for the sake of results.

They also set out the Group policy, and provide guidance and support to staff, in the following specific areas:

- Whistleblowing;
- Conflicts of interest;
- Bribery and corruption;
- Entertainment and gifts;
- Political contributions;
- Charitable contributions;
- Accurate accounting and record-keeping;
- Protection of corporate assets;
- Confidentiality and information security;
- Insider dealing and market abuse;
- Competition and anti-trust laws;
- Money laundering and anti-terrorism;
- Trade in the Group's products; and
- Sanctions.

In addition, the principles set out within the Statement of Business Principles are designed to help meet the expectations placed on the Group by its various stakeholders.

Together, the Statement of Business Principles and Standards of Business Conduct underpin the Company's commitment to high standards of corporate behaviour.

No manager has the authority to order or approve any action contrary to the Standards and violation of them is a disciplinary matter and may, where appropriate, result in dismissal. At the end of each year, the General Manager of each Group company and each Head of Function in BAT's UK Head Office is required formally to confirm that the company or department for which he or she is responsible complies with the Standards. Continuous information on performance against the Standards through the year is gathered at a global level and reported quarterly to the Audit Committee.

28.2 Combined Code

BAT is committed to high standards of corporate governance and currently complies, and has complied, throughout the year to 31 December 2007, with the provisions set out in section 1 of Combined Code on Corporate Governance adopted by the UK Financial Reporting Council in June 2006 ("**Combined Code**"). The Combined Code is the UK equivalent of the King Report on Corporate Governance for South Africa.

28.3 Board Committees

The Board has established four principal committees: the Audit Committee, the Nominations Committee, the Remuneration Committee and the Corporate Social Responsibility Committee.

28.3.1 Audit Committee

The Audit Committee, comprising only independent Non-Executive Directors, is chaired by Robert Lerwill, who has recent and relevant financial experience. The other members of the Audit Committee are: Christine Morin-Postel, Anthony Ruys and Sir Nicholas Scheele.

The Audit Committee's role is to monitor the integrity of the financial statements of the Company, review and, where appropriate, make representations to the Board on business risks, internal control and compliance.

The Audit Committee's terms of reference include tasks such as monitoring the integrity of the Company's financial statements and all formal announcements concerning the Company's performance, and reviewing significant accounting judgements contained in

them before their submission to the Board for approval. The Audit Committee keeps under review the consistency of accounting policies on a year to year basis across the Group, and reviews any proposed major discretionary accounting policy change in advance of its implementation. It also keeps under review the effectiveness of the accounting, internal control and business risk systems of the Company and its subsidiaries, and monitors and reviews the effectiveness of the Company's internal audit function. It is responsible for the Group's internal confidential disclosure policy and procedures, which allow staff to raise genuine concerns about possible improprieties without fear of reprisal.

The Audit Committee receives regular briefings from senior management on the matters falling within its terms of reference, including regular reports from the Head of Audit and Business Risk and the Head of Group Security.

The Audit Committee makes recommendations to the Board on the reappointment, for approval by Shareholders, of the Company's external auditors and approves their fees and terms of engagement. It has an established policy on the appointment of the auditors to perform non-audit services for the Group over and above the external audit, and keeps this issue under continual review in order to satisfy itself that the objectivity and independence of the auditors are not in any way impaired by reason of this further work.

The Audit Committee meets at least four times a year and met five times in 2008. It meets alone with the external auditors at the end of each meeting.

28.3.2 Nominations Committee

The Nominations Committee is chaired by the Chairman, Jan du Plessis. The Nominations Committee is responsible for making recommendations to the Board on suitable candidates for appointment to the Board and Management Board and ensuring that both boards have an appropriate balance of expertise and ability. In addition, it is responsible for reviewing the succession plans for the Executive Directors and members of the Management Board.

The Nominations Committee comprises a majority of independent Non-Executive Directors. Its other members are Robert Lerwill, Karen de Segundo, Dr Ana Maria Llopis, Christine Morin-Postel, Anthony Ruys, Sir Nicholas Scheele and Matthys Visser.

Under its terms of reference the Nominations Committee oversees the search and selection process of new Directors and aims to do so within the parameters set by the Combined Code. The Nominations Committee evaluates the skills and knowledge required on the Board and in light of this prepares a description of the role and capabilities required for a particular appointment. The Nominations Committee meets at such times as the Chairman or any member of the Committee may request. Executive Directors are entitled to attend at the invitation of the Nominations Committee.

28.3.3 Remuneration Committee

The Remuneration Committee normally meets twice a year and at such other times as the Chairman or any member of the Committee may request. It comprises only independent Non-Executive Directors and is chaired by Anthony Ruys. Its other members are Robert Lerwill, Karen de Segundo, Dr Ana Maria Llopis, Christine Morin-Postel and Sir Nicholas Scheele.

The Remuneration Committee is responsible for determining the framework of, and policy on, the terms of engagement (including remuneration) of the Chairman, the Executive Directors and Senior Managers, and the specific remuneration of each Executive Director and the Senior Managers (including entitlements under share incentive schemes and pension schemes) and any compensation payments.

British American Tobacco's Remuneration Policy seeks to reward the achievement of corporate and individual goals by linking success in those areas to the Group's strategy. This includes taking a balanced approach to achieving growth, improving productivity, managing the business in a responsible manner and developing a winning organisation, all of which help to build a sustainable business. In determining the Remuneration Policy, the Committee takes into account the need to provide for levels of remuneration which are

sufficient to attract, retain and motivate the Chairman, Executive Directors and Senior Managers of appropriate quality, and the requirement for performance related elements of remuneration to form a significant proportion of the total remuneration package and to be linked to corporate performance.

The Committee has a guideline that approximately 50% of the remuneration (assuming 'on target' performance) should be performance-related or variable in nature. The remuneration package comprises both performance-based variable rewards (cash and share incentive annual bonus plans and the LTIPs) and core fixed elements (base salary, pension and other benefits).

The Chairman, Chief Executive and the Senior Manager responsible for Human Resources regularly attend meetings of the Remuneration Committee by invitation. With effect from 1 January 2008, Deloitte and Touche were appointed to provide remuneration services and advice to the Company for 2008 with specific reference to the needs of the Remuneration Committee.

28.3.4 The Corporate Social Responsibility Committee

The Corporate Social Responsibility Committee is comprised of only Non-Executive Directors and is chaired by Karen de Segundo. The Corporate Social Responsibility Committee reviews the Group's social, environmental and corporate citizenship performance, evaluates Group policies in the area of social, environmental and reputational risks and, where necessary, makes recommendations to the Board for change. The other members of the Corporate Social Responsibility Committee are: Dr Ana Maria Llopis, Sir Nicholas Scheele and Matthys Visser.

28.4 Board balance and independence

The Board considers that six of the seven Non-Executive Directors are independent. Matthys Visser is presumed not to be independent under the Combined Code, because of the shareholdings that he represents. Accordingly, he does not sit on the Audit or Remuneration Committees, both of which comprise solely of independent Non-Executive Directors.

Sir Nicholas Scheele is the Senior Independent Director. He is available should occasion arise where there is a need to convey concerns to the Board other than through the Chairman or Chief Executive. He and the other Non-Executive Directors remain available to meet with major investors in order to understand their views and concerns.

The roles of Chairman and Chief Executive are separate, with each having distinct and clearly defined responsibilities. The Chairman is responsible for leadership of the Board, ensuring its effectiveness and setting its agenda, and for ensuring that a clear business and financial strategy for the Group is formulated for recommendation to the Board. The Chief Executive's responsibility is to ensure delivery of the strategic and financial objectives agreed by the Board.

The composition of the Board and the division of responsibilities as described above ensures a balance of power and authority, such that no one individual or small group of individuals is able to dominate the Board's decision making.

PART IV : FINANCIAL INFORMATION

29. SELECTED HISTORICAL FINANCIAL INFORMATION

The following tables set forth selected historical financial information for the Group. The selected historical financial information (other than sales volume, adjusted diluted earnings per share, headline earnings per share, diluted headline earnings per share, net asset value per share and tangible net asset value per share) has been extracted, without adjustment to the numbers, from BAT's audited Annual Report and Accounts for the financial years ended 31 December 2007 and 31 December 2006 (including unaudited comparative information for the financial year ended 31 December 2005) and BAT's Interim Report to 30 June 2008 (including unaudited comparative information for the six months ended 30 June 2007). The selected historical financial information for the financial years ended 31 December 2007 and 31 December 2006 and the six months ended 30 June 2008 and 30 June 2007 has been prepared in accordance with IFRS as adopted by the European Union. The restated selected historical financial information for the financial year ended 31 December 2005 has been prepared on the basis of IFRS as adopted by the European Union and extracted from BAT's audited Annual Report and Accounts for the financial year ended 31 December 2006, but has not been audited.

Selected Group Consolidated Financial Data (£ millions)	Financial year ended 31 December			Six months ended 30 June	
	2007	2006	2005 Restated ⁽²⁾ unaudited	2008 unaudited	2007 unaudited
Selected Group Income Statement Data					
Gross turnover (including duty, excise and other taxes) ⁽¹⁾	26,234	25,189	23,984	14,539	12,334
Revenue	10,018	9,762	9,325	5,457	4,725
Raw materials and consumables used	(2,802)	(2,861)	(2,760)	(1,537)	(1,386)
Changes in inventories of finished goods and work in progress	30	(11)	(2)	52	78
Employee benefit costs	(1,586)	(1,554)	(1,557)	(806)	(711)
Depreciation and amortisation costs	(336)	(401)	(383)	(174)	(156)
Other operating income	205	181	179	54	70
Other operating expenses	(2,624)	(2,494)	(2,382)	(1,322)	(1,128)
Profit from operations	2,905	2,622	2,420	1,724	1,492
After (charging)/crediting					
– restructuring and integration costs	(173)	(216)	(271)	(33)	(40)
– Net gains/(losses) on disposal of a business, brands and joint venture	75	41	72		11
Net finance costs	(269)	(289)	(228)	(179)	(126)
Share of post-tax results of associates and joint ventures	442	431	392	293	222
After (charging)/crediting					
– restructuring and integration costs			(13)		
– U.S. Federal tobacco buy-out			(12)		
– brand impairments	(7)	(13)	(29)		
– exceptional tax credits and other impairments		17	57		
– additional ST income				13	
– termination of joint venture				45	
Profit on ordinary activities before taxation	3,078	2,764	2,584	1,838	1,588
Taxation on profit on ordinary activities	(791)	(716)	(690)	(494)	(420)
Profit for the period	2,287	2,048	1,894	1,344	1,168

Notes:

(1) Gross turnover is a non-IFRS measure and is defined in the "Presentation of Information" section of this Pre-listing statement.

- (2) The restated historical financial information for the year ended on 31 December 2005 has been prepared in accordance with IFRS and reflects the adoption of an amendment to IAS21 on foreign exchange rates, the application of IAS32 and IAS39 from 1 January 2005 and the adoption of IFRIC Interpretation 4. See the "Presentation of Information" section of this Pre-listing statement.

Selected Group Consolidated Financial Data (£ millions)	Fiscal year ended 31 December			Half year ended 30 June	
	2007	2006	2005 Restated ⁽²⁾ unaudited	2008 unaudited	2007 unaudited
Selected Group Balance Sheet Data					
Assets					
Non-current assets	13,362	12,385	13,147	14,128	12,508
Current assets ⁽³⁾	5,366	5,391	5,904	7,371	5,143
Total assets	18,728	17,776	19,051	21,499	17,651
Liabilities					
Current liabilities ⁽⁴⁾	4,554	4,453	5,836	5,685	4,457
Non-current liabilities ⁽⁵⁾	7,076	6,635	6,338	8,943	6,518
Total liabilities	11,630	11,088	12,174	14,628	10,975
Net assets	7,098	6,688	6,877	6,871	6,676
Selected Group Cash Flow Data					
Net cash from operating activities	2,600	2,362	2,324	1,286	1,118
Net cash from investing activities	(122)	(315)	(292)	(888)	(51)
Net cash from financing activities	(2,621)	(2,339)	(2,147)	582	(1,324)
Net cash flows from operating, investing, and financing activities	(143)	(292)	(115)	980	(257)
Differences on exchange	47	(96)	49	91	10
Change in net cash and cash equivalents for the period	(96)	(388)	(66)	1,071	(247)
Opening net cash and cash equivalents	1,276	1,664	1,730	1,180	1,276
Closing net cash and cash equivalents	1,180	1,276	1,664	2,251	1,029

Notes:

- (3) As at 31 December 2007, 31 December 2006 and 31 December 2005, current assets include cash and cash equivalents balance of £1,258 million, £1,456 million and £1,790 million, respectively. At 30 June 2008 and 30 June 2007, cash and cash equivalents were £2,326 million and £1,141 million, respectively.
- (4) As at 31 December 2007, 31 December 2006 and 31 December 2005, current liabilities include borrowings of £861 million, £1,058 million and £2,202 million, respectively. At 30 June 2008 and 30 June 2007, current liabilities comprise borrowings of £1,760 million and £1,194 million, respectively.
- (5) As at 31 December 2007, 31 December 2006 and 31 December 2005, non-current liabilities include borrowings of £6,062 million, £5,568 million and £5,058 million, respectively. At 30 June 2008 and 30 June 2007, non-current liabilities comprise borrowings of £7,895 million and £5,440 million, respectively.

Other Financial Data (£ millions)	Fiscal year ended 31 December			Half year ended 30 June	
	2007	2006	2005 Restated unaudited	2008 unaudited	2007 unaudited
Sales volume (billion) ⁽⁶⁾	684.0	690.8	678.0	333.7	329.7
Basic earnings per share ⁽⁷⁾	105.19	92.08	84.34	62.48	52.94
Unadjusted diluted earnings per share ⁽⁸⁾	104.46	91.33	83.66	62.08	52.58
Adjusted diluted earnings per share ⁽⁹⁾	108.53	98.12	89.34	62.02	53.51
Dividends per share (pence) ⁽¹⁰⁾	66.2	55.9	47.0	22.1	18.6
Headline earnings per share (unaudited) ⁽⁶⁾	103.46	94.27	85.01	60.28	52.65
Diluted headline earnings per share (unaudited) ⁽⁶⁾	102.75	93.50	84.33	59.89	52.29
Net asset value per share (unaudited) ⁽⁶⁾	353.31	326.56	332.06	344.58	329.84
Tangible net asset value per share (unaudited) ⁽⁶⁾	(50.12)	(38.48)	(53.60)	(100.35)	(43.73)

Notes:

- (6) Sales volume, adjusted diluted earnings per share, headline earnings per share, net asset value and tangible net asset are non-IFRS measures and are defined in the "Presentation of Information" section of this Pre-listing statement.
- (7) The number of Shares used to calculate basic earnings per share is based on the weighted average number of Shares in issue during the relevant year (excluding treasury shares).
- (8) The number of Shares used to calculate unadjusted diluted earnings per share is increased to reflect the potential dilutive effect of employees' share schemes.
- (9) Earnings are affected by a number of exceptional items together with certain distortions to net finance costs under IFRS and to deferred tax. Adjusted diluted earnings per share removes the impact of these items. The exceptional items relate to restructuring and integration costs and the disposal of businesses, brands and joint ventures. In addition, the calculation adjusts for the impact of the potential conversion of Shares.
- (10) Dividends per share are presented according to the financial period to which they relate.

30. COMPLETE HISTORICAL FINANCIAL INFORMATION

The following historical financial information is set out in Annexure I to this Pre-listing statement: (i) audited consolidated financial statements of the Group for the financial years ended 31 December 2007 and 31 December 2006 (including unaudited comparative information for the financial year ended 31 December 2005); and (ii) the unaudited consolidated financial statements of the Group for the six months ended 30 June 2008 (including unaudited comparative information for the six months ended 30 June 2007).

The financial information for the financial years ended 31 December 2007, 31 December 2006 and 31 December 2005 set out in Annexure I to this Pre-listing statement have been extracted, without adjustment to the numbers, from BAT's audited Annual Reports and Accounts for the financial years ended 31 December 2007 and 31 December 2006. The financial information for the six months ended 30 June 2008 and 30 June 2007 set out in Annexure I to this Pre-listing statement has been extracted, without adjustment to the numbers, from BAT's Interim Report to 30 June 2008.

The financial information for the financial years ended 31 December 2007 and 31 December 2006 and the six months ended 30 June 2008 and 30 June 2007 has been prepared in accordance with IFRS as adopted by the European Union. The restated selected historical financial information for the financial year ended 31 December 2005 has been prepared on the basis of IFRS as adopted by the European Union, but has not been audited.

The Group's consolidated financial information as at and for the years ended 31 December 2007 and 2006, included in Annexure I to this Pre-listing statement, have been audited by PricewaterhouseCoopers LLP, the Group's independent auditors and members of The Institute of Chartered Accountants in England &

Wales, as stated in their report appearing in Annexure I to this Pre-listing statement. The audit report of PricewaterhouseCoopers LLP for each of these two years was unqualified and did not contain a statement under section 237(2) or 237(3) of the UK Companies Act 1985. In the 27 February 2008 report of PricewaterhouseCoopers LLP, with respect to such audited consolidated financial information, in accordance with guidance issued by The Institute of Chartered Accountants in England and Wales, it is stated that: "This report, including the opinion, has been prepared for, and only for, the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing." Shareholders should understand these statements are intended to disclaim any liability to parties other than the Company and its Shareholders with respect to those reports.

31. DIVIDENDS AND DIVIDEND POLICY

The Board's dividend policy is to ensure that Shareholders benefit directly and smoothly from the successful growth of the business, while continuing to provide sufficient funds to invest in future growth.

Prior to 2006, BAT's dividend policy was to pay out at least 50% of long term sustainable earnings in dividends. In 2007, the Board decided to raise the payout ratio to 65% by 2008 in progressive steps.

In relation to interim dividends, the Board's policy is that the interim dividend will be approximately one-third of the total dividends paid in the previous financial year.

At the 2008 AGM, the Shareholders approved the payment of a final dividend on 7 May 2008 of 47.6 pence per share which when combined with the 18.6 pence per share interim dividend means the total dividend for 2007 was 66.2 pence per share.

The dividends paid in respect of the three financial years ended 31 December 2007, 31 December 2006 and 31 December 2005 and the six-month period ended 30 June 2008, respectively, were 66.2 pence, 55.9 pence, 47.0 pence and 22.1 pence respectively.

The relevant extracts from the Articles governing dividends are summarised in paragraph 6 of Annexure IV to this Pre-listing statement. There is no arrangement under which future dividends are waived or agreed to be waived.

32. PROPERTY, PLANT AND EQUIPMENT

In 2007, the Group sold approximately 684 billion cigarettes (excluding the Group's associates) produced by forty-seven cigarette factories in 40 markets. As of July 2008, pursuant to the acquisition of the cigarette and/or snus business of ST and Tekel the Group has an additional six operational factories. None of these properties are individually material in the context of the Group as a whole.

33. LOANS AND BORROWING POWERS

Details of the Group's borrowings are set out in Annexure V to this Pre-listing statement.

Except as otherwise disclosed in the annual financial statements set out in Annexure I to this Pre-listing Statement or in Annexure V to this Pre-listing Statement, BAT has not created any debentures in terms of a trust deed and there are no such debentures to be issued or agreed to be issued or issued any debentures or debenture stock by way of conversion or replacement of debentures previously issued.

The borrowing powers of the Directors as set out in the Articles are discussed in paragraph 4 of Annexure IV to this Pre-listing statement. The borrowing powers of BAT have not been exceeded. There are no material exchange control or other restrictions on the borrowing powers of the Group.

The borrowing powers of the Group are further regulated in terms of the Company's statement of delegated authorities. The Group's organisation is designed to encourage the exercise of a high degree of freedom within the overall group strategy and a framework of delegated authority approved by the Board. The levels of reference are set so that matters of the greatest importance are referred to the Board and other matters are referred to the Management Board or the Standing Committee. In principle, operational management is under the control of end market companies. These authorities are part of a

policy framework which, while supporting the principle of local management responsibility, seeks to support good corporate governance and prudent control of risk and investment management.

Proposals for borrowings by the Company from an unrelated third party or guarantees and letters of comfort from the Company (Daylight overdrafts do not need to be referred) are considered as follows: where the underlying transaction is (i) US\$250 million or more – the Board; and (ii) below US\$250 million – Transactions Committee (quorum to include one of Chairman, Chief Executive or Chief Operating Officer).

Proposals for borrowings by any Group company (other than the Company) from an unrelated third party or guarantees and letters of comfort from any other Group company (Daylight overdrafts do not need to be referred) are considered as follows: where the underlying transaction is (i) US\$250 million or more - Main Board (ii) above US\$100 million but under US\$250 million – Transactions Committee (quorum to include Chairman, Chief Executive Officer or Chief Operating Officer); (iii) below US\$100 million but over US\$25 million – Finance Director; and (iv) below US\$25 million – Group Treasurer.

The Group has numerous banking relationships in the jurisdictions in which it operates and is not wholly reliant on any single bank counterparty.

34. MATERIAL CAPITAL COMMITMENTS, LEASE PAYMENTS AND CONTINGENT LIABILITIES

Capital expenditure is met by cash flows provided by operating activities, cash balances and borrowing facilities and primarily relates to upgrade work on existing factories and cigarette machinery, as well as purchases of IT equipment used by the Group's employees.

Details of the Group's material commitments and lease payments are set out in Annexure V to this Pre-listing statement. The Group has no material contingent liabilities other than as disclosed in this Pre-listing statement and/or reflected in the financial statements set out in Annexure I to this Pre-Listing Statement.

35. LOANS RECEIVABLE

The Group has not made any material loans to third parties which were outstanding as at 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement).

36. RELATED PARTY TRANSACTIONS

The Group has a number of intra-group transactions with associated companies and Shareholders. Details of these are set out below.

Transactions and balances with associates relate mainly to the sale and purchase of cigarettes and tobacco leaf. Amounts receivable from associates in respect of dividends included in the table below were £53 million in 2007 (compared to £48 million in 2006). The Group's share of dividends from associates included in "other net income" in the table below was £290 million in 2007 (compared to £267 million in 2006). Legal fees recovered from Reynolds American included in "other net income" amounted to £1 million in 2007 (compared to £2 million in 2006).

Transactions	2007 £m	2006 £m
– revenue	32	35
– purchases	(275)	(292)
– other net income	292	272
Amounts receivable at December 31	67	58
Amounts payable at December 31	(37)	(24)

As discussed in Note 3(f) to the Annual Report and Accounts for the year ended 31 December 2007, the Group completed the sale of its Belgian cigar factory and associated brands to the cigars division of ST on 3 September 2007. These assets were not part of the cigarette business acquired from ST in July 2008. The gain on disposal is not included in the above table.

Other than in their capacity as Shareholders, there have been no material transactions with Richemont and Remgro, who together indirectly owned 30.06% at 30 June 2008 (compared to 29.95% at 30 June 2007 of the ordinary share capital of BAT (excluding shares held in treasury)).

The details of the Group's material inter-company balances are set out in Annexure XII to this Pre-listing statement.

37. WORKING CAPITAL STATEMENT

In the opinion of the Directors, the working capital available to the Group is sufficient for the Group's present requirements, that is, for at least the twelve months following the date of publication of this Pre-listing statement.

PART V : SHARE CAPITAL

38. AUTHORISED AND ISSUED SHARE CAPITAL

BAT was incorporated on 23 July 1997 with an authorised share capital of £100,000 divided into 100,000 ordinary shares of £1 each, of which two ordinary shares (the “**Subscriber Shares**”) were issued, nil paid, to the subscribers to the Memorandum of Association.

On 29 October 1997 the Subscriber Shares were transferred to Clare Alice Wilson and Mark Zerdin and subsequently, on 20 February 1998, transferred to Maryse Gray and Stephen Clarence Hancock and paid up in full.

On 6 May 1998 the authorised share capital of BAT was increased to £149,998 by the creation of 49,998 Redeemable Preference Shares of £1 each which were allotted to Starnclose Limited, such Redeemable Preference Shares being fully paid up in cash, at par, which together with the Subscriber Shares enabled BAT to obtain a certificate permitting it to commence business under Section 117 of the UK Companies Act 1985.

At an extraordinary general meeting of BAT on 14 May 1998:

- each of the issued and unissued ordinary shares of £1 each was subdivided into 4 ordinary shares of 25p each (i.e. the Shares); and
- the authorised ordinary share capital of BAT was increased from £100,000 to £499,950,002 by the creation of 1,999,400,008 Shares.

On 3 September 1998 the 49,998 Redeemable Preference Shares of £1 each were redeemed and, in accordance with the rights of those Redeemable Preference Shares, were subdivided and redesignated as Shares each such that the authorised capital of BAT became £500,000,000 divided into 2,000,000,000 Shares.

Under a Scheme of Arrangement for the reorganisation of B.A.T Industries p.l.c., on 4 September 1998 the Company acquired all the equity shares in BAT Reconstructions Limited being 1,570,644,276 shares of 25p each which broadly carried the rights in respect of the economic interests in the then B.A.T Industries Group’s tobacco interests. In consideration for the investment in BAT Reconstructions Limited the Company, on 7 September 1998, issued and allotted as fully paid 1,570,644,276 Shares to the former B.A.T Industries shareholders.

On 8 April 1999 the authorised capital of the Company was, subject to conditions relating to the completion of the merger with Rothmans, increased from £500,000,000 to £775,000,000 by the creation of 858,265,349 new Shares and 241,734,651 Convertible Redeemable Limited Voting Participating Preference Shares of 25p each (the “**Convertible Redeemable Preference Shares**”).

Subsequently, in accordance with the terms of the Convertible Redeemable Preference Shares, 50% were redeemed for cash on 7 June 2000 and the remaining 50% were converted into the same number of Shares on 3 June 2004. The terms of the Convertible Redeemable Preference Shares were removed from the Articles by special resolution on 26 April 2007. To the extent that the Directors wish to issue any new Convertible Redeemable Preference Shares in future, they will need to determine the terms of such Convertible Redeemable Preference Shares and will need to obtain Shareholder approval for the issue of such Convertible Redeemable Preference Shares.

The provisions of Section 89 of the UK Companies Act 1985 (which to the extent not disapplied, from time to time, pursuant to Section 95 of the UK Companies Act 1985, confer on shareholders rights of pre-emption in respect of the allotment of equity securities which are, or are to be, paid up in cash) apply to the authorised but unissued share capital of BAT.

The following table sets out the authorised and issued and fully paid share capital of BAT as at 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement) and as it will be, (assuming that no options granted under the ESOS and the Sharesave Scheme are exercised between the date of this Pre-listing statement and 28 October 2008) following the listing of the Shares.

	Authorised		Issued and fully paid		Aggregate Nominal Value (£)
	Nominal value (£)	Number	Nominal value (£)	Number	
Shares	0.25	2,858,265,349	0.25	2,025,021,814	506,255,453.50
Convertible Redeemable Preference Shares	0.25	241,734,651	0.25	Fully redeemed or converted	N/A
Treasury Shares	–	–	0.25	24,082,497	6,020,624.25

As at 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement) BAT had a share premium of £56,000,000.

39. RIGHTS ATTACHING TO THE SHARES AND POWER TO ISSUE SHARES

The Shares rank pari passu in the following respects:

- (i) they are in all respects identical;
- (ii) they are of same nominal value and the same amount per Share has been paid up;
- (iii) they carry the same rights as to unrestricted transfer, attendance and voting in general/annual general meetings, and in all other respects; and
- (iv) they are entitled to dividends at the same rate and for the same period, so that at the next ensuing distribution the dividend payable on each Share will be the same amount.

All the Shares are fully paid up and freely transferable.

Subject to the provisions of the UK Companies Acts, the unissued Shares shall be at the disposal of the Directors, who may allot, grant options over or otherwise dispose of them to such persons and on such terms as the Directors think fit.

40. LISTING ON OTHER STOCK EXCHANGES

The Shares are admitted to trading on the main market of the London Stock Exchange for listed securities. On the London Stock Exchange, the ISIN Code for the Shares is GB0002875804 and the common code for the Shares is BATS. They are also traded on the American Stock Exchange, New York, in the form of American Depositary Receipts (“**ADRs**”) under the symbol BTI with a CUSIP number 110448107. Each ADR represents two Shares. As at 31 December 2007, 26,501,452 ADRs were outstanding, representing 53,002,904 Shares.

41. STATEMENT AS TO LISTING ON THE JSE AND TRADING OF THE SHARES

The JSE has granted a secondary listing by way of introduction of all of the issued Shares in the tobacco sector of the main board of the JSE under the abbreviated name BATS and trading code BTI, with effect from the commencement of trading on the JSE on Tuesday, 28 October 2008.

Shares will be traded on the JSE in electronic form only. Accordingly, any person who purchases Shares and who receives such Shares in certificated form will be required to dematerialise their interest in such certificated Shares in order to be able to trade such Shares on the JSE. More details on settlement and trading are set out in Part VI of this Pre-listing Statement.

In accordance with section 18 of the JSE Listings Requirements, the LSE (being the primary exchange) will generally take precedence in the enforcement of any listings requirements ahead of the JSE (being the secondary exchange). However, the JSE reserves the right to instruct BAT to comply with certain specific sections of, or in full with, the JSE Listings Requirements, where it determines such requirements to be in the interest of Shareholders. BAT will comply with the specific requirements of section 18, including the requirement to ensure that all information released on the LSE will also be released on the JSE and that such release takes place no later than the equivalent release on the LSE,

provided that if the JSE is not open for business, it will ensure that such information is released through SENS at the commencement of business on the next business day.

42. ISSUES AND OFFERS OF SHARES

During the three years ended 31 December 2005, 2006 and 2007 and for the period between 1 January 2008 and 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement):

- (i) there have been no issues or offers of Shares, other than a total of 4,092,814 Shares which have been issued in connection with the exercise of options granted pursuant to the Share Schemes (see paragraph 50 below); and
- (ii) the following shares or securities were issued by the material subsidiaries of BAT:
 - on 6 June 2005 the capital of British American Tobacco (Germany) GmbH was increased following a subscription of Euro 750,000 by the company's sole shareholder; and
 - on 19 February 2007 299,395,000 ordinary shares of 0.1 ruble each were issued at par by CJSC 'International Tobacco Marketing Services'. The ordinary shares were issued to the company's shareholders pro-rata to their shareholdings in the company immediately prior to the issue.

43. SHARE BUY-BACK PROGRAMME

The Company initiated an on-market share buy-back programme at the end of February 2003. At the close of business on 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement), the Company had repurchased approximately 17.2 million Shares since 1 January 2008 at an approximate cost of £319.9 million. As announced on 28 February 2008, the Company decided to scale back the 2008 buy-back to some £400 million due to the Tekel and ST acquisitions and with a view to maintaining the Group's current credit rating.

During 2007, 2006 and 2005, approximately 45.3 million, 35.2 million and 45.2 million Shares were bought respectively at a cost of £750 million, £500 million and £501 million respectively.

During 2005, the Company made on-market repurchases totalling approximately 45.2 million Shares, representing 2.11% of the issued share capital as at 31 December 2005 and for an aggregate consideration of £501 million. The repurchased Shares were cancelled.

During 2006, the Company made on-market purchases totalling approximately 28.3 million Shares, representing 1.37% of the issued share capital as at the end of 2006 and for an aggregate consideration of £400 million. The repurchased Shares were cancelled. Between 22 September 2006 and 4 December 2006, the Company sought to repurchase approximately 6.9 million Shares for an aggregate consideration of £100 million. The repurchased Shares were cancelled. As a result of a technical infringement of the UK Companies Act 1985, the repurchase and cancellation of these Shares was invalid. These Shares were subsequently repurchased on 1 March 2007 from their holders, the Company's brokers, at the same prices agreed between 22 September 2006 and 4 December 2006.

During 2007, the Company made on-market repurchases totalling approximately 45.3 million Shares, representing 2.24% of the issued share capital (excluding treasury shares) as at the end of 2007 and for an aggregate consideration of £750 million. Of these repurchased Shares, approximately 38.4 million were cancelled and the share capital was reduced accordingly. Since 1 October 2007, the Company's policy has been to hold any repurchased Shares as treasury shares and as at 31 December 2007 the number of treasury shares was 6.9 million. While treasury shares are held no dividends are paid on them and they have no voting rights; treasury shares may be re-sold at a later date.

At the 2008 AGM, Shareholders granted authority to continue the on-market share buy-back programme. The maximum number of Shares that may be purchased under the granted authority is 201.8 million. The minimum price that may be paid for such Shares is 25 pence and the maximum price that may be paid is an amount equal to 105% of the average of the middle market prices shown in the quotation for a Share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the Share is contracted to be purchased. The Company's current authority to purchase the Shares will expire at the conclusion of the next AGM.

44. MAJOR SHAREHOLDERS

Save as disclosed below, the Directors are not aware, nor have they received notice of, any person who, directly or indirectly, held, as at 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement) voting rights in financial instruments of 3% or more of BAT's voting rights in ordinary issued share capital:

Name of Shareholder	Number of Shares held	Percentage of voting rights in ordinary issued share capital
R&R	604,336,627	30.20 ⁽¹⁾

Note:

- (1) The voting rights of R&R are limited pursuant to the Standstill Agreement entered between BAT and Richemont and Rembrandt, as more fully described in Annexure VIII to this Pre-listing statement. Moreover, after implementation of the Proposals, R&R will cease to be a Shareholder. BAT believes that following the implementation of the Proposals, the residual Reinet shareholding, the Luxembourg investment company to be listed as part of the Proposals, is likely to be less than 10%. Shareholders are referred to the Remgro Circular and the Richemont Information Memoranda for further details of the Proposals.

No Shareholder is in a position to exercise control over BAT. There has been no controlling Shareholder of BAT in the past five years.

45. COMMISSIONS, DISCOUNTS AND BROKERAGES

There has been no commission, discount, brokerage or other special terms granted during the three years preceding the date of this Pre-listing statement in connection with the issue or sale of any securities, stock or debentures in the capital of BAT which are not disclosed in the audited consolidated financial statements of the Group.

46. PRELIMINARY EXPENSES

There were no preliminary expenses incurred by BAT in relation to this listing in the three years preceding the date of this Pre-listing statement.

47. TRADING HISTORY

A trading history of the Shares on the LSE is set out in Annexure VI to this Pre-listing statement.

48. PROVISIONS OF THE ARTICLES RELATING TO SHARE CAPITAL AND RIGHTS OF SHAREHOLDERS

The relevant provisions from the Articles relating to share capital are summarised in Annexure IV to this Pre-listing statement.

49. OPTIONS

Other than pursuant to the Shares Schemes, there are no contracts or arrangements or proposed contracts or arrangements to which BAT is a party, whereby any option or preferential right of any kind was or is proposed to be given to any person(s) to subscribe for any Shares or shares in any other material subsidiaries of the Group.

50. SHARE SCHEMES

The Share Schemes operated by BAT are the following:

- (i) the British American Tobacco p.l.c. Deferred Annual Share Bonus Scheme (the "**DSBS**");
- (ii) the British American Tobacco Employee Share Ownership Plan (the "**ESOP**") and the British American Tobacco International Employee Share Ownership Plan;
- (iii) the British American Tobacco p.l.c. Share Option Scheme (the "**ESOS**");
- (iv) the British American Tobacco Long Term Incentive Plan and the British American Tobacco 2007 Long Term Incentive Plan (the "**LTIPs**"); and

(v) the British American Tobacco Sharesave Scheme (the “**Sharesave Scheme**”).

A summary of the principal features of each of the Share Schemes which have been established by BAT is set out in Annexure VII to this Pre-listing statement.

During the three years ended 31 December 2005, 2006 and 2007 and for the period between 1 January 2008 and 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement):

- (i) a total of 3,677,776 Shares have been issued in connection with the exercise of options granted pursuant to the Sharesave Scheme at an average exercise price of £6.3047; and
- (ii) a total of 415,038 Shares have been issued in connection with the exercise of options granted pursuant to the ESOS at an average exercise price of £6.6022.

As at 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement) the following options are outstanding under the Sharesave Scheme and the ESOS:

Name of Scheme/Plan	Date of grant/award	Exercise from	Expiry Date	Number of Shares	Exercise price
Sharesave Scheme					
5 year scheme	27/11/2003	01/01/2009	01/07/2009	149,304	568.0p
5 year scheme	25/11/2004	01/01/2010	01/07/2010	221,820	663.0p
3 year scheme	25/11/2005	01/01/2009	01/07/2009	124,681	977.0p
5 year scheme	25/11/2005	01/01/2011	01/07/2011	117,556	977.0p
3 year scheme	24/11/2006	01/01/2010	01/07/2010	97,762	1152.0p
5 year scheme	24/11/2006	01/01/2012	01/07/2012	120,643	1152.0p
3 year scheme	29/11/2007	01/01/2011	01/07/2011	103,020	1435.0p
5 year scheme	29/11/2007	01/01/2013	01/07/2013	138,820	1435.0p
ESOS					
	10/03/2000	10/03/2003	10/03/2010	61,988	£2.5367
	12/03/2001	12/03/2004	12/03/2011	32,045	£5.6442
	20/03/2002	20/03/2005	20/03/2012	35,185	£6.393
	19/03/2003	19/03/2006	19/03/2013	53,176	£5.98
	17/03/2004	17/03/2007	17/03/2014	41,648	£8.085

The future exercise of these options may be satisfied by the issue of new Shares. In addition to the grants shown above, a further number of options over Shares are outstanding under the ESOS, the exercise of which may be satisfied by the transfer of Shares from one of the BAT’s employee benefit trusts (see paragraph 6, Annexure VII). To date, awards of Shares under the DSBS and the LTIPs have also been satisfied in this way and therefore, not being settled through the issue of Shares, do not have a dilutive effect.

PART VI : TAX AND EXCHANGE CONTROL

51. TAXATION

The following paragraphs set out a general summary of the tax implications for Shareholders resident or deemed to be resident in South Africa for tax purposes based on legislation enacted and in force at the date of the Pre-listing statement. The tax analysis is therefore not comprehensive or determinative. Shareholders should seek advice from appropriate professional advisers if they are in any doubt whatsoever about their tax position and in particular to confirm how the general comments apply in their specific circumstances. The paragraphs summarise the position of Shareholders who (unless the position of non-resident Shareholders is expressly referred to) are resident in South Africa for tax purposes, who are the absolute beneficial owners of their Shares and who hold their Shares as an investment. Certain Shareholders, such as dealers in securities, collective investment schemes and employees of the Group (or a connected company), may be taxed differently and are not considered.

51.1 Dividends not distributed from reserves created by a reduction in BAT's share capital or share premium

For South African tax purposes, gross income, in relation to any year of assessment, specifically includes all local and foreign dividends accrued. For so long as the Shares are listed on the JSE and the London Stock Exchange (or other non-South African exchange recognised for this purpose under the Income Tax Act), South African resident Shareholders may claim exemption from tax in respect of dividends on the Shares. Distributions from reserves created by a reduction in BAT's share capital and share premium account may be treated as a return of capital in the hands of South African resident Shareholders rather than dividend income. Please refer to paragraph 51.3 below for a discussion of the treatment of such distributions.

51.2 Interest incurred in the production of foreign dividends

Where for any reason, the dividend exemption referred to above in respect of the Shares is not applicable, a deduction may be claimed in respect of interest actually incurred on loans used to purchase the Shares. The deduction is limited to the amount of taxable foreign dividends included in the taxpayer's income during the year of assessment, the balance (after deducting other foreign dividends exempt from tax) being carried forward for deduction against foreign dividends accrued in later years. However, provided that the dividend exemption referred to above applies, no such deduction will be available.

51.3 Dividends distributed from reserves created by a reduction in BAT's share capital or share premium

Dividends declared by BAT out of reserves created by a reduction in BAT's share capital or share premium account may not be treated as dividend income in the hands of South African resident Shareholders, but in practical effect as a return of capital. The distribution would then trigger a part disposal of the Shares for capital gains tax ("CGT") purposes, with the distribution being treated as proceeds received, from which must be deducted a portion of the base cost to arrive at the capital gain subject to CGT. The proportion of the base cost to be deducted is the same ratio thereof as the distribution bears to the market value of the Shares prior to the distribution.

There is partial relief for interest incurred in connection with the purchase of the Shares, to the extent that relief has not been claimed elsewhere in the determination of taxable income. This relief is obtained through the calculation of the Shareholders' base cost in the Shares (see paragraph 51.4 below).

Future dividends out of distributable reserves currently created by the reduction of BAT's share capital may, on another interpretation of the law, be viewed as foreign dividend income and not a return of capital.

It should be noted that a new dividend definition is proposed to be introduced at the time that secondary tax on companies ("STC") is replaced with the proposed dividend tax on shareholders of South African tax resident companies. As part of this proposal, consideration is to be given to the taxation of foreign dividends and there is no indication at this stage what form this may take. As such, Shareholders should take note that the taxation of distributions by BAT in their hands may in the future vary from that indicated above.

51.4 Taxation of capital gains and losses

51.4.1 South African resident Shareholders – individuals

A disposal of Shares by an individual Shareholder who is resident in South Africa for tax purposes may give rise to a gain (or loss) for the purposes of taxation of capital gains. The capital gain (or loss) on disposal of the Shares is equal to the difference between the disposal proceeds and the base cost.

Disposal proceeds of Shares registered on the South African overseas branch register should be denominated in ZAR. For other disposals, depending on the individual circumstances of the Shareholder, where the proceeds are denominated in a currency other than ZAR, the consideration would be translated to ZAR either at the average exchange rate for the relevant recipient taxpayer's year of assessment (if so elected for by the taxpayer), or the spot rate on the date of disposal.

A Shareholder's base cost in their Shares will generally be the consideration paid for those Shares. Where the purchase price is not denominated in ZAR, the consideration paid should be translated to ZAR either at the average exchange rate for the relevant taxpayer's year of assessment (if so elected for by the taxpayer), or the spot rate on the date of acquisition.

Specific rules apply to the Shares received pursuant to the Proposals. Please refer to Annexure 6 of the Remgro Circular.

The base cost in the Shares may be increased by one third of any interest incurred to finance the cost of acquiring the Shares or other costs incurred in the maintenance, protection, and insurance of the Shares, to the extent that any such amount is not otherwise allowable for deduction in the determination of taxable income.

A gain on a disposal of Shares, together with other gains, less allowable losses in a year of assessment, is subject to tax at the individual's marginal tax rate to the extent that it exceeds the annual exclusion (R16,000 for the year of assessment ending 28 February 2009). Only 25% of the net capital gain is included in taxable income, resulting in a maximum effective tax rate on capital gains of 10%.

On the death of a taxpayer, there is a deemed disposal of the Shares at market value, unless the Shares are, inter alia, bequeathed to or are in favour of a surviving spouse. Deemed disposals to a surviving spouse, who is a South African resident, are treated, in practical effect, as taking place at no gain or loss. The annual exclusion increases from R16,000 to R120,000 where death occurs during the year of assessment ending 28 February 2009.

Where a taxpayer emigrates (i.e. gives up South African tax residence) there is also a deemed disposal of the Shares at market value.

Specific rules apply to the Shares received pursuant to the Proposals. Shareholders are referred to the Remgro Circular and Richemont Information Memoranda for more detail.

51.4.2 South African resident Shareholders – corporates

A disposal of Shares by a South African resident corporate Shareholder may give rise to a gain (or loss) for the purposes of taxation of capital gains. The capital gain (or loss) on disposal of the Shares is equal to the difference between the disposal proceeds and the base cost.

Disposal proceeds of Shares registered on the South African overseas branch register should be denominated in ZAR. For other disposals, where the proceeds are denominated in a currency other than ZAR, the consideration would be translated into ZAR at the spot rate on the date of disposal.

A Shareholder's base cost in the Shares will generally be the consideration paid for the Shares. Where the purchase price is not denominated in ZAR, the consideration paid should be translated into ZAR at spot rate on date of acquisition.

The base cost in the Shares may be increased by one third of any interest incurred to finance the cost of acquiring the Shares or other costs incurred in the maintenance, protection, and insurance of the Shares, to the extent that any such amount is not otherwise allowable for deduction in the determination of taxable income.

A gain on a disposal of Shares by a corporate Shareholder, together with other gains, less allowable losses in a year of assessment, is subject to tax at the normal tax rate for companies and close corporations (currently generally 28%). Only 50% of the net capital gain is included in taxable income, resulting in a maximum effective tax rate on capital gains of 14% (before accounting for any STC that may be triggered by a subsequent distribution of the gain by such corporate shareholder by way of dividend).

Specific rules apply to the Shares received pursuant to the Proposals. Shareholders are referred to the Remgro Circular and Richemont Information Memoranda for more detail.

51.5 Estate duty

Where a person who is ordinarily resident in South Africa holds Shares at the date of his or her death, the market value of such Shares will be included in the estate. Shareholders who are not ordinarily resident in South Africa will not be liable to estate duty in South Africa in respect of their holding of Shares unless the Shares and the transfer of the Shares are respectively registered and recorded on the South African overseas branch register.

Estate duty is levied at a flat rate of 20% on the net value of the estate to the extent that it exceeds R3.5 million.

In determining the net value of an estate, deductions are, inter alia, allowed for the value of bequests and property left to a surviving spouse, and estate liabilities, including capital gains tax paid on the deemed disposal of the Shares on date of death.

There is also allowed as a deduction from the total value of the assets, the value of any right in or to assets situated outside of South Africa (e.g. Shares and the transfer of the Shares that are respectively registered and recorded on the UK principal register):

- acquired by the deceased South African resident before becoming ordinarily resident in South Africa for the first time; or
- donated to the taxpayer by a non-South African resident individual; or
- inherited from a non-South African resident person; or
- proved to be acquired out of the proceeds from the disposal of such property mentioned above or acquired out of profits from such asset mentioned above.

51.6 Securities transfer tax

Securities transfer tax (“STT”) provides for the levying of tax in respect of the change in beneficial ownership in any securities of a company incorporated, established or formed outside South Africa and listed on the JSE. A change in beneficial ownership includes any cancellation or redemption of a security but does not include the issue of a security.

A change of beneficial ownership of the Shares registered on the South African overseas branch register as a result of every purchase of these Shares through the agency of or from any member (registered broker) of the JSE (i.e. the Shares registered on the South African overseas branch register) is liable to payment of STT at the rate of 0.25% of the consideration for the Shares concerned in respect of such change in beneficial ownership.

The selling broker is liable to make payment of the tax by not later than the fourteenth day of the month following that in which the change in beneficial ownership is effected, but may recover any tax payable from the transferee.

Where a change in the beneficial ownership in the Shares registered on the BAT South African overseas branch register is effected by a CSDP, this change in beneficial ownership is liable to payment of STT at the rate of 0.25% on the greater of the consideration payable and the closing price of the Shares on the date of the transaction. Where any change in beneficial ownership of the rights or entitlements to receive any distribution from BAT takes place through a CSDP, this change in beneficial ownership is also liable to payment of STT at the rate of 0.25% on the greater of the consideration payable and fair market value of those rights or entitlements on the date of the transaction. In both cases the CSDP is liable to make payment of the tax by not later than the fourteenth day of the month following that in which the change in beneficial ownership is effected, but may recover any tax payable from the transferee.

Where a change in the beneficial ownership in the Shares registered on the South African overseas branch register is effected in any other manner, this change in beneficial ownership is liable to payment of STT at the rate of 0.25% on the greater of the consideration payable and the closing price of the Shares on the date of the transaction. Where any change in beneficial ownership of the rights or entitlements to receive any distribution from BAT takes place in any other manner, this change in beneficial ownership is also liable to payment of STT at the rate of 0.25% on the greater of the consideration payable and fair market value of those rights or entitlements on the date of the transaction. In both cases, the transferee is liable for payment of the tax, which must be paid through the member of the JSE or CSDP holding the security in custody by not later than the fourteenth day of the month following that in which the change in beneficial ownership is effected.

Where Shares are acquired for registration outside of South Africa, normally when the transferee is resident outside of South Africa, the Shares are not transacted through Strate and no STT is payable.

51.7 Tax consequences for BAT

The listing of the Shares on the JSE will have no specific tax consequences for BAT. As a non-resident, BAT is not required to pay STC and will not be affected by the new dividend tax which is to replace STC. In addition, dividends paid by BAT will not be subject to any UK withholding taxes.

52. EXCHANGE CONTROL

The information contained in this Part VI (excluding the “Restrictions on South African Shareholders holding Shares” below) has been extracted from the “Applicable Legislation” referred to in paragraph 52.1 below. The following is a general summary of the current position, and is intended as a guide only and is therefore not comprehensive. Persons who are in any doubt as to the position in any particular case should consult their independent professional advisers. Please note that BAT is not responsible for obtaining any exchange control consents that any investor may need to obtain in order to buy or sell Shares.

52.1 Applicable Legislation

The present South African Exchange Control system was introduced in 1961. Section 9 of the Currency and Exchanges Act No. 9 of 1933, as amended (the “**Currency and Exchanges Act**”), empowers the President to make regulations with regard to any matter directly or indirectly relating to or affecting or having any bearing upon currency, banking and exchanges. The regulations made in terms of the Currency and Exchanges Act are contained in the Exchange Control Regulations, as amended. Orders and Rules, as amended, are issued under the Exchange Control Regulations (“**Orders and Rules**”). The exchange control system is used principally to control capital movements by South African residents to countries outside the CMA.

52.2 Delegation of Powers

The Minister of Finance has, pursuant to Exchange Control Regulation 22E, delegated to the Governor, the Deputy Governors and certain other employees of the South African Reserve Bank (“**SARB**”) all the powers, functions and duties assigned to and imposed on the Treasury under the Exchange Control Regulations with the exception of the powers, functions and duties assigned to and imposed on the Treasury by Regulations 3(5), 3(8), 16, 20 and 22 (excluding Regulations 22A, 22B, 22C and 22D from such exemption). The Exchange Control Department of the SARB (“**Excon**”), has wide discretion in implementing and enforcing the requirements of the Exchange Control Regulations. Such discretion is, however, not exercised arbitrarily but is based upon a set of norms, and is subject to the policy guidelines laid down by the Minister of Finance and Director General: Finance.

52.3 Authorised Dealers

In terms of the Exchange Control Regulations and pursuant to the Orders and Rules, certain commercial banks are appointed by the Minister of Finance as “authorised dealers” in foreign exchange (“**Authorised Dealers**”). Their function is to undertake and deal with certain aspects of exchange controls on behalf of their clients and in terms of the Exchange Control Rulings (which

are rulings issued by Excon to Authorised Dealers and which set out certain approvals which may be granted by Authorised Dealers to their clients without reference to Excon). All approvals sought and which do not fall within the ambit of (and are not authorised by) the Exchange Control Rulings, must be referred by an Authorised Dealer to Excon for its consideration. All applications to Excon have to be made through an Authorised Dealer.

52.4 Transactions subject to Exchange Control Regulation

Transactions between South African residents and non-residents are subject to Exchange Control Regulation. Under the Exchange Control Regulations, the ordinary shares of a South African company are freely transferable (but subject to certain administrative procedures having been complied with) outside South Africa to persons who are not residents of the CMA. The only requirement is that such transfer must take place for fair value and the purchase consideration must be received in South Africa. Additionally, where ordinary shares are sold on the JSE on behalf of shareholders who are not residents of the CMA, the proceeds of such sales will be freely exchangeable into foreign currency and remittable to them. There are no exchange control restrictions on the remittance abroad of dividends to non-resident shareholders by a South African company, including a company in which 75% or more of the voting stock, capital or earnings is held or controlled, directly or indirectly, by non-residents (an "**affected company**"). The payment of such dividends by an affected company must however not result in the affected company being placed into an "over borrowed" position regarding its local borrowings. The ability of an affected company to obtain financial assistance in the South African domestic market is subject to certain restrictions. Financial assistance includes the lending of currency, the granting of credit and the taking up of securities, but excludes normal trade activities. An affected company's ability to borrow money from a South African lender is restricted by a formula which depends on both the composition of the company's foreign shareholding and the extent of the shareholder advances to the company. Excon currently permits, on application, an affected company to borrow locally up to 300% of the foreign shareholder investment in the affected company.

52.5 General South African Reserve Bank requirements

Shareholders' attention is drawn to the SARB's requirements that all share transactions pertaining to Shares registered on the South African overseas branch register shall be subject to South African tax legislation which is already in force or which may come into force.

52.6 Relaxation of Exchange Controls

The South African Government has committed itself to a gradual relaxation of exchange controls. Exchange controls over non-residents were abolished on 13 March 1995 with the effect that the local sale proceeds of non-resident owned South African assets are regarded as freely transferable from South Africa, provided that the local sale is at arm's-length and at market value (which it will be if transacted on the JSE) and the purchase consideration is received in South Africa. Significant relaxations of exchange controls have occurred in recent years, the most significant of which are that:

- South African institutional investors (being retirement funds, asset managers, long-term insurers and collective investment scheme management companies) may within pre-determined prudential limits, invest in foreign portfolios;
- South African companies may acquire foreign investments, subject to complying with Excon's criteria in respect thereof. There is no limit on the size of such investment;
- South African companies who have received approval to acquire a foreign investment need not repatriate profits or dividends to the Republic and may expand their operations abroad on notification to Excon and provided that there is no recourse to South Africa;
- emigrants of the CMA are entitled, subject to the payment of a 10% levy, to transfer all their assets out of the Republic.

52.7 Inward listing on the JSE

BAT has obtained SARB approval for the secondary (inward) listing of its Shares on the JSE.

The SARB approval specifically provides the following:

- the approval of the inward listing of the Shares on the JSE; and
- BAT's South African Shareholders will be treated according to the provisions of Section H.(A) of the Exchange Control Rulings following the secondary (inward) listing of the Shares on the JSE.

Upon the listing of the Shares on the JSE, the Exchange Control Regulations provided for in Section H of the Exchange Control Rulings will apply to the acquisition of Shares by South African residents.

Shareholders who are not entitled to retain their Shares received pursuant to the Proposals or are required to dispose of their Shares within a stipulated period, should consult their broker or other professional adviser immediately. Shareholders that are uncertain of whether the SARB will allow them to retain their Shares should consult their broker or other professional adviser immediately.

The following is a summary of Exchange Controls insofar as they have application to South African resident Shareholders in relation to the holding of Shares. This summary description is intended as a guide only and is therefore not comprehensive. If you are in any doubt you should consult an appropriate professional adviser immediately.

52.7.1 *South African individuals*

South African individuals will be able to acquire Shares on the South African overseas branch register, via the JSE, without restriction. Consequently, the purchase of Shares by a South African individual will not affect such person's offshore investments allowance. A South African individual need not take any additional administrative actions and can instruct its broker to accept, buy and sell Shares on its behalf as it would with any other listed security on the JSE.

52.7.2 *South African institutional investors*

South African retirement funds, long-term insurers, collective investment scheme management companies and asset managers may invest in approved inward listed instruments based on foreign reference assets or issued by foreign entities, using their permissible foreign portfolio investment allowances.

South African institutional investors may utilise their general foreign portfolio investment allowance to acquire Shares pursuant to the Proposals. If the BAT Shares received pursuant to the Proposals will result in the South African institutional investors' general foreign portfolio investment allowance being exceeded, they will, pursuant to a directive received from Excon, be granted 24 months to realign their portfolios following the distribution of the Shares. This will not apply to institutional shareholders who acquire Shares other than pursuant to the Proposals.

It has come to BAT's attention that various parties have made or may make representations to the South African Government either to (a) extend the 24 month period granted to institutional investors to realign their portfolios; and/or (b) treat the Shares as shares which have been issued by a South African company (i.e. as a "domestic security"). If such representations are successful BAT will advise Shareholders. However, BAT does not give any assurances and/or guidance as to the prospects of such representations being successful.

52.7.3 *Member brokers of the JSE*

A special dispensation has, in terms of Section H(E) of the Exchange Control Rulings, been provided to local brokers to facilitate the trading of inward listed shares on the JSE. South African brokers are now allowed, as a book building exercise, to purchase shares offshore and to transfer them to the South African overseas branch register. This special dispensation is confined to shares of inward listed companies and brokers may warehouse such shares for a maximum period of 30 days only.

52.7.4 South African corporate entities and trusts

South African corporate entities or trusts will be able to acquire Shares on the South African overseas branch register, via the JSE, without restriction. A South African corporate entity or trust need not take any additional administrative actions and can instruct its broker to accept, buy and sell Shares on its behalf as it would with any other listed security on the JSE.

52.7.5 Rights issues

South African institutional investors, corporates, banks, trusts, partnerships and private individuals will be allowed to exercise their rights in terms of rights offers by BAT. Institutional investors will be given twelve months to realign their portfolios should they be in excess of their portfolio investment limits as a result of exercising their rights.

52.7.6 Non residents of the CMA

Non-residents of the CMA may acquire Shares on the JSE, provided that payment is received in foreign currency of ZAR from a non-resident account. Proceeds from the sale of Shares by non-residents are freely transferable. However, former residents of the CMA who have emigrated may not use emigrant blocked funds to acquire Shares.

53. SETTLEMENT AND TRADING

53.1 Strate

53.1.1 General

Strate is the authorised Central Securities Depository (“**CSD**”) for the electronic settlement of all financial instruments in South Africa. Shares which are not represented by documents of title and which have been replaced with electronic records of ownership are referred to as dematerialised or uncertificated shares. Shares which are evidenced by share certificates or other documents of title are referred to as certificated shares.

The CSDPs are the only market participants who can liaise directly with Strate. There are currently six CSDPs, most of whom are banks. Under the Strate system, there are essentially two types of clients: controlled and non-controlled.

A controlled broker client is one who elects to keep his shares and cash in the custody of his broker and, therefore, indirectly the broker’s chosen CSDP. Because CSDPs are the only market players who liaise directly with Strate, all brokers must have accounts with CSDPs and communicate electronically with them using an international network called SWIFT (Society for Worldwide Inter-bank Financial Telecommunications). A controlled client deals directly and exclusively with his broker and his regular share statement comes from his broker.

A non-controlled broker client is one who appoints their own CSDP to act on their behalf. They surrender their certificates and open an account with their selected CSDP, while dealing with their broker only when they want to trade. They would have to provide their broker with the details of their share account at the CSDP when trading. A non-controlled client receives his share statements directly from his CSDP.

Brokers are obliged to register clients’ shares in their nominee name. Of the six CSDPs, only Computershare is currently offering ‘own-name registration’. All other CSDPs will register all shares in their nominee name.

Issuers are obliged to distribute company information to all beneficial shareholders, which are investors recorded behind a nominee company, who wish to receive it, irrespective of how their shares are registered. As such, there will be a designated field on the mandate signed with your broker or CSDP that gives the option to elect to receive such information from the company.

53.1.2 Shares

The Shares will only be traded and settled on the JSE through Strate as uncertificated Shares. Accordingly, any person who acquires Shares, whether pursuant to the Proposals or otherwise, and who elects to receive such Shares in certificated form will be required to dematerialise their interest in such certificated Shares in order to be able to trade such Shares on the JSE.

Under the UK Companies Act 2006, Shares may only be held in certificated form or through CREST. To facilitate trading on the JSE through Strate, the dematerialised Shares on the South African overseas branch register will be immobilised and registered in certificated form in the name of PLC Nominees, a company which is jointly owned by the JSE and Strate. This will not, however, affect the operation of Strate system. The beneficial holders of such Shares will have their beneficial interests in such Shares recorded in accounts maintained by each CSDP and transfer and settlement of such beneficial title will be effected through Strate and in accordance with the Strate rules. Each beneficial holder will be required to maintain an account with a CSDP or broker and will instruct their CSDPs or brokers regarding voting and other matters in accordance with the mandate entered into between such beneficial holder and his or her CSDP or broker. If a beneficial holder wishes to attend at any meeting of BAT in person, he or she will need to request a letter of representation from his or her CSDP or broker who will then obtain such letter from PLC Nominees. The dividends due to the beneficial holders will be paid into their accounts by their CSDP or broker. BAT will procure the distribution of all circulars and other documentation to all beneficial holders who have indicated their desire to receive such circulars and other relevant documentation.

53.2 Overseas Branch Register

BAT will for the purposes of its listing on the JSE maintain an overseas branch register in South Africa. Due to restrictions imposed by the UK Companies Acts, only South African residents will be allowed to hold Shares directly on the South African overseas branch register in certificated form.

In accordance with the conditions laid down by the SARB in terms of the Exchange Control Regulations, which regulations are applicable in all countries within the CMA, and taking into account the requirements of the UK Companies Acts governing the operation of the share registers of BAT, the position relating to Shareholders acquiring Shares on the JSE pursuant to the Proposals will be as follows:

53.2.1 Residents of the CMA

The distributed Shares received by a Shareholder who had, whether as the beneficial holder or through a nominee, a registered address within the CMA will:

- in the case of a dematerialised Shareholder, be credited to his securities accounts at his CSDP or broker;
- in the case of certificated Shareholder, if his registered address is in: (a) South Africa, be registered on the South African overseas branch register in his name or the name of his nominee, as appropriate, with his South African address; or (b) the Republic of Namibia or the Kingdoms of Lesotho or Swaziland, be registered on the South African overseas branch register in the name of a nominee resident in, and with an address in, South Africa and if such nominee and address is not submitted by the Shareholder in writing, the nominee and address will be nominated by BAT.

53.2.2 Emigrants from the CMA

The distributed Shares received by a Shareholder who is an emigrant from the CMA will:

- in the case of a dematerialised Shareholder, be credited to his blocked securities accounts at his CSDP or broker;
- in the case of a certificated Shareholder whose documents of title are restrictively endorsed in terms of the Exchange Control Regulations, be registered on the South African overseas branch register in the name of a nominee resident in, and with an address in, South Africa and if such nominee and address are not submitted by the

Shareholder in writing, the nominee and address will be nominated by BAT. The share certificates or share statements, as the case may be, in respect of such Shares will be forwarded to the Authorised Dealer controlling the blocked assets of that emigrant Shareholder.

53.2.3 *All other non-residents of the CMA*

The distributed Shares received by a Shareholder who had, whether as the beneficial holder or through a nominee, a registered address outside the CMA and is not an emigrant from the CMA will:

- in the case of a dematerialised Shareholder, be credited to his securities accounts at his CSDP or broker;
- in the case of a certificated Shareholder, be registered on the UK principal register of BAT in his name and with such address, free from any control in terms of the Exchange Control Regulations and the share certificate or share statement, as the case may be, in respect of such Shares will be posted from the United Kingdom at the risk of the Shareholder to the address set out in the register.

Non-South African resident Shareholders who hold shares on the South African overseas branch register through South African nominees who wish to register their holdings into their own names will be required to transfer their registrations from the South African overseas branch register to the UK principal register (either into their own names or into the name of a non-South African nominee) through CREST or in certificated form. In order to do so they will be required to obtain the consent of the South African Reserve Bank, for which purpose they should approach an Authorised Dealer.

New non-South African resident Shareholders who wish to hold Shares on the South African overseas branch register in certificated form will need to appoint a South African resident nominee. In the case of non-CMA residents, the appointment of such nominee must be referred to the exchange control division of an Authorised Dealer.

Non-South African resident Shareholders who hold dematerialised Shares through Strate and who wish to rematerialise such Shares will need to appoint a South African resident nominee to be the registered holder in respect of such Shares. In the case of non-CMA residents, the appointment of such nominee must be referred to the exchange control division of an Authorised Dealer. Such non-CMA residents will also be able to instruct their CSDP or broker to withdraw Shares from Strate and transfer them onto the UK principal register through CREST or in certificated form. They will, however, be required to obtain the consent of the South African Reserve Bank to do so, for which purpose they should approach an Authorised Dealer.

Non-CMA residents Shareholders will be able to transfer Shares into Strate.

There are certain costs associated with the various transfers.

53.3 Overseas Branch Register Rules

Article 34 of the Articles gives the Directors the power to make and vary such provisions as they may think fit respecting the keeping of any such overseas branch register. The following is a summary of the regulations which were made in accordance with Article 34 of the Articles and adopted by the Directors on 3 October 2008.

The South African overseas branch register will be kept at the offices of the South African Transfer Secretaries in South Africa.

Subject to any written requests from the transferee to register otherwise, the Directors will lodge a transfer of Shares in South Africa on the South African overseas branch register if the instrument of transfer is lodged in South Africa and on the UK principal register if the instrument of transfer is lodged in the United Kingdom.

Only members resident in South Africa will be registered on the South African overseas branch register and accordingly the Directors will refuse to register a transfer (including pursuant to a re-materialisation of such member's interest in Shares) on the South African overseas branch register

if the transferee is not a South African resident and shall instead register such transfer on the UK principal register. For the purposes of determining residency, the Directors will rely on the address of such transferee. An address in the CMA (other than in South Africa) will be regarded as a non-South African address.

The Directors shall have the power to transfer the Shares of a member from the UK principal register to the South African overseas branch register and vice versa, without the consent of the member, if the transfer is required to avoid a breach of applicable laws. The Directors will notify the member of the transfer as soon as practical and in any event within one month.

A Shareholder may request a transfer of his Shares from one register to another. The Directors may refuse to process a removal request from a member if the request is not accompanied by all documentation and approvals required by applicable laws. The Directors will refuse to process a transfer of Shares from the UK principal register to the South African overseas branch register if the transferee is not a South African resident. The Directors may suspend the process of transfers at such times and for such periods as the Directors may determine.

Notwithstanding Article 135(4), BAT shall send any notice, document or information sent by the Company to members in accordance with Article 135 to: (i) any member holding shares in BAT on the South African overseas branch register; and (ii) any person holding a beneficial interest in BAT's shares through the electronic system operated by Strate who has indicated their desire to receive such notices, documents and information in accordance with the rules and directives issued by Strate, unless to do so would result in BAT breaching any applicable law (whether in the United Kingdom, South Africa or elsewhere) or would result, directly or indirectly, in BAT being required to comply with additional filing or other regulatory requirements in any jurisdiction.

PART VII : GENERAL INFORMATION

54. MATERIAL CONTRACTS

The contracts set out in Annexure VIII to this Pre-listing statement are all of the contracts (not being contracts entered into in the ordinary course of business) that have been entered into by any member of the Group (i) within the two years immediately preceding the date of this Pre-listing statement and are, or may be, material to the Group; or (ii) at any time and contain obligations or entitlements which are, or may be, material to the Group as at the date of this Pre-listing statement.

55. MATERIAL CHANGES

No material changes in the financial or trading position of the Group has occurred between 30 June 2008 (being the period for which the last unaudited Interim Report has been published for the Group) and 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement). Shareholders are alerted to the results of the Group for nine months ended 30 September 2008 which will be released, inter alia, on SENS on 30 October 2008.

56. MATERIAL LITIGATION

The details of all the legal or arbitration proceedings, including any proceedings that are pending or threatened of which the Group is aware, that may have or have had in the recent past, being at least the previous twelve months, a material effect on the Group's financial position are set out in Annexure IX to this Pre-listing statement.

57. ROYALTIES

No material royalties have been paid by the Group during the three years preceding 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement) or are payable by the Group.

58. TECHNICAL OR SECRETARIAL FEES

No material technical or secretarial fees have been paid by the Group during the three years preceding 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement).

59. EXPENSES OF THE LISTING

The estimated costs and expenses payable by BAT in connection with the Listing are set out below:

Expense	Payable to	£ (excluding VAT)
JSE – documentation	JSE	2,900
– listing fees	JSE	100,000
Printing, publication, distribution and advertising	Ince (Proprietary) Limited	20,000
Sponsor fees	J.P. Morgan	625,000
	UBS South Africa	625,000
Legal Fees	Werksmans	200,000
	Edward Nathan Sonnenbergs Inc.	35,000
	Herbert Smith LLP	600,000
	Cravath, Swaine & Moore LLP	20,000
Auditors	PricewaterhouseCoopers LLP	120,000
Transfer Secretaries	Computershare Investor Services (Proprietary) Limited	5,500
	Computershare Investor Services PLC	21,000
Total		2,374,400

60. PROMOTERS' INTERESTS

No promoter has had any material beneficial interest, direct or indirect, in the promotion of BAT or in any property acquired or proposed to be acquired by BAT, or any other issue in the preceding three years to this Pre-listing statement, and no amount of cash or securities was paid or any benefit given within the three preceding years, or is proposed to be paid or given, to any promoter not being a Director.

61. ADVISERS' INTERESTS

None of Cravath, Swaine & Moore LLP, Edward Nathan Sonnenbergs Incorporated, Herbert Smith LLP, J.P. Morgan, PricewaterhouseCoopers LLP, UBS South Africa and Werksmans hold any material interests in Shares or have agreed to acquire any material interests in Shares at the date of this Pre-listing statement.

62. CONSENTS

PricewaterhouseCoopers LLP has given and not withdrawn its written consent to the inclusion herein of its reports in Annexure I in the form and the context in which they are included.

The written consents of Computershare Investor Services PLC, Computershare Investor Services (Proprietary) Limited, Cravath, Swaine & Moore LLP, Edward Nathan Sonnenbergs Incorporated, Herbert Smith LLP, J.P. Morgan, UBS South Africa and Werksmans to act in the capacities stated on the inside front cover of this Pre-listing statement, and to their names being stated where appropriate in this Pre-listing statement, have been given and have not been withdrawn prior to the issue of this Pre-listing statement.

63. DIRECTORS' RESPONSIBILITY STATEMENT

The Directors whose names are given on page 33 of this Pre-listing statement collectively and individually accept full responsibility for the accuracy of the information contained in this Pre-listing statement and certify that to the best of their knowledge and belief there are no facts that have been omitted which would make any statement false or misleading, and that all reasonable enquiries to ascertain such facts have been made and that the Pre-listing statement contains all information required by the JSE Listings Requirements.

64. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents will be available for inspection at BAT's registered office, BAT's representative office in South Africa and the offices of Werksmans during usual business hours on any weekday (Saturdays and public holidays excepted) for a period from and including the date of this Pre-listing statement until Friday, 28 November 2008:

- (i) the Memorandum of Association and Articles of Association for BAT and each of the material subsidiaries listed in paragraph 5 of this Pre-listing statement;
- (ii) the Overseas Branch Register Regulations referred to in paragraph 53.3 of this Pre-listing statement;
- (iii) the Annual Report and Accounts of BAT for the three financial years ended 31 December 2005, 2006 and 2007;
- (iv) the Interim Report of BAT for the six months to 30 June 2008;
- (v) copies of the service agreements of the Directors, company secretary and Senior Managers;
- (vi) the various documents constituting the Share Schemes;
- (vii) the Base Prospectus and other constitutive documents in respect of the EMTN Programme;
- (viii) the letters of consent referred to in paragraph 62 of this Pre-listing statement; and
- (ix) this Pre-listing statement.

This Pre-listing statement has been signed in London on behalf of the Directors in terms of powers of attorney granted.

British American Tobacco p.l.c.

Tuesday, 21 October 2008

FINANCIAL STATEMENTS FOR THE GROUP

INDEX TO FINANCIAL STATEMENTS

The financial statements contained herein use different defined terms to those used elsewhere in this Pre-listing statement. In particular, unless otherwise specified, on any given such page, the term "company", "Company", or "parent Company," means British American Tobacco p.l.c. and "group" or "Group" means British American Tobacco p.l.c. together with its consolidated subsidiaries.

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The above mentioned financial statements have been extracted, without adjustment to the numbers, from the 2007 and 2006 Annual Reports and Accounts of BAT and the 2008 Interim Report of BAT (see the section on "Presentation of Financial Information" commencing on page 2 of this Pre-listing statement) and contain cross-references to other parts of such Annual Reports and Accounts and Interim Report or other sources. Such cross-referenced material is not part of, and is not incorporated by reference into, this Pre-listing statement and should be disregarded for the purpose of this Pre-listing statement.

As this information only represents extracts of each of the Annual Reports and Accounts and the Interim Report, there are certain references made to pages in each of the Annual Reports and Accounts and the Interim Report which have a different pagination in this Pre-listing statement or to other pages in each of the Annual Reports and Accounts and the Interim Report that have not been included in this Pre-listing statement.

Shareholders are referred to Part II of the Pre-listing statement and the full Annual Reports and Accounts for a general review of the business and operations of BAT.

Copies of the Annual Reports and Accounts and Interim Report can be obtained from BAT's representative office in South Africa and BAT's website: www.bat.com.

Unaudited Consolidated Financial Statements for the six-months ended 30 June 2008

GROUP INCOME STATEMENT – unaudited

3 months to			6 months to		Year to
30.6.08	30.6.07		30.6.08	30.6.07	31.12.07
£m	£m		£m	£m	£m
		Gross turnover (including duty, excise and other taxes of £9,082 million (30.6.07: £7,609 million – 31.12.07: £16,216 million))	14,539	12,334	26,234
7,767	6,515		5,457	4,725	10,018
2,916	2,493	Revenue	(1,537)	(1,386)	(2,802)
(881)	(771)	Raw materials and consumables used			
		Changes in inventories of finished goods and work in progress	52	78	30
55	53	Employee benefit costs	(806)	(711)	(1,586)
(421)	(367)	Depreciation and amortisation costs	(174)	(156)	(336)
(91)	(82)	Other operating income	54	70	205
31	40	Other operating expenses	(1,322)	(1,128)	(2,624)
(692)	(558)				
917	808	Profit from operations	1,724	1,492	2,905
		after (charging)/crediting:			
(23)	(32)	– restructuring and integration costs	(33)	(40)	(173)
	11	– gains on disposal of businesses and brands		11	75
31	25	Finance income	121	55	136
(115)	(93)	Finance costs	(300)	(181)	(405)
(84)	(68)	Net finance costs	(179)	(126)	(269)
134	111	Share of post-tax results of associates and joint ventures after (charging)/crediting:	293	222	442
		– brand impairments			(7)
13		– additional ST income	13		
		– termination of joint venture	45		
967	851	Profit before taxation	1,838	1,588	3,078
(270)	(221)	Taxation on ordinary activities	(494)	(420)	(791)
697	630	Profit for the period	1,344	1,168	2,287
		Attributable to:			
650	584	Shareholders' equity	1,249	1,079	2,130
47	46	Minority interests	95	89	157
		Earnings per share			
32.56p	28.70p	Basic	62.48p	52.94p	105.19p
32.35p	28.52p	Diluted	62.08p	52.58p	104.46p

GROUP STATEMENT OF CHANGES IN TOTAL EQUITY – unaudited

	30.6.08	6 months to 30.6.07	Year to
	£m	£m	31.12.07 £m
Differences on exchange	(199)	88	312
Cash flow hedges			
– net fair value gains	19	5	15
– reclassified and reported in profit for the period	(22)	(6)	(42)
Available-for-sale investments			
– net fair value gains/(losses)	1	(1)	1
– reclassified and reported in profit for the period	(1)	(2)	1
Net investment hedges			
– net fair value (losses)/gains	(39)	15	(35)
Tax on items recognised directly in equity	(23)	(13)	(19)
Net (losses)/gains recognised directly in equity	(264)	86	233
Profit for the period <i>page 11</i>	1,344	1,168	2,287
Total recognised income for the period	1,080	1,254	2,520
– shareholders' equity	969	1,159	2,348
– minority interests	111	95	172
Employee share options			
– value of employee services	26	17	37
– proceeds from shares issued	7	19	27
Dividends and other appropriations			
– ordinary shares	(954)	(821)	(1,198)
– to minority interests	(80)	(84)	(173)
Purchase of own shares			
– held in employee share ownership trusts	(116)	(29)	(41)
– share buy-back programme	(191)	(358)	(750)
Acquisition of minority interests	(1)	(2)	(9)
Other movements	2	(8)	(3)
	(227)	(12)	410
Balance at 1 January	7,098	6,688	6,688
Balance at period end	6,871	6,676	7,098

GROUP BALANCE SHEET – unaudited

	30.6.08	30.6.07	31.12.07
	£m	£m	£m
Assets			
Non-current assets			
Intangible assets	8,872	7,561	8,105
Property, plant and equipment	2,496	2,192	2,378
Investments in associates and joint ventures	2,147	2,212	2,269
Retirement benefit assets	60	37	50
Deferred tax assets	274	265	262
Trade and other receivables	159	143	123
Available-for-sale investments	24	19	22
Derivative financial instruments	96	79	153
Total non-current assets	14,128	12,508	13,362
Current assets			
Inventories	2,637	2,208	1,985
Income tax receivable	94	50	85
Trade and other receivables	1,749	1,503	1,845
Available-for-sale investments	76	95	75
Derivative financial instruments	204	93	82
Cash and cash equivalents	2,326	1,141	1,258
	7,086	5,090	5,330
Assets classified as held for sale	285	53	36
Total current assets	7,371	5,143	5,366
Total assets	21,499	17,651	18,728

GROUP BALANCE SHEET – unaudited

	30.6.08 £m	30.6.07 £m	31.12.07 £m
Equity			
Capital and reserves			
Share capital	506	509	506
Share premium, capital redemption and merger reserves	3,905	3,898	3,902
Other reserves	357	499	637
Retained earnings	1,855	1,534	1,835
Shareholders' funds	6,623	6,440	6,880
after deducting – cost of treasury shares	(554)	(174)	(296)
Minority interests	248	236	218
Total equity	6,871	6,676	7,098
Liabilities			
Non-current liabilities			
Borrowings	7,895	5,440	6,062
Retirement benefit liabilities	306	395	357
Deferred tax liabilities	336	304	294
Other provisions for liabilities and charges	153	145	165
Trade and other payables	139	152	149
Derivative financial instruments	114	82	49
Total non-current liabilities	8,943	6,518	7,076
Current liabilities			
Borrowings	1,760	1,194	861
Income tax payable	274	281	227
Other provisions for liabilities and charges	300	230	263
Trade and other payables	3,167	2,665	2,976
Derivative financial instruments	181	82	225
	5,682	4,452	4,552
Liabilities directly associated with assets classified as held for sale	3	5	2
Total current liabilities	5,685	4,457	4,554
Total equity and liabilities	21,499	17,651	18,728

GROUP CASH FLOW STATEMENT – unaudited

	30.6.08 £m	6 months to 30.6.07 £m	Year to 31.12.07 £m
Cash flows from operating activities			
Cash generated from operations <i>page 25</i>	1,569	1,434	3,181
Dividends and other distributions received from associates	172	94	285
Tax paid	(455)	(410)	(866)
Net cash from operating activities	1,286	1,118	2,600
Cash flows from investing activities			
Interest received	63	49	114
Dividends received from investments	1	1	2
Purchases of property, plant and equipment	(117)	(157)	(416)
Proceeds on disposal of property, plant and equipment	17	27	46
Purchases of intangibles	(15)	(18)	(66)
Proceeds on disposal of intangibles	17	16	16
Purchases and disposals of investments	15	37	71
Purchases of subsidiaries and minority interests	(2)	(6)	(15)
Proceeds on disposals of subsidiaries			126
Purchase of Tekel cigarette assets	(867)		
Net cash from investing activities	(888)	(51)	(122)
Cash flows from financing activities			
Interest paid	(179)	(173)	(384)
Interest element of finance lease rental payments	(1)	(1)	(3)
Capital element of finance lease rental payments	(13)	(10)	(21)
Proceeds from issue of shares to Group shareholders	3	4	5
Proceeds from exercise of options over own shares held in employee ownership trusts	4	15	22
Proceeds from increases in and new borrowings	2,727	445	438
Movements relating to derivative financial instruments	(301)	(13)	(89)
Purchases of own shares	(137)	(358)	(750)
Purchase of own shares held in employee share ownership trusts	(116)	(29)	(41)
Reductions in and repayments of borrowings	(372)	(300)	(427)
Dividends paid to shareholders	(954)	(821)	(1,198)
Dividends paid to minority interests	(79)	(83)	(173)
Net cash from financing activities	582	(1,324)	(2,621)
Net cash flows from operating, investing and financing activities	980	(257)	(143)
Differences on exchange	91	10	47
Increase/(decrease) in net cash and cash equivalents in the period	1,071	(247)	(96)
Net cash and cash equivalents at 1 January	1,180	1,276	1,276
Net cash and cash equivalents at period end	2,251	1,029	1,180

Notes to the Unaudited Consolidated Financial Statements

ACCOUNTING POLICIES AND BASIS OF PREPARATION

The financial information comprises the unaudited interim results for the six months to 30 June 2008 and 30 June 2007, together with the audited results for the year ended 31 December 2007. This condensed set of financial statements has been prepared in accordance with IAS34 'Interim Financial Reporting' as adopted by the European Union and the Disclosure and Transparency Rules issued by the Financial Services Authority. They are unaudited but have been reviewed by the auditors and their review report is set out on page 10.

The condensed set of financial statements does not constitute statutory accounts within the meaning of Section 240 of the UK Companies Act 1985 and should be read in conjunction with the annual consolidated financial statements for the year ended 31 December 2007, which were prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) and implemented in the UK. The annual consolidated financial statements for 2007 represent the statutory accounts for that year and have been filed with the Registrar of Companies. The auditors' report on those statements was unqualified and did not contain any statement concerning accounting records or failure to obtain necessary information and explanations.

This condensed set of financial statements has been prepared under the historical cost convention, except in respect of certain financial instruments, and on a basis consistent with the IFRS accounting policies as set out in the Annual Report and Accounts for the year ended 31 December 2007, as updated for the business combination described on page 21. The update extends the Group's accounting policy on 'intangible assets other than goodwill' to cover trademarks acquired by the Group's subsidiary undertakings. As with other intangible assets shown on the Group balance sheet, acquired trademarks are carried at cost less accumulated amortisation and impairment. Trademarks with indefinite lives are not amortised but are reviewed annually for impairment. Other trademarks are amortised on a straight-line basis over their useful lives, which do not exceed twenty years. Consistent with the existing policy for associated companies, impairments are recognised in the income statement but increases in values are not recognised.

As indicated in the 2007 Annual Report and Accounts, IFRIC14 (IAS19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction) will be effective from 1 January 2008, once it has been endorsed by the EU. The interpretation clarifies the conditions under which a surplus in a post-retirement benefit scheme can be recognised in the financial statements, as well as setting out the accounting implications where minimum funding requirements exist. Currently, it is not expected that this change would materially alter the Group's reported equity and profit at 1 January 2008 or 31 December 2008.

The preparation of the condensed set of financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities at the date of the condensed set of financial statements. Such estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable in the circumstances and constitute management's best judgement at the date of the financial statements. In the future, actual experience may deviate from these estimates and assumptions, which could affect the condensed set of financial statements as the original estimates and assumptions are modified, as appropriate, in the period in which the circumstances change.

SEGMENTAL ANALYSES OF REVENUE AND PROFIT – unaudited

The analyses for the six months are as follows:

Revenue	30.6.08			30.6.07		
	External £m	Inter segment £m	Revenue £m	External £m	Inter segment £m	Revenue £m
Europe	2,057	115	2,172	1,683	125	1,808
Asia-Pacific	1,025	10	1,035	932	17	949
Latin America	1,051	292	1,343	939	253	1,192
Africa and Middle East	647		647	546	9	555
America-Pacific	260		260	221		221
	5,040	417	5,457	4,321	404	4,725

The analyses for the year ended 31 December 2007 are as follows:

	External £m	Inter segment £m	Revenue £m
Europe	3,621	225	3,846
Asia-Pacific	1,874	22	1,896
Latin America	1,979	585	2,564
Africa and Middle East	1,224	15	1,239
America-Pacific	473		473
	9,171	847	10,018

The segmental analysis of revenue above is based on location of manufacture and figures based on location of sales would be as follows:

	30.6.08 £m	30.6.07 £m	31.12.07 £m
Europe	2,071	1,708	3,655
Asia-Pacific	1,028	932	1,876
Latin America	1,056	944	1,983
Africa and Middle East	745	664	1,445
America-Pacific	557	477	1,059
	5,457	4,725	10,018

Profit from operations

	30.6.08	30.6.07				31.12.07
	Segment	Adjusted	Segment	Adjusted	Segment	Adjusted
	result	segment	result	segment	result	segment
	£m	result*	£m	result*	£m	result*
Europe	505	530	376	404	782	842
Asia-Pacific	400	403	339	335	667	672
Latin America	381	381	386	386	680	680
Africa and Middle East	252	259	247	249	447	470
America-Pacific	237	235	189	192	436	446
Segmental results	1,775	1,808	1,537	1,566	3,012	3,110
Unallocated costs	(51)	(51)	(45)	(45)	(107)	(107)
Profit from operations	1,724	1,757	1,492	1,521	2,905	3,003

*Excluding restructuring and integration costs and gains on disposal of businesses and brands as explained on page 20.

The segmental analysis of the **Group's share of the post-tax results of associates and joint ventures** is as follows:

	30.6.08	30.6.07				31.12.07
	Segment	Adjusted	Segment	Adjusted	Segment	Adjusted
	result	segment	result	segment	result	segment
	£m	result*	£m	result*	£m	result*
Europe	38	25	21	21	48	48
Asia-Pacific	66	66	55	55	110	110
Latin America	1	1	1	1	1	1
Africa and Middle East	1	1	1	1	1	1
America-Pacific	187	142	144	144	282	289
	293	235	222	222	442	449

*Excluding gain on termination of joint venture, additional ST income and charges for brand impairments as explained on page 23.

NON-GAAP MEASURES

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

The principal non-GAAP measure which the Group uses is adjusted diluted earnings per share, which is reconciled to diluted earnings per share. The exceptional items that mainly drive the adjustments made, are separately disclosed as memorandum information on the face of the Income Statement and the segmental analysis.

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

FOREIGN CURRENCIES

The results of overseas subsidiaries and associates have been translated to sterling as follows:

The income statement has been translated at the average rates for the respective periods. The total equity has been translated at the relevant period end rates. For high inflation countries, the local currency results are adjusted for the impact of inflation prior to translation to sterling at closing exchange rates.

The principal exchange rates used were as follows:

	30.6.08	Average 30.6.07	31.12.07	30.6.08	Closing 30.6.07	31.12.07
US dollar	1.975	1.971	2.001	1.990	2.006	1.991
Canadian dollar	1.989	2.235	2.147	2.019	2.134	1.965
Euro	1.291	1.482	1.462	1.263	1.486	1.362
South African rand	15.127	14.120	14.110	15.579	14.149	13.605
Brazilian real	3.351	4.028	3.894	3.165	3.864	3.543
Australian dollar	2.138	2.437	2.390	2.074	2.365	2.267
Russian rouble	47.251	51.380	51.161	46.658	51.704	48.847

EXCEPTIONAL ITEMS

(a) Restructuring and integration costs

During 2003, the Group commenced a detailed review of its manufacturing operations and organisational structure, including the initiative to reduce overheads and indirect costs. The restructuring continued, with major announcements which covered the cessation of production in the UK, Ireland, Canada and Zevenaar in the Netherlands, with production to be transferred elsewhere.

The results for the twelve months to 31 December 2007 included a charge for restructuring of £173 million, principally in respect of costs associated with restructuring the operations in Italy and with the reorganisation of the business across the Europe and Africa and Middle East regions, as well as further costs related to restructurings announced in prior years. On 18 May 2007, the Group's Italian subsidiary announced the results of a review of its manufacturing infrastructure, including an intention to consolidate its operations at the plant in Lecce, close its operations at Rovereto and sell its facilities at Chiaravalle together with three national brands. The disposal of Chiaravalle was completed on 12 September 2007.

The six months to 30 June 2008 includes a charge for restructuring and integration of £33 million (2007: £40 million), principally in respect of further costs related to restructurings announced in prior years.

(b) Gains on disposal of businesses and brands

On 20 February 2007, the Group announced that it had agreed to sell its pipe tobacco trademarks to the Danish company, Orlik Tobacco Company A/S, for €24 million. The sale was completed during the second quarter in 2007 and resulted in a gain of £11 million included in other operating income in the profit from operations. However, the Group retained the Dunhill and Captain Black pipe tobacco brands.

On 23 May 2007, the Group announced that it had agreed to sell its Belgian cigar factory and associated brands to the cigars division of Skandinavisk Tobakskompagni. The sale included a factory in Leuven as well as trademarks including Corps Diplomatique, Schimmelpennick, Don Pablo and Mercator. The transaction was completed on 3 September 2007 and a gain on disposal of £45 million was included in other operating income in the profit from operations for the twelve months to 31 December 2007.

On 1 October 2007, the Group agreed the termination of its license agreement with Philip Morris for the rights to the Chesterfield trademark in a number of countries in Southern Africa. This transaction resulted in a gain of £19 million included in other operating income in the profit from operations for the twelve months to 31 December 2007.

TEKEL

On 22 February 2008, the Group announced that it had won the public tender to acquire the cigarette assets of Tekel, the Turkish state-owned tobacco company, with a bid of US\$1,720 million. The acquisition only relates to the cigarette assets of Tekel, which principally comprise brands, factories and tobacco leaf stocks. The acquisition did not include employees and the Group had directly employed the required workforce by the effective date of the transaction. Completion of this transaction was subject to regulatory approval which was subsequently received and on 24 June 2008 the Group completed the transaction. Work is continuing in respect of the fair value exercise, and therefore the provisional values shown in the table below will be updated in due course as permitted under IFRS 3.

Provisional values	Book value £m	Fair value adjustments £m	Fair value £m
Intangible assets		124	124
Property, plant and equipment	77	15	92
Deferred tax asset		1	1
Inventories	154	(15)	139
Trade and other receivables		8	8
Other provisions for liabilities and charges		(2)	(2)
Assets classified as held for sale	6	29	35
Net assets acquired	237	160	397
Goodwill			476
Total consideration			873
Consideration satisfied by:			
– Cash			866
– Acquisition costs			7
Total consideration			873

Included within the cigarette assets acquired from Tekel are certain items of property, plant and equipment that are being actively marketed for sale. These assets are expected to be sold within a period of one year from the balance sheet date and have been included as 'Assets classified as held for sale'.

The book values of the acquired assets have been revalued to fair value as at the acquisition date. The main adjustments relate to the revaluations of land and buildings, recognition of cigarette trademarks and the recognition of a pre-paid operating lease rental agreement. The book values are based on the latest management information available.

The provisional goodwill of £476 million arising on the acquisition of the cigarette assets of Tekel represents a strategic premium to acquire Tekel's significant market position in the Turkish cigarette market and anticipated synergies that will arise post acquisition.

Although the acquisition was completed on 24 June 2008, the results generated from the acquired Tekel cigarette assets for the period to 30 June 2008 were not material for the Group.

If the acquisition had occurred on 1 January 2008, before accounting for anticipated synergy, restructuring and pricing benefits, it is currently estimated that Group revenue would have been £5,565 million and Group profit from operations would have been £1,728 million for the 6 months to 30 June 2008. These amounts have been estimated based on the Tekel results for the 6 months prior to acquisition, adjusted to reflect changes arising as a result of the acquisition fair value adjustments. The amounts reported for profit from operations are after charging £4 million for amortisation of acquired intangibles for the six months to 30 June 2008.

NET FINANCE COSTS

Net finance costs comprise:

	30.6.08	6 months to	30.6.07
	£m		£m
Interest payable	(224)		(185)
Interest and dividend income	66		53
Fair value changes – derivatives	(157)	(36)	
Exchange differences	136	42	
	(21)		6
	(179)		(126)

Net finance costs at £179 million were £53 million higher than last year, principally reflecting the impact of derivatives and exchange differences, as well as a higher interest cost as a result of increased borrowings.

The net £21 million loss (2007: £6 million gain) of fair value changes and exchange differences reflects a loss of £9 million (2007: £6 million gain) from the net impact of exchange rate movements and a loss of £12 million (2007: £nil) principally due to interest related changes in the fair value of derivatives.

IFRS requires fair value changes for derivatives, which do not meet the tests for hedge accounting under IAS39, to be included in the income statement. In addition, certain exchange differences are required to be included in the income statement under IFRS and, as they are subject to exchange rate movements in a period, they can be a volatile element of net finance costs. These amounts do not always reflect an economic gain or loss for the Group and, accordingly, the Group has decided that, in calculating the adjusted diluted earnings per share, it is appropriate to exclude certain amounts.

The adjusted diluted earnings per share for the period ended 30 June 2008 exclude, in line with previous practice, an £11 million loss (2007: £nil) relating to exchange losses in net finance costs where there is a compensating exchange gain reflected in differences in exchange taken directly to changes in total equity.

ASSOCIATES

The share of post-tax results of associates was £293 million (2007: £222 million) after taxation of £151 million (2007: £120 million). For the year to 31 December 2007, the share of post-tax results was £442 million after tax of £246 million. The share is after exceptional charges and credits.

On 21 February 2008, Reynolds American announced that it would receive a payment from Gallaher Limited resulting from the termination of a joint venture agreement. While the payment will be received over a number of years, in the six months to 30 June 2008 Reynolds American recognised a pre-tax gain of US\$328 million. The Group's share of this gain included in the results for the six months, amounts to £45 million and is treated as an exceptional item (net of tax).

In the year ended 31 December 2007, Reynolds American modified the previously anticipated level of support between certain brands and the projected net sales of certain brands, resulting in a brand impairment charge of which the Group's share amounted to £7 million (net of tax).

The year end of the Group's associate company Skandinavisk Tobakskompagni (ST) is 30 June, and, for practical reasons, the Group had previously equity accounted for its interest based on the information available from ST which was 3 months in arrears to that of the Group. As explained on page 28 under 'Post balance sheet event', the Group acquired 100 per cent of ST's cigarette and snus business on 2 July 2008. Consequently, in order to account for the Group's share of the net assets of ST at the date of the acquisition, the estimated results of ST for the period up to 30 June 2008 have been included in these results, resulting in one additional quarter's income in 2008. This contributed an additional £13 million to the share of post-tax results of associates and joint ventures, but this has been treated as an exceptional item and excluded from the calculation of the adjusted diluted earnings per share.

The carrying value of the Group's interest in ST has been classified as 'Held for sale' at 30 June 2008.

TAXATION

The tax rate in the income statement of 26.9 per cent for the six months to 30 June 2008 (30 June 2007: 26.4 per cent) is affected by the inclusion of the share of associates' post-tax profit in the Group's pre-tax results. The underlying rate for subsidiaries reflected in the adjusted earnings per share below was 30.1 per cent and 30.8 per cent in 2007. The decrease arises primarily from a change in the mix of profits and a reduction in national tax rates in several countries. The charge relates to taxes payable overseas.

The tax charge for 2008 includes a one-off net deferred tax charge of £22 million as a result of the acquisition of the cigarette assets of Tekel. This has been excluded from the adjusted diluted earnings per share and consequently from the underlying tax rate above.

EARNINGS PER SHARE

Basic earnings per share are based on the profit for the period attributable to ordinary shareholders and the average number of ordinary shares in issue during the period (excluding treasury shares).

For the calculation of the diluted earnings per share the average number of shares reflects the potential dilutive effect of employee share schemes.

The earnings per share are based on:

	30.6.08		30.6.07		31.12.07	
	Earnings £m	Shares m	Earnings £m	Shares m	Earnings £m	Shares m
Basic	1,249	1,999	1,079	2,038	2,130	2,025
Diluted	1,249	2,012	1,079	2,052	2,130	2,039

The earnings have been affected by exceptional items, together with certain distortions to net finance costs under IFRS (see page 22) and to deferred tax (see page 23) in 2008, and to illustrate the impact of these distortions the adjusted diluted earnings per share are shown below:

	Diluted earnings per share	6 months to	Year to
	30.6.08	30.6.07	31.12.07
	pence	pence	pence
Unadjusted earnings per share	62.08	52.58	104.46
Effect of restructuring and integration costs	1.19	1.32	6.48
Effect of disposals of businesses and brands		(0.39)	(2.75)
Net finance cost adjustment	0.55		
Effect of associates' brand impairments and termination of joint ventures	(2.24)		0.34
Effect of additional ST income	(0.65)		
Effect of deferred tax adjustment	1.09		
Adjusted diluted earnings per share	62.02	53.51	108.53
Adjusted diluted earnings per share are based on:			
– adjusted earnings (£m)	1,248	1,098	2,213
– shares (m)	2,012	2,052	2,039

Similar types of adjustments would apply to basic earnings per share. For the six months to 30 June 2008, basic earnings per share on an adjusted basis would be 62.43p (2007: 53.87p) compared to unadjusted amounts of 62.48p (2007: 52.94p) .

CASH FLOW

(a) Alternative cash flow

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

	30.6.08	6 months to	Year to
	£m	30.6.07	31.12.07
		£m	£m
Net cash from operating activities before restructuring costs and taxation	1,815	1,604	3,656
Restructuring costs	(74)	(76)	(190)
Taxation	(455)	(410)	(866)
Net cash from operating activities (page 15)	1,286	1,118	2,600
Net interest	(125)	(135)	(280)
Net capital expenditure	(115)	(148)	(436)
Dividends to minority interests	(79)	(83)	(173)
Free cash flow	967	752	1,711
Dividends paid to shareholders	(954)	(821)	(1,198)
Share buy-back	(137)	(358)	(750)
Purchase of Tekel cigarette assets (page 21)	(867)		
Other net flows	(136)	25	152
Net cash flows	(1,127)	(402)	(85)

The Group's net cash flow from operating activities at £1,286 million was £168 million higher, with the growth in underlying operating performance only partly offset by higher tax payments and adverse working capital movements reflecting timing and one-off differences in 2007 and 2008. In addition, dividends and other distributions received from associates were higher as a result of timing and the inclusion of an amount of £19 million in respect of the Group's participation in the share buy-back programme conducted by Reynolds American Inc.

With relatively small changes in net interest and dividends paid to minorities, as well as lower net capital expenditure, the free cash flow was £967 million, £215 million higher than 2007.

Below free cash flow, the principal charge is the outflow of £867 million for the Tekel asset acquisition. In addition, the cash flows for the first six months of the year include the payment of the prior year's final dividend (2008: £954 million – 2007: £821 million). However, the share buy-back outflow is lower at £137 million (2007: £358 million). The change in other net flows from a £25 million inflow in 2007 to a £136 million outflow in 2008 includes the increased purchase of own shares to be held in employee share ownership trusts.

The above flows resulted in net cash outflows of £1,127 million (30 June 2007: £402 million outflow – 31 December 2007: £85 million outflow). After taking account of transactions related to borrowings, especially net new borrowings, the above flows resulted in a net increase of cash and cash equivalents of £980 million, (30 June 2007: £257 million decrease – 31 December 2007: £143 million decrease) as shown in the IFRS cash flow on page 15.

These cash flows, after a positive exchange impact of £91 million, resulted in cash and cash equivalents, net of overdrafts, increasing by £1,071 million in 2008 (30 June 2007: £247 million decrease – 31 December 2007: £96 million decrease).

Borrowings, excluding overdrafts but taking into account derivatives relating to borrowings, were £9,547 million compared to £6,836 million at 31 December 2007. The increase principally reflected the impact of additional borrowings to finance acquisitions as well as exchange rate movements.

Current available-for-sale investments at 30 June 2008 were £76 million (30 June 2007: £95 million and 31 December 2007: £75 million).

As a result of the above, total borrowings including related derivatives, net of cash, cash equivalents and current available-for-sale investments, were £7,216 million (31 December 2007: £5,581 million).

(b) Cash generated from operations (page 15)

	30.6.08	6 months to 30.6.07	Year to 31.12.07
	£m	£m	£m
Profit before taxation	1,838	1,588	3,078
<i>Adjustments for:</i>			
Share of post-tax results of associates and joint ventures	(293)	(222)	(442)
Net finance costs	179	126	269
Gains on disposal of businesses and brands		(11)	(75)
Depreciation and impairment of property, plant and equipment	153	141	293
Amortisation and write off of intangible assets	21	15	43
(Increase)/decrease in inventories	(415)	(146)	170
Decrease/(increase) in trade and other receivables	120	134	(83)
Increase/(decrease) in trade and other payables	55	(94)	61
(Decrease) in net retirement benefit liabilities	(58)	(55)	(120)
(Decrease) in other provisions for liabilities and charges	(41)	(43)	(16)
Other	10	1	3
Cash generated from operations	1,569	1,434	3,181

(c) IFRS investing and financing activities

The investing and financing activities in the IFRS cash flows on page 15 include the following items:

The proceeds on disposal of intangibles of £16 million for the six months ended 30 June 2007 and the year ended 31 December 2007 arose from the pipe tobacco trademark sale explained on page 20. In the six months ended 30 June 2008, the £17 million proceeds on disposal of intangibles arose from the termination of a licence agreement in Southern Africa in 2007, as explained on page 20.

Purchases and disposals of investments (which comprise available-for-sale investments and loans and receivables) include an inflow in respect of current investments of £14 million for the six months to 30 June 2008 (30 June 2007: £33 million inflow – 31 December 2007: £65 million inflow) and £1 million sales proceeds of non-current investments for the six months to 30 June 2008 (30 June 2007: £4 million – 31 December 2007: £6 million).

Proceeds on disposals of subsidiaries for the year ended 31 December 2007 principally reflected the proceeds from sale of the Belgian Cigar factory and associated brands.

In the six months to 30 June 2008, the cash outflow of £867 million on the purchase of Tekel assets comprises the purchase price and part of the acquisition costs as shown on page 21. The purchase of subsidiaries and minority interests in 2008 and 2007 arises from the acquisition of minority interests in the Group's subsidiaries in Africa and Middle East, Europe and Asia-Pacific.

In the six months to 30 June 2008, the €1.8 billion revolving credit facility arranged in December last year was cancelled and replaced with the issue of €1.25 billion and £500 million bonds maturing in 2015 and 2024 respectively. In addition to this, the Group increased its €1 billion 5.375 per cent bond by an additional €250 million, bringing the total size of the bond to €1.25 billion. In the six months to 30 June 2007, €800 million of notes with a maturity of 2009 were replaced by a €1 billion bond with a maturity of 2017.

On 13 February 2008, the Group entered into a revolving credit facility whereby lenders agreed to make available an amount of US\$2 billion to finance certain acquisition activities. On 1 May 2008, this facility was syndicated in the market and was redenominated into two euro facilities, one of €420 million and one of €860 million. These facilities expire on 31 October 2009. There was a net draw down on these revolving credit facilities of €1.13 billion during the six months to 30 June 2008 (2007 €nil).

During the six months to 30 June 2008, the Group also repaid the US\$330 million fixed rate bond upon maturity in May 2008.

The movement relating to derivative financial instruments is in respect of derivatives taken out to hedge cash and cash equivalents and external borrowings, derivatives taken out to hedge inter company loans and derivatives treated as net investment hedges. Derivatives taken out as cash flow hedges in respect of financing activities are also included in the movement relating to derivative financial instruments, while other such derivatives in respect of operating and investing activities are reflected along with the underlying transactions.

(d) Net cash and cash equivalents in the Group cash flow statement comprise:

	30.6.08	30.6.07	31.12.07
	£m	£m	£m
Cash and cash equivalents per balance sheet	2,326	1,141	1,258
Accrued interest	(4)	(1)	
Overdrafts	(71)	(111)	(78)
Net cash and cash equivalents	2,251	1,029	1,180

NET DEBT/FINANCING

The Group remains confident in its ability to access successfully the debt capital markets and reviews its options on an ongoing basis. The main financing agreements since the beginning of the financial year are described on page 26, with issue proceeds used to finance certain acquisition activities, as well as repay maturing debt.

DIVIDENDS

The Directors have declared an interim dividend for the six months to 30 June 2008, for payment on 17 September 2008, at the rate of 22.1p per share. This interim dividend amounts to £440 million. The comparative dividend for the six months to 30 June 2007 of 18.6p per share amounted to £377 million. Valid transfers received by the Registrar of the Company up to 8 August 2008 will be in time to rank for payment of the interim dividend.

In accordance with IFRS, the interim dividend will be charged in the Group results for the third quarter. The results for the six months to 30 June 2008 include the final dividend paid in respect of the year ended 31 December 2007 of 47.6p per share amounting to £954 million (30 June 2007: 40.2p amounting to £821 million).

TOTAL EQUITY

	30.6.08	30.6.07	31.12.07
	£m	£m	£m
Share capital	506	509	506
Share premium account	56	52	53
Capital redemption reserves	101	98	101
Merger reserves	3,748	3,748	3,748
Translation reserve	(218)	(94)	59
Hedging reserve	(14)	9	(11)
Available-for-sale reserve	16	11	16
Other reserves	573	573	573
Retained earnings	1,855	1,534	1,835
after deducting:			
– cost of treasury shares	(554)	(174)	(296)
Total shareholders' funds	6,623	6,440	6,880
Minority interest	248	236	218
Total equity	6,871	6,676	7,098

SHARE BUY-BACK PROGRAMME

The Group initiated an on-market share buy-back programme at the end of February 2003. During the six months to 30 June 2008, 7 million shares were bought at a cost of £141 million (30 June 2007: 22 million shares at a cost of £358 million).

'Purchase of own shares' in the Group statement of changes in total equity, includes an amount of £50 million provided for the potential buy-back of shares during July 2008 under an irrevocable non-discretionary contract.

RELATED PARTY DISCLOSURES

The Group's related party transactions and relationships for 2007 were disclosed in the British American Tobacco Annual Report and Accounts for the year ended 31 December 2007. In the six months to 30 June 2008, there were no material changes in related parties or related party transactions, other than in relation to the ST Group (see below) and Reynolds American Inc. (see page 25).

CONTINGENT LIABILITIES

As noted in the Report and Accounts for the year ended 31 December 2007, there are contingent liabilities in respect of litigation, overseas taxes and guarantees in various countries.

Group companies, as well as other leading cigarette manufacturers, are defendants in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant. At least in the aggregate and despite the quality of defences available to the Group, it is not impossible that the results of operations or cash flows of the Group in particular quarterly or annual periods could be materially affected by this.

Having regard to these matters, the Directors (i) do not consider it appropriate to make any provision in respect of any pending litigation and (ii) do not believe that the ultimate outcome of this litigation will significantly impair the financial condition of the Group.

POST BALANCE SHEET EVENT

Skandinavisk Tobakskompagni (ST)

On 27 February 2008, the Group agreed to acquire 100 per cent of ST's cigarette and snus business in exchange for its 32.35 per cent holding in ST and payment of DKK11,598 million (£1,239 million) in cash, subject to finalisation of completion accounts. Completion of this transaction was subject to regulatory approval which was subsequently received on the condition that the Group agreed to divest a small number of local brands, primarily in Norway. The transaction was completed on 2 July 2008.

At this stage, for practical reasons including geographical spread and timing of completion, it is not possible to provide the full IFRS 3 'Business Combinations' disclosures. Work on identifying the fair values of the acquired assets and liabilities is continuing and it is expected that relevant disclosures will be provided as part of the Q3 announcement.

The transaction will be accounted for as a disposal of our 32.35 per cent interest in the non-cigarette and snus businesses of ST and an acquisition of 67.65 per cent of the cigarette and snus business' net assets of ST.

Until the date of the transaction the results of ST were equity accounted for as an associated undertaking and following the transaction, the results of the acquired businesses will be consolidated. At 30 June 2008, the carrying value of the existing business in ST has been shown as 'assets classified as held for sale'.

The estimated book value of the net assets of the cigarette and snus business is approximately £200 million, comprising assets of £630 million and liabilities of £430 million.

FINANCIAL CALENDAR 2008

6 August	Ex-dividend date for 2008 interim dividend
8 August	Record date 2008 interim dividend
17 September	Payment date 2008 interim dividend
30 October	Third quarter results announced

DISCLAIMERS

This Report does not constitute an invitation to underwrite, subscribe for, or otherwise acquire or dispose of any British American Tobacco p.l.c. shares or other securities.

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

Neither the Company nor the Directors accept any liability to any person in relation to this Report except to the extent that such liability could arise under English law. Accordingly, any liability to a person who has demonstrated reliance on any untrue or misleading statement or omission shall be determined in accordance with section 90A of the Financial Services and Markets Act 2000.

Past performance is no guide to future performance and persons needing advice should consult an independent financial advisor.

Independent Auditors' Report to the Members of British American Tobacco p.l.c.

We have audited the Group Financial Statements of British American Tobacco p.l.c. for the year ended 31 December 2007 which comprise the Group income statement, the Group statement of changes in total equity, the Group balance sheet, the Group cash flow statement, and the related notes including the Principal subsidiary undertakings and the Principal associate undertakings. These Group Financial Statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company Financial Statements of British American Tobacco p.l.c. for the year ended 31 December 2007 and on the information in the Remuneration report that is described as having been audited.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and Accounts, including the Group Financial Statements, in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, are set out in the Statement of directors' responsibilities in relation to the Financial Statements, included in the Directors' report.

Our responsibility is to audit the Group Financial Statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the Group Financial Statements give a true and fair view and whether the Group Financial Statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether, in our opinion, the information given in the Directors' report is consistent with the Group Financial Statements. The information given in the Directors' report includes that specific information presented in the Operating and financial review that is cross referred from the Business review section of the Directors' report.

In addition, we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the Corporate governance statement reflects the Company's compliance with the nine provisions of the Combined Code (2006) specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and Accounts and consider whether it is consistent with the audited Group Financial Statements. The other information comprises only the Quick read, the Operating and financial review, the Board of Directors, the Management Board, the Directors' report, the Remuneration report, the Corporate governance statement, the Five year summary, the Quarterly analyses of profit, the parent company Financial Statements and the Shareholder information. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group Financial Statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group Financial Statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Group Financial Statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group Financial Statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the Group Financial Statements.

Opinion

In our opinion

- the Group Financial Statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2007 and of its profit and cash flows for the year then ended;
- the Group Financial Statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' report is consistent with the Group Financial Statements.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
1 Embankment Place, London

27 February 2008

Group Income Statement for the years ended 31 December 2007 and 31 December 2006

	Notes	2007 £m	2006 £m
Gross turnover (including duty, excise and other taxes of £16,216 million (2006: £15,427 million))		26,234	25,189
Revenue	2	10,018	9,762
Raw materials and consumables used		(2,802)	(2,861)
Changes in inventories of finished goods and work in progress		30	(11)
Employee benefit costs	3a	(1,586)	(1,554)
Depreciation and amortisation costs	3b	(336)	(401)
Other operating income	3c	205	181
Other operating expenses	3d	(2,624)	(2,494)
Profit from operations	2	2,905	2,622
after (charging)/crediting			
– restructuring costs	3e	(173)	(216)
– net gains/(losses) on disposal of businesses and brands	3f	75	41
Finance income		136	110
Finance costs		(405)	(399)
Net finance costs	4	(269)	(289)
Share of post-tax results of associates and joint ventures	5	442	431
after (charging)/crediting			
– brand impairments	5	(7)	(13)
– exceptional tax credits	5		17
Profit before taxation		3,078	2,764
Taxation on ordinary activities	6	(791)	(716)
Profit for the year		2,287	2,048
Attributable to:			
Shareholders' equity		2,130	1,896
Minority interests		157	152
Earnings per share			
Basic	7	105.19p	92.08p
Diluted	7	104.46p	91.33p

All of the activities during both years are in respect of continuing operations.

Notes are shown on pages 91 to 161 and pages 166 to 168.

**Group Statement of Changes in Total Equity for the years ended 31 December 2007
and 31 December 2006**

	Notes	2007 £m	2006 £m
Differences on exchange		312	(685)
Cash flow hedges			
– net fair value gains		15	13
– reclassified and reported in profit for the year		(42)	(15)
Available-for-sale investments			
– net fair value gains/(losses)		1	(2)
– reclassified and reported in profit for the year		1	
Net investment hedges			
– net fair value (losses)/gains		(35)	117
Tax on items recognised directly in equity	6c	(19)	(12)
Net gains/(losses) recognised directly in equity		233	(584)
Profit for the year <i>page 86</i>		2,287	2,048
Total recognised income for the year		2,520	1,464
– shareholders' equity		2,348	1,334
– minority interests		172	130
Employee share options			
– value of employee services	27	37	41
– proceeds from shares issued		27	28
Dividends and other appropriations			
– ordinary shares	8	(1,198)	(1,008)
– to minority interests		(173)	(137)
Purchase of own shares			
– held in employee share ownership trusts		(41)	(77)
– share buy-back programme		(750)	(500)
Acquisition of minority interests		(9)	(13)
Other movements		(3)	13
		410	(189)
Balance 1 January	20	6,688	6,877
Balance 31 December	20	7,098	6,688

The increase in total equity of £410 million (2006: £189 million decrease) comprised £419 million increase (2006: £169 million decrease) in respect of shareholders' funds and £9 million decrease (2006: £20 million decrease) in respect of minority interests.

Notes are shown on pages 91 to 161 and pages 166 to 168.

Group Balance Sheet as at 31 December 2007 and December 2006

	Notes	2007 £m	2006 £m
Assets			
Non-current assets			
Intangible assets	9	8,105	7,476
Property, plant and equipment	10	2,378	2,207
Investments in associates and joint ventures	11	2,269	2,108
Retirement benefit assets	12	50	29
Deferred tax assets	13	262	273
Trade and other receivables	14	123	192
Available-for-sale investments	15	22	24
Derivative financial instruments	16	153	76
Total non-current assets		13,362	12,385
Current assets			
Inventories	17	1,985	2,056
Income tax receivable	18	85	59
Trade and other receivables	14	1,845	1,568
Available-for-sale investments	15	75	128
Derivative financial instruments	16	82	124
Cash and cash equivalents	19	1,258	1,456
		5,330	5,391
Assets classified as held for sale	26	36	
Total current assets		5,366	5,391
Total assets		18,728	17,776

	Notes	2007 £m	2006 £m
Equity			
Capital and reserves			
Share capital		506	517
Share premium, capital redemption and merger reserves		3,902	3,886
Other reserves		637	419
Retained earnings		1,835	1,639
Shareholders' funds		6,880	6,461
after deducting			
– cost of treasury shares		(296)	(197)
Minority interests		218	227
Total equity	20	7,098	6,688
Liabilities			
Non-current liabilities			
Borrowings	21	6,062	5,568
Retirement benefit liabilities	12	357	435
Deferred tax liabilities	13	294	296
Other provisions for liabilities and charges	22	165	161
Trade and other payables	23	149	146
Derivative financial instruments	16	49	29
Total non-current liabilities		7,076	6,635
Current liabilities			
Borrowings	21	861	1,058
Income tax payable	18	227	292
Other provisions for liabilities and charges	22	263	253
Trade and other payables	23	2,976	2,766
Derivative financial instruments	16	225	84
		4,552	4,453
Liabilities directly associated with assets classified as held for sale	26	2	
Total current liabilities		4,554	4,453
Total equity and liabilities		18,728	17,776

Notes are shown on pages 91 to 161 and pages 166 to 168.

On behalf of the Board

Jan du Plessis

Chairman

27 February 2008

Group Cash Flow Statement for the years ended 31 December 2007 and 31 December 2006

	Notes	2007 £m	2006 £m
Cash flows from operating activities			
Cash generated from operations	25	3,181	2,816
Dividends received from associates		285	259
Tax paid		(866)	(713)
Net cash from operating activities		2,600	2,362
Cash flows from investing activities			
Interest received		114	119
Dividends received from investments		2	2
Purchases of property, plant and equipment		(416)	(425)
Proceeds on disposal of property, plant and equipment		46	64
Purchases of intangibles		(66)	(58)
Proceeds on disposal of intangibles	25	16	60
Purchases and disposals of investments	25	71	(37)
Purchases of subsidiaries and minority interests	25	(15)	(101)
Proceeds on disposal of subsidiaries	25	126	62
Purchases of associates			(1)
Net cash from investing activities		(122)	(315)
Cash flows from financing activities			
Interest paid		(384)	(389)
Interest element of finance lease rental payments		(3)	(3)
Capital element of finance lease rental payments		(21)	(19)
Proceeds from issue of shares to Group shareholders		5	5
Proceeds from the exercise of options over own shares held in employee share ownership trusts		22	23
Proceeds from increases in and new borrowings	25	438	1,365
Movements relating to derivative financial instruments	25	(89)	142
Purchases of own shares		(750)	(500)
Purchases of own shares to be held in employee share ownership trusts		(41)	(77)
Reductions in and repayments of borrowings	25	(427)	(1,739)
Dividends paid to shareholders	8	(1,198)	(1,008)
Dividends paid to minority interests		(173)	(139)
Net cash from financing activities		(2,621)	(2,339)
Net cash flows from operating, investing and financing activities		(143)	(292)
Differences on exchange		47	(96)
Decrease in net cash and cash equivalents in the year		(96)	(388)
Net cash and cash equivalents at 1 January		1,276	1,664
Net cash and cash equivalents at 31 December	19	1,180	1,276

Notes are shown on pages 91 to 161 and pages 166 to 168.

Notes on the Accounts

1 Accounting policies

Basis of Accounting

The Group accounts have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS.

The 2005 Financial Statements were the Group's first consolidated Financial Statements prepared under IFRS, with a transition date of 1 January 2004. However, as permitted under IFRS, IAS32 and IAS39 on financial instruments were applied from 1 January 2005.

The Financial Statements have been prepared under the historical cost convention except as described in the accounting policy below on financial instruments.

In 2007, the Group adopted IFRS7 (Financial Instruments: Disclosures) and amendments to IAS1 (Capital Disclosures). As these only required amended disclosures, including comparatives, they have had no effect on the Group's reported profit and equity.

The preparation of the Group accounts requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities at the date of the financial statements. The key estimates and assumptions are set out in the accounting policies below, together with the related notes to the accounts.

The most significant items include:

- The exemptions taken under IFRS1 on the first time adoption of IFRS at 1 January 2004 and, in particular, those relating to goodwill on business combinations and retirement benefit costs which are explained in the accounting policies on pages 92 and 93, respectively. The main adjustments made in the transition to IFRS are summarised on page 163.
- The review of asset values, especially goodwill and impairment testing. The key assumptions used in respect of goodwill and impairment testing are the determination of cash generating units, the long term growth rate for cash flow projections and the rate used to discount the cash flow projections. These are described in note 9 on page 108.
- The estimation of and accounting for retirement benefit costs. The determination of the carrying value of assets and liabilities, as well as the charge for the year, involves judgements made in conjunction with independent actuaries. These involve estimates about uncertain future events based on the environment in different countries, including life expectancy of scheme members, salary and pension increases, inflation and expected returns on assets, as well as discount rates and asset values at the year end. The resultant volatility is moderated in the accounts by the deferral of some actuarial gains and losses as explained in the accounting policy on page 93. The assumptions used by the Group and sensitivity analysis are described in note 12 on page 113.
- The estimation of other provisions including taxation. Provisions and liabilities, which are subject to uncertain future events, may extend over several years and so the amount and/or timing may differ from current assumptions. The accounting policy for taxation is explained on page 94 and the recognised deferred tax assets and liabilities, together with a note of unrecognised amounts, are shown in note 13 on page 120. Other provisions are as set out in note 22 on page 140. The accounting policy on contingent liabilities, which are not provided for, is set out on page 97 and the contingent liabilities of the Group are explained in note 30 on page 153.
- The definition of exceptional items, which are separately disclosed as memorandum information, is explained in the accounting policy on page 97 and the impact of these on the calculation of adjusted earnings is described in note 7 on page 107.

Such estimates and assumptions are based on historical experience and various other factors that are

believed to be reasonable in the circumstances and constitute management's best judgement at the date of the Financial Statements. In the future, actual experience may deviate from these estimates and assumptions, which could affect the Financial Statements as the original estimates and assumptions are modified, as appropriate, in the year in which the circumstances change.

Basis of consolidation

The consolidated financial information includes the accounts of British American Tobacco p.l.c. and its subsidiary undertakings, together with the Group's share of the results of its associates and joint ventures.

A subsidiary is an entity controlled by the Group, where control is the power to govern the financial and operating policies of the entity so as to obtain benefit from its activities.

Associates and joint ventures comprise investments in undertakings, which are not subsidiary undertakings, where the Group's interest in the equity capital is long term and over whose operating and financial policies the Group exercises a significant influence and, in the case of joint ventures, has joint control. They are accounted for using the equity method.

The results of Group undertakings acquired during the period are included from the date of acquisition of a controlling interest at which date, for the purposes of consolidation, the purchase consideration is allocated between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair value.

The results of Group undertakings which have been sold during the year are included up to the date of disposal. The profit or loss on sale is calculated by reference to the net asset value at the date of disposal, adjusted for purchased goodwill previously consolidated in the Balance Sheet.

Where accumulated losses applicable to a minority exceed the minority's interest in the equity of a subsidiary, the excess is allocated to the Group's interest in the subsidiary, except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Inter-company balances and transactions, and any unrealised gains arising from inter-company transactions, are eliminated in preparing the consolidated Financial Statements.

Goodwill

Goodwill arising on acquisitions is capitalised and is considered to have an indefinite life subject to impairment reviews. Any impairment of goodwill is recognised immediately in the Income Statement and is not subsequently reversed.

Goodwill represents the excess of the cost of acquisition of a subsidiary, associate or joint venture over the Group's share of the fair value of identifiable net assets acquired. Goodwill is stated at cost less accumulated impairment losses and amortisation prior to 1 January 2004.

The Group's policy up to and including 1997 was to eliminate goodwill against reserves. Goodwill acquired from 1998 to 31 December 2003 was capitalised and amortised over its useful economic life. As permitted under IFRS1, in respect of acquisitions prior to 1 January 2004, the classification and accounting treatment of business combinations was not amended on transition to IFRS. Goodwill previously written off direct to reserves is not recycled to the Income Statement on the disposal of the subsidiary or associate to which it relates.

Goodwill in respect of subsidiaries is included in intangible assets. In respect of associates, goodwill is included in the carrying value of the investment in the associated company. On disposal of a subsidiary or associate, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Foreign currencies

The Income and Cash Flow Statements of Group undertakings expressed in currencies other than sterling are translated to sterling at average rates of exchange in each year provided that the average rate approximates the exchange rate at the date of the underlying transactions. Assets and liabilities of these undertakings are

translated at rates of exchange at the end of each year. For high inflation countries, the translation from local currencies to sterling makes allowance for the impact of inflation on the local currency results.

The differences between retained profits of overseas subsidiary and associated undertakings translated at average and closing rates of exchange are taken to reserves, as are differences arising on the retranslation to sterling (using closing rates of exchange) of overseas net assets at the beginning of the year. Any differences that have arisen since 1 January 2004 are presented as a separate component of equity. As permitted under IFRS1, any differences prior to that date are not included in this separate component of equity. On the disposal of an overseas undertaking, the cumulative amount of the related exchange differences deferred in the separate component of equity are recognised in the income statement when the gain or loss on disposal is recognised.

Foreign currency transactions are initially recorded at the exchange rate ruling at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of foreign currency assets and liabilities at year end rates of exchange are recognised in the Income Statement, except when deferred in equity as qualifying cash flow hedges, qualifying net investment hedges and on inter-company quasi-equity loans. Foreign exchange gains or losses recognised in the Income Statement are included in profit from operations or net finance costs depending on the underlying transactions that gave rise to these exchange differences.

Revenue

Revenue principally comprises sales of cigarettes, cigars, leaf and other tobacco products to external customers. Revenue excludes duty, excise and other taxes and is after deducting rebates, returns and other similar discounts. Revenue is recognised when the significant risks and rewards of ownership are transferred to a third party.

Retirement benefit costs

The Group operates both defined benefit and defined contribution schemes. The net deficit or surplus for each defined benefit pension scheme is calculated in accordance with IAS19, based on the present value of the defined benefit obligation at the balance sheet date less the fair value of the scheme assets.

As permitted under IFRS1, all actuarial gains and losses as at 1 January 2004, the date of transition to IFRS, were recognised. In respect of actuarial gains and losses that arise subsequent to that date, to the extent that cumulatively they exceed 10 per cent of the greater of the present value of the defined benefit obligation and the fair value of the scheme assets, that portion is recognised in the income statement over the expected average remaining working lives of the employees participating in the plan. Otherwise, the accumulated actuarial gains and losses are not recognised, except where there are unrecognised scheme surpluses. In such instances, the actuarial gains and losses are recognised as they occur.

Where the actuarial valuation of the scheme demonstrates that the scheme is in surplus, the recognised asset is limited to that for which the Group expects to benefit in future, by refunds or a reduction in contributions.

Past service costs resulting from enhanced benefits are expensed over the period to vesting and if they vest immediately, then they are recognised at that time in the Income Statement.

The Group also has certain post-retirement healthcare schemes and they are accounted for on a similar basis to the defined benefit pension schemes.

For defined benefit schemes, the actuarial cost charged to profit from operations consists of current service cost, interest cost, expected return on plan assets, past service cost and the impact of any settlements or curtailments, as well as actuarial gains or losses to the extent they are recognised, and changes in unrecognised scheme surpluses.

Some benefits are provided through defined contribution schemes and payments to these are charged as an expense as they fall due.

Share-based payments

The Group has equity-settled and cash-settled share-based compensation plans.

Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed over the vesting period, based on the Group's estimate of awards that will eventually vest. For plans where vesting conditions are based on total shareholder returns, the fair value at date of grant reflects these conditions, whereas earnings per share vesting conditions are reflected in the calculation of awards that will eventually vest over the vesting period. For cash-settled share-based payments, a liability equal to the portion of the services received is recognised at its current fair value determined at each balance sheet date. Fair value is measured by the use of the Black-Scholes option pricing model, except where vesting is dependent on market conditions when the Monte Carlo option pricing model is used. The expected life used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

Research and development

Research expenditure is charged to income in the year in which it is incurred. Development expenditure is charged to income in the year it is incurred, unless it meets the recognition criteria of IAS38 Intangible Assets.

Taxation

Taxation is that chargeable on the profits for the period, together with deferred taxation.

Deferred taxation is provided in full using the liability method for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for taxation purposes. Deferred tax is provided on temporary differences arising on investments in Group undertakings, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that it will not reverse in the foreseeable future. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. As required under IAS12, deferred tax assets and liabilities are not discounted.

Deferred tax is determined using the tax rates that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or deferred tax liability is settled.

Tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Intangible assets other than goodwill

These intangible assets shown on the Group Balance Sheet consist mainly of computer software which is carried at cost less accumulated amortisation and impairment, and is amortised on a straight-line basis over a period ranging from three to five years.

The investments in associates shown in the Group Balance Sheet include brand names arising from the combination of Brown & Williamson (B&W) and R.J. Reynolds (RJR) in 2004 to form Reynolds American Inc. (RAI), as well as those arising on the acquisition of Conwood by RAI in 2006. As the combination of B&W and RJR for the Group involved the partial disposal of B&W and an investment in RAI, fair values were assigned to brands formerly owned by RJR but not to those formerly owned by B&W. Most of the carrying value of the brands relates to brands which are deemed to have indefinite lives and each brand is subject to an annual impairment test. Certain minor brands are being amortised over their remaining lives consistent with the pattern of economic benefits expected to be received. Any impairments of brands are recognised in the Income Statement but increases in brand values are not recognised.

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and impairment. Depreciation is calculated on a straight-line basis to write off the assets over their useful economic life. No depreciation is provided on freehold land. Freehold and long leasehold property are depreciated at rates between 2.5 per cent and 4 per cent per annum, and plant and equipment at rates between 7 per cent and 25 per cent per annum. In accordance with the benchmark treatment under IAS23, borrowing costs associated with expenditure on property, plant and equipment are not capitalised.

Leased assets

Assets held under finance leases are included as part of property, plant and equipment. Finance lease assets are initially recognised at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, then depreciated over the shorter of the lease term and their estimated useful lives. Leasing payments consist of capital and finance charge elements and the finance element is charged to the Income Statement.

Rental payments under operating leases are charged to the Income Statement on a straight-line basis over the lease term.

Where arrangements are entered into which, while they are not in the legal form of a lease, are in substance a lease under IFRIC Interpretation 4, then they are recognised on the same basis as the leased assets above.

Impairment of non-financial assets

Assets are reviewed for impairment whenever events indicate that the carrying amount of a cash-generating unit may not be recoverable. In addition, assets that have indefinite useful lives are tested annually for impairment. An impairment loss is recognised to the extent that the carrying value exceeds the higher of the asset's fair value less costs to sell and its value in use.

A cash-generating unit is the smallest identifiable group of assets, that generates cash flows which are largely independent of the cash flows from other assets or groups of assets. At the acquisition date, any goodwill acquired is allocated to the relevant cash-generating unit or group of cash-generating units expected to benefit from the acquisition for the purpose of impairment testing of goodwill.

Impairment of financial assets

Financial assets are reviewed at each balance sheet date, or whenever events indicate that the carrying amount may not be recoverable. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the investment below its cost is considered as an indicator that the investment is impaired.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is based on the average cost incurred in acquiring inventories and bringing them to their existing location and condition, which will include raw materials, direct labour and overheads where appropriate. Net realisable value is the estimated selling price less costs to completion and sale. Tobacco inventories which have an operating cycle that exceeds 12 months are classified as current assets, consistent with recognised industry practice.

Financial instruments

Financial assets and financial liabilities are recognised when the Group becomes a party to the contractual provisions of the relevant instrument and derecognised when it ceases to be a party to such provisions. Such assets and liabilities are classified as current if they are expected to be realised or settled within 12 months after the balance sheet date or if they are derivative financial instruments not designated as hedges in accordance with IAS39. If not, they are classified as non-current.

Non-derivative financial assets are classified on initial recognition as available-for-sale investments, loans and receivables or cash and cash equivalents as follows:

Available-for-sale investments: available-for-sale investments are those non-derivative financial assets that cannot be classified as loans and receivables or cash and cash equivalents.

Loans and receivables: these are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Cash and cash equivalents: cash and cash equivalents include cash in hand and deposits held on call, together with other short term highly liquid investments. Cash equivalents normally comprise instruments with maturities of three months or less at date of acquisition. In the Cash Flow Statement, cash and cash equivalents are shown net of bank overdrafts, which are included as current borrowings in the liabilities on the Balance Sheet.

Apart from available-for-sale investments, non-derivative financial assets are stated at amortised cost using the effective interest method, subject to reduction for allowances for estimated irrecoverable amounts. These estimates for irrecoverable amounts are recognised when there is objective evidence that the full amount receivable will not be collected according to the original terms of the asset. Such evidence might include financial difficulties of the debtor, defaults of payment or significant overdue balances. For interest-bearing assets, their carrying value includes accrued interest receivable.

Available-for-sale investments are stated at fair value, with changes in fair value being recognised directly in equity. When such investments are derecognised (e.g. through disposal) or become impaired, the accumulated gains and losses, previously recognised in equity, are recognised in the Income Statement within 'finance income'. Dividend and interest income on available-for-sale investments are included within 'finance income' when the Group's right to receive payments is established.

Fair values for quoted investments are based on observable market prices. If there is no active market for a financial asset, the fair value is established by using valuation techniques principally involving discounted cash flow analysis.

Non-derivative financial liabilities are stated at amortised cost using the effective interest method. For borrowings, their carrying value includes accrued interest payable, as well as unamortised issue costs.

Derivative financial assets and liabilities are initially recognised, and subsequently measured, at fair value, which includes accrued interest receivable and payable where relevant. Changes in their fair values are recognised as follows:

- For derivatives that are designated as cash flow hedges, the changes in their fair values are recognised directly in equity, to the extent that they are effective, with the ineffective portion being recognised in the Income Statement. Where the hedged item results in a non-financial asset, the accumulated gains and losses, previously recognised in equity, are included in the initial carrying value of the asset (basis adjustment) and recognised in the Income Statement in the same periods as the hedged item. Where the underlying transaction does not result in such an asset, the accumulated gains and losses are recognised in the Income Statement;
- For derivatives that are designated as fair value hedges, the carrying value of the hedged item is adjusted for the fair value changes attributable to the risk being hedged, with the corresponding entry being made in the Income Statement. The changes in fair value of these derivatives are also recognised in the Income Statement;
- For derivatives that are designated as hedges of net investments in foreign operations, the changes in their fair values are recognised directly in equity, to the extent that they are effective, with the ineffective portion being recognised in the Income Statement. Where non-derivatives such as foreign currency borrowings are designated as net investment hedges, the relevant exchange differences are similarly recognised. The accumulated gains and losses are recognised in the Income Statement when the foreign operation is disposed of; and

- For derivatives that do not qualify for hedge accounting or are not designated as hedges, the changes in their fair values are recognised in the Income Statement in the period in which they arise.

In order to qualify for hedge accounting, the Group is required to document prospectively the relationship between the item being hedged and the hedging instrument. The Group is also required to demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is reperformed periodically to ensure that the hedge has remained, and is expected to remain, highly effective.

Hedge accounting is discontinued when a hedging instrument is derecognised (e.g. through expiry or disposal), or no longer qualifies for hedge accounting. Where the hedged item is a highly probable forecast transaction, the related gains and losses remain in equity until the transaction takes place, when they are removed from equity in the same manner as for cash flow hedges as described above. When a hedged future transaction is no longer expected to occur, any related gains and losses, previously recognised in equity, are immediately recognised in the Income Statement.

Derivative fair value changes recognised in the Income Statement are either reflected in arriving at profit from operations (if the hedged item is similarly reflected) or in finance costs.

Dividends

Final dividend distributions to the Company's shareholders are recognised as a liability in the Group's Financial Statements in the period in which the dividends are approved by the Company's shareholders at the Annual General Meeting, while interim dividend distributions are recognised in the period in which the dividends are declared and paid.

Segmental analysis

A segment is a distinguishable component of the Group that is engaged in providing products or services within a particular economic environment, and the Group's geographical segments form the focus of the Group's internal reporting systems. The Group is a single product business providing cigarettes and other tobacco products. While the Group has clearly differentiated brands, global segmentation between a wide portfolio of brands is not part of the regular internally reported financial information. It is not feasible to segment global results by brand without a high degree of estimation, especially given that geographically the same operations are used to produce the different brands, and brand results are managed in the context of the geographic markets in which they are sold.

The prices agreed between Group companies for intragroup sales of materials, manufactured goods, charges for royalties, commissions, services and fees, are based on normal commercial practices which would apply between independent businesses. Royalty income, less related expenditure, is included in the region in which the licensor is based.

Exceptional items

Exceptional items are items in the profit from operations and the Group share of the post-tax results of associates which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's financial performance. These items are separately disclosed as memorandum information on the face of the Income Statement and in the segmental analyses.

Provisions

Provisions are recognised when either a legal or constructive obligation as a result of a past event exists at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and a reasonable estimate can be made of the amount of the obligation.

Contingent liabilities

Subsidiaries and associate companies are defendants in tobacco-related litigation. Provision for this litigation would be made at such time as an unfavourable outcome became probable and the amount could be reasonably estimated.

The Group records its external legal fees and other external defence costs for tobacco-related litigation as these costs fall due.

Repurchase of share capital

When share capital is repurchased the amount of consideration paid, including directly attributable costs, is recognised as a deduction from equity. Repurchased shares which are not cancelled, or shares purchased for the employee share ownership trusts, are classified as treasury shares and presented as a deduction from total equity.

Future changes to accounting policies

Certain changes to IFRS will be applicable for the Group accounts in future years and set out below are those which are considered to affect the Group.

- IFRIC14 (IAS19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction) will be effective from 1 January 2008, once it has been endorsed by the EU. The interpretation clarifies the conditions under which a surplus in a post-retirement benefit scheme can be recognised in the financial statements, as well as setting out the accounting implications where minimum funding requirements exist. It is not expected that this change would materially alter the Group's reported profit and equity for 1 January 2007 or 31 December 2007.

There are other changes which are effective from 1 January 2009 but can be adopted before 2009.

- IFRS8 (Operating Segments) has been endorsed by the EU. This standard requires segmental reporting in the financial statements to be on the same basis as is used for internal management reporting. This will not require any change to the segments currently reported by the Group but there will be some additional disclosures.
- The revised IAS1 (Presentation of Financial Statements) is awaiting EU endorsement. This standard will require some changes in the format of the financial statements and permit some changes in terminology, but it will not affect the measurement of reported profit or equity.
- The revised IAS23 (Borrowing costs) is also awaiting endorsement by the EU. This standard requires borrowings directly attributable to the acquisition, construction or production of an asset that takes a substantial period of time to get ready for its intended use or sale, to be capitalised as part of the cost of the asset. The Group's current policy is to expense such borrowing costs as they are incurred. It is not expected that this change would materially affect the Group's reported profit or equity.

In addition, the revised IFRS3 (Business Combinations) and IAS27 (Consolidated and Separate Financial Statements) have been issued and change the accounting for business combinations and transactions with minorities. While these revised standards are applicable for periods beginning on or after 1 July 2009, with early adoption permitted from on or after 30 June 2007, these are only to be applied prospectively and so there is no restatement of transactions prior to the effective date. Moreover, these standards have not yet been endorsed by the EU and will only be applicable once that endorsement has occurred.

2 Segmental analyses

Segmental analyses of revenue, profit, assets and liabilities for the year ended 31 December:

	Europe		Asia-Pacific	
	2007	2006	2007	2006
	£m	£m	£m	£m
Revenue				
External sales	3,621	3,495	1,874	1,755
Inter-segment sales	225	526	22	27
Revenue	3,846	4,021	1,896	1,782
Results				
Segment result before restructuring costs and net gains/(losses) on disposal of businesses and brands	842	781	672	616
Restructuring costs	(116)	(132)	(5)	(7)
Net gains/(losses) on disposal of businesses and brands	56	27		
Segmental result	782	676	667	609
Unallocated costs				
Profit from operations				
Net finance costs				
Share of post-tax results of associates and joint ventures				
Profit on ordinary activities before taxation				
Taxation on ordinary activities				
Profit for the year				
<i>Attributable to:</i>				
Shareholders' equity				
Minority interests				
Unallocated costs represent net corporate costs not directly attributable to individual segments.				
Other segment items				
Capital expenditure	245	232	70	59
Depreciation and amortisation	138	126	45	48
Impairment, accelerated depreciation and amounts written off	4	49	3	
Assets				
Segment assets before goodwill	2,586	2,653	1,047	1,056
Goodwill	3,508	3,295	1,329	1,244
Segment assets including goodwill <i>page 100</i>	6,094	5,948	2,376	2,300
Investments in associates and joint ventures	203	203	508	394
Assets classified as held for sale	5		27	
Unallocated assets				
Total assets <i>page 88</i>				
Liabilities				
Segment liabilities <i>page 100</i>	1,846	1,797	526	532
Liabilities directly associated with assets classified as held for sale			2	
Unallocated liabilities				
Total liabilities <i>page 89</i>				

The restructuring costs and net gains/(losses) on disposal of businesses and brands are explained on page 103 in note 3. The 2006 analysis of revenue above has been restated to reflect changes in manufacturing operations.

Latin America		Africa and Middle East		America-Pacific		Elimination		Consolidated	
2007	2006 restated	2007	2006	2007	2006 restated	2007	2006	2007	2006
£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
1,979	1,780	1,224	1,063	473	760			9,171	8,853
585	332	15	24	847	909				
2,564	2,112	1,239	1,087	473	760			10,018	9,762
680	611	470	468	446	424			3,110	2,900
		(42)	(24)	(10)	(53)			(173)	(216)
		19			14			75	41
680	611	447	444	436	385			3,012	2,725
								(107)	(103)
								2,905	2,622
								(269)	(289)
								442	431
								3,078	2,764
								(791)	(716)
								2,287	2,048
								2,130	1,896
								157	152
110	102	72	69	32	51			529	513
63	64	37	39	31	35			314	312
		11	3	4	37			22	89
1,305	1,191	897	1,004	459	560	(412)	(439)	5,882	6,025
188	186	815	803	2,102	1,822			7,942	7,350
1,493	1,377	1,712	1,807	2,561	2,382	(412)	(439)	13,824	13,375
3	2	11	10	1,544	1,499			2,269	2,108
1		1		2				36	
								2,599	2,293
								18,728	17,776
678	564	584	546	568	580	(657)	(625)	3,545	3,394
								2	
								8,083	7,694
								11,630	11,088

Segment assets and segment liabilities include inter-company balances with entities reported as corporate liabilities and corporate assets on page 100.

(a) Segment revenue

The segmental analysis of revenue is based on location of manufacture. Figures based on external sales by subsidiaries in each segment are as follows:

	2007	2006
	£m	£m
Europe	3,655	3,545
Asia-Pacific	1,876	1,839
Latin America	1,983	1,791
Africa and Middle East	1,445	1,489
America-Pacific	1,059	1,098
Segment revenue <i>pages 98 and 99</i>	10,018	9,762

(b) Segment assets

	2007	2006
	£m	£m
Total assets <i>page 88</i>	18,728	17,776
<i>Less</i>		
– investments in associates and joint ventures	2,269	2,108
– available-for-sale investments <i>note 15</i>	97	152
– deferred tax assets	262	273
– interest receivable <i>note 14</i>	11	1
– income tax receivable	85	59
– dividends receivable from associates <i>note 14</i>	53	48
– derivatives in respect of net debt <i>note 16</i>	188	125
– loans	77	85
– interest bearing cash and cash equivalents	1,063	972
– assets classified as held for sale	36	
– corporate assets	763	578
Segment assets <i>pages 98 and 99</i>	13,824	13,375

(c) Segment liabilities

	2007	2006
	£m	£m
Total current and non-current liabilities <i>page 89</i>	11,630	11,088
<i>Less</i>		
– borrowings <i>note 21</i>	6,923	6,626
– deferred tax liabilities	294	296
– derivatives in respect of net debt <i>note 16</i>	179	79
– dividends payable	5	4
– income tax payable	227	292
– interest payable <i>note 23</i>	4	12
– liabilities directly associated with assets classified as held for sale	2	
– corporate liabilities	451	385
Segment liabilities <i>pages 98 and 99</i>	3,545	3,394

(d) Segmental analysis of the Group's share of the revenue and post-tax results of associates and joint ventures

External revenue

	2007	2006
	£m	£m
Europe	763	771
Asia-Pacific	547	456
Latin America	1	1
Africa and Middle East	9	20
America-Pacific	1,888	1,942
	3,208	3,190

Post-tax results

	Segment result		Adjusted segment result*	
	2007	2006	2007	2006
	£m	£m	£m	£m
Europe	48	46	48	46
Asia-Pacific	110	92	110	92
Latin America	1		1	
Africa and Middle East	1	4	1	4
America-Pacific	282	289	289	285
	442	431	449	427

*Excluding brand impairments and exceptional tax credits (page 105 note 5).

3 Profit from operations

(a) Employee benefit costs

	2007	2006
	£m	£m
Wages and salaries	1,301	1,233
Social security costs	164	159
Other pension and retirement benefit costs <i>page 113 note 12</i>	60	112
Share-based payments <i>page 146 note 27</i>	61	50
	1,586	1,554

(b) Depreciation and amortisation costs

	2007	2006
	£m	£m
Intangibles including goodwill – amortisation	37	34
– amounts written off	6	
Property, plant and equipment – depreciation	277	278
– impairment and accelerated depreciation	16	89
	336	401

Impairment and accelerated depreciation in respect of property, plant and equipment arose in relation to the restructuring costs (see note (e) below) and, for 2006, in respect of the impairment of a business (see note (f) below). Goodwill arising on the acquisition of minority interests in Africa and Middle East in 2007 has been expensed as part of restructuring costs of that region.

(c) Other operating income

This represents income arising from the Group's activities which falls outside the definition of revenue and includes gains on the disposal of businesses and brands, property disposals, service fees and other shared costs charged to third parties, manufacturing fees and trademark income.

(d) Other operating expenses include:

	2007	2006
	£m	£m
Research and development expenses (excluding employee benefit costs and depreciation)	43	36
Exchange differences	(18)	7
Rent of plant and equipment (operating leases)		
– minimum lease payments	25	25
– contingent rents	2	1
Rent of property (operating leases)		
– minimum lease payments	64	61
– sublease payments	2	2
Fees payable for audit services pursuant to legislation:		
– fees payable to PricewaterhouseCoopers LLP for parent company and Group audit	1.5	1.3
– fees payable to other PricewaterhouseCoopers firms and associates for local statutory and Group reporting audits	6.7	6.1
Audit fees payable to PricewaterhouseCoopers firms and associates	8.2	7.4
Audit fees payable to other firms	0.5	0.6
Total audit fees payable	8.7	8.0
Fees payable to PricewaterhouseCoopers firms and associates for other services:		
– other services pursuant to statutory legislation	0.3	0.2
– tax advisory services	3.7	4.3
– tax compliance	0.5	0.4
– services relating to information technology	0.3	0.1
– other non-audit services	0.8	0.3
	5.6	5.3

The total fees payable to PricewaterhouseCoopers firms and associates included above are £13.8 million (2006: £12.7 million).

Total research and development costs including employee benefit costs and depreciation were £91 million (2006: £76 million).

(e) Restructuring costs

These were the costs incurred as a result of a review of the Group's manufacturing operations and organisational structure, including the initiative to reduce overheads and indirect costs, and are included in the profit from operations under the following headings:

	2007	2006
	£m	£m
Employee benefit costs	84	100
Depreciation and amortisation costs	22	74
Other operating expenses	73	62
Other operating income	(6)	(20)
	173	216

Restructuring costs in 2007 principally relate to costs associated with restructuring the operations in Italy and with the reorganisation of the business across the Europe and Africa and Middle East regions, as well as further costs related to restructurings announced in prior years. The restructuring costs in 2006 principally relate to manufacturing rationalisation in the Netherlands, with further costs for the earlier restructurings in the UK and in Canada.

Other operating income relates to gains on property disposals arising from the restructuring exercises.

(f) Net gains/(losses) on disposal of businesses and brands

On 10 March 2006, the Group's Italian subsidiary signed an agreement to sell its cigar business, Toscano, to Maccaferri for €95 million. The sale was subject to regulatory and governmental approval and was completed on 19 July 2006. The sale resulted in the recognition of a loss of £19 million, reflecting an impairment charge of £15 million included in depreciation and amortisation costs in the profit from operations and £4 million of other costs included in other operating expenses in the profit from operations.

On 29 November 2006, the Group completed a trademark transfer agreement with Philip Morris International. Under this arrangement the Group sold its Muratti Ambassador brand in certain markets, as well as the L&M and Chesterfield trademarks in Hong Kong and Macao, while acquiring the Benson & Hedges trademark in certain African countries. These transactions resulted in a gain of £60 million included in other operating income in the profit from operations.

On 20 February 2007, the Group announced that it had agreed to sell its pipe tobacco trademarks to the Danish company, Orlik Tobacco Company A/S, for €24 million. The sale was completed during the second quarter and resulted in a gain of £11 million included in other operating income in the profit from operations. However, the Group has retained the Dunhill and Captain Black pipe tobacco brands.

On 23 May 2007, the Group announced that it had agreed to sell its Belgian cigar factory and associated brands to the cigars division of Skandinavisk Tobakskompagni AS. The sale includes a factory in Leuven as well as trademarks including Corps Diplomatique, Schimmelpennick, Don Pablo and Mercator. The transaction was completed on 3 September 2007 and a gain on disposal of £45 million is included in other operating income in the profit from operations.

On 1 October 2007, the Group agreed the termination of its license agreement with Philip Morris for the rights to the Chesterfield trademark in a number of countries in Southern Africa. This transaction resulted in a gain of £19 million included in other operating income in the profit from operations.

4 Net finance costs

	2007		2006	
	£m	£m	£m	£m
Finance costs				
– interest payable		382		410
– fair value changes		143		(212)
– exchange differences		(120)		197
– loss on net monetary position				4
		405		399
Finance income				
– interest and dividend income		(111)		(122)
– exchange differences		(25)		12
		(136)		(110)
Net finance costs		269		289
Net finance costs comprise:				
Interest payable				
– bank borrowings	67		94	
– finance leases	3		3	
– other	312		313	
		382		410
Interest receivable	(109)		(120)	
Dividend income	(2)		(2)	
		(111)		(122)
Fair value changes				
– cash flow hedges transferred from equity	(26)		4	
– fair value changes on hedged items	(6)		(113)	
– fair value hedges	(14)		39	
– ineffective portion of fair value hedges	8		2	
– instruments not designated as hedges	181		(144)	
	143		(212)	
Exchange differences	(145)		209	
Loss on net monetary position			4	
		(2)		1
		269		289

Other interest payable includes interest on the bonds and notes detailed in note 21.

Included within the interest receivable above is £3 million (2006: £6 million) in respect of available-for-sale investments. Included within dividend income above is £1 million (2006: £2 million) in respect of available-for-sale investments.

Included within exchange differences above is a loss of £35 million (2006: £71 million loss) in respect of items subject to fair value hedges.

5 Associates and joint ventures

	2007		2006	
	Total £m	Group's share £m	Total £m	Group's share £m
Gross turnover (including duty, excise and other taxes)	12,089	4,436	11,831	4,384
Duty, excise and other taxes	(3,503)	(1,228)	(3,349)	(1,194)
Revenue	8,586	3,208	8,482	3,190
Profit from operations	1,926	735	1,765	677
Net finance costs	(99)	(42)	(61)	(26)
Profit on ordinary activities before taxation	1,827	693	1,704	651
Taxation on ordinary activities	(646)	(246)	(564)	(216)
Profit on ordinary activities after taxation	1,181	447	1,140	435
after (charging)/crediting				
– brand impairments	(16)	(7)	(30)	(13)
– exceptional tax credits			40	17
<i>Attributable to:</i>				
British American Tobacco's shareholders <i>page 86</i>		442		431
Minority interests		5		4
Dividends				
– listed investments		(245)		(222)
– unlisted investments		(45)		(45)
		(290)		(267)

The share of post-tax results of associates and joint ventures is after brand impairments and exceptional tax credits.

In the year ended 31 December 2007, Reynolds American modified the previously anticipated level of support between certain brands and the projected net sales of certain brands, resulting in a brand impairment charge of which the Group's share amounted to £7 million (net of tax) (2006: £13 million).

In the year ended 31 December 2006, Reynolds American also benefited from the favourable resolution of tax matters of which the Group's share was £17 million.

6 Taxation on ordinary activities

(a) Summary of tax on ordinary activities

	2007 £m	2006 £m
UK corporation tax		14
comprising		
– current year tax expense	977	768
– double taxation relief	(977)	(754)
Overseas tax	765	681
comprising		
– current year tax expense	816	743
– adjustments in respect of prior periods	(51)	(62)
Total current tax	765	695
Deferred tax	26	21
comprising		
– deferred tax relating to origination and reversal of temporary differences	38	16
– deferred tax relating to a previously unrecognised tax loss		(14)
– deferred tax relating to changes in tax rates	(12)	19
	791	716

(b) Factors affecting the tax charge

The taxation charge differs from the standard 30 per cent rate of corporation tax in the UK. The major causes of this difference are listed below:

	2007		2006	
	£m	%	£m	%
Profit before tax	3,078		2,764	
Less: Share of associates post-tax profit	(442)		(431)	
	2,636		2,333	
Tax at 30% (2006: 30%) on the above	791	30.0	700	30.0
Factors affecting the tax rate:				
Tax at standard rates other than				
UK corporation tax rate	(72)	(2.7)	(56)	(2.4)
National tax rate relief	18	0.7	(15)	(0.6)
State and local taxes	52	2.0	50	2.1
Permanent differences	(51)	(1.9)	9	0.5
Overseas withholding taxes	63	2.4	50	2.1
Double taxation relief on UK profits	(8)	(0.3)	(13)	(0.6)
Unutilised tax losses	28	1.0	13	0.6
Adjustments in respect of previous periods	(51)	(1.9)	(62)	(2.7)
Deferred tax charges at other tax rates	33	1.2	21	0.9
Deferred tax attributable to a (decrease)/increase in the rate of domestic income tax	(12)	(0.5)	19	0.8
	791	30.0	716	30.7

(c) Tax on items recognised directly in equity

	2007 £m	2006 £m
Current tax	25	14
Deferred tax	(6)	(2)
Charged to equity	19	12

7 Earnings per share

Basic earnings per share are based on equity earnings of £2,130 million (2006: £1,896 million) and 2,025 million (2006: 2,059 million) ordinary shares of 25p each, being the weighted average number of shares in issue during the year (excluding shares held as treasury shares).

For the calculation of diluted earnings per share, the weighted average number of shares in issue is increased to 2,039 million (2006: 2,076 million) to reflect the potential dilutive effect of employee share schemes.

	2007			2006		
	Earnings £m	Weighted average number of shares m	Earnings per share pence	Earnings £m	Weighted average number of shares m	Earnings per share pence
Basic earnings per share	2,130	2,025	105.19	1,896	2,059	92.08
Share options		14	(0.73)		17	(0.75)
Diluted earnings per share	2,130	2,039	104.46	1,896	2,076	91.33

Earnings have been affected by a number of exceptional items. To illustrate the impact of these, an alternative earnings per share is shown below:

Alternative earnings per share calculation

	2007		Diluted 2006		2007		Basic 2006	
	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence
Unadjusted earnings per share	2,130	104.46	1,896	91.33	2,130	105.19	1,896	92.08
Restructuring costs per Income Statement	173	8.49	216	10.40	173	8.54	216	10.49
Tax and minority interests on restructuring costs	(41)	(2.01)	(48)	(2.31)	(41)	(2.02)	(48)	(2.33)
Net (gains)/losses on disposal of businesses and brands per Income Statement	(75)	(3.68)	(41)	(1.98)	(75)	(3.70)	(41)	(1.99)
Tax on net (gains)/losses on disposal of businesses and brands	19	0.93	18	0.87	19	0.94	18	0.87
Associates: brand impairments and exceptional tax credits per Income Statement	7	0.34	(4)	(0.19)	7	0.34	(4)	(0.19)
Adjusted earnings per share	2,213	108.53	2,037	98.12	2,213	109.29	2,037	98.93

8 Dividends and other appropriations

	2007		2006	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim				
2007 paid 12 September 2007	18.60	377		
2006 paid 13 September 2006			15.70	323
Final				
2006 paid 3 May 2007	40.20	821		
2005 paid 4 May 2006			33.00	685
	58.80	1,198	48.70	1,008

The Directors have recommended to shareholders a final dividend of 47.60 pence per share for the year ended 31 December 2007. If approved, this dividend will be paid to shareholders on 7 May 2008. This dividend is subject to approval by shareholders at the Annual General Meeting and therefore, in accordance with IAS10, it has not been included as a liability in these Financial Statements. The total estimated dividend to be paid is £954 million which takes the total dividends declared in respect of 2007 to £1,331 million (2006: £1,144 million) representing 66.20 pence per share (2006: 55.90 pence per share).

As described on page 172 in note 4, while the 2006 interim dividend did not comply with the technical requirements of the Companies Act 1985, the payment has been presented as a dividend payment above.

9 Intangible assets

	Goodwill £m	Computer software £m	Trademarks, brands and licences £m	Assets in the course of development £m	Total £m
1 January 2007					
Cost	7,350	258	23	39	7,670
Accumulated amortisation		(180)	(14)		(194)
Net book value at 1 January 2007	7,350	78	9	39	7,476
Differences on exchange	612	6		1	619
Additions					
– internal development		2		26	28
– acquisitions of subsidiaries and minority interests	7				7
– separately acquired		21	3	17	41
Reallocations		35		(35)	
Amortisation charge		(38)	(1)		(39)
Amounts written off	(6)				(6)
Disposals	(21)				(21)
31 December 2007					
Cost	7,942	305	29	48	8,324
Accumulated amortisation		(201)	(18)	(219)	
Net book value at 31 December 2007	7,942	104	11	48	8,105

	Goodwill £m	Computer software £m	Trademarks, brands and licences £m	Assets in the course of development £m	Total £m
1 January 2006					
Cost	7,887	228	16	31	8,162
Accumulated amortisation		(162)	(13)		(175)
Net book value at 1 January 2006	7,887	66	3	31	7,987
Differences on exchange	(617)	(4)		(1)	(622)
Additions					
– internal development		9		12	21
– acquisitions of subsidiaries and minority interests	80		5		85
– separately acquired		23	2	14	39
Reallocations		17		(17)	
Amortisation charge		(33)	(1)		(34)
31 December 2006					
Cost	7,350	258	23	39	7,670
Accumulated amortisation		(180)	(14)		(194)
Net book value at 31 December 2006	7,350	78	9	39	7,476

Included in computer software and assets in the course of development above are internally developed assets with a carrying value of £104 million (2006: £80 million). The costs of internally developed assets include capitalised expenses of third party consultants as well as software licence fees from third party suppliers.

From August 2006, the Group purchased minority interests in its subsidiary in Chile for a cost of £91 million, raising the Group shareholding from 70.4 per cent to 96.6 per cent. The goodwill arising on this transaction was £80 million and the minority interests in Group equity were reduced by £11 million. In addition, a number of smaller acquisitions of minority interests were made during 2007 in Africa and Middle East, Europe, and Asia-Pacific.

Impairment testing for intangible assets with indefinite lives including goodwill

Goodwill of £7,942 million (2006: £7,350 million) included in intangible assets in the balance sheet is mainly the result of the following acquisitions: Rothmans Group £4,067 million (2006: £3,889 million); Imperial Tobacco Canada £2,046 million (2006: £1,768 million); and ETI (Italy) £1,212 million (2006: £1,113 million). The principal allocations of goodwill in the Rothmans' acquisition are to the cash-generating units of Continental Europe and South Africa, with the remainder mainly relating to operations in the domestic and export market in the United Kingdom and operations in Asia-Pacific.

Goodwill has been allocated for impairment testing purposes to 13 (2006: 13) individual cash-generating units – four in Europe, one in Africa and Middle East, three in Asia-Pacific, three in Latin America and two in America-Pacific. The carrying amounts of goodwill allocated to the cash-generating units of South Africa (£814 million, 2006: £803 million), Continental Europe (£1,112 million, 2006: £1,020 million), Canada (£2,046 million, 2006: £1,768 million) and Italy (£1,218 million, 2006: £1,119 million) are considered significant in comparison with the total carrying amount of goodwill.

The recoverable amount of all cash-generating units has been determined on a value-in-use basis. The key assumptions for the recoverable amount of all units are the long term growth rate and the discount rate. The long term growth rate is a nominal rate used purely for the impairment testing of goodwill under IAS36 Impairment of Assets and does not reflect long term planning assumptions used by the Group for investment proposals or for any other assessments. The discount rate is based on the weighted average cost of capital, taking into account the cost of capital and borrowings, to which specific market-related premium adjustments are made. These assumptions have been applied to the individual cash flows of each unit as compiled by local management in the different markets.

The valuation uses cash flow projections based on detailed financial budgets approved by management covering a two year period, with cash flow beyond two years extrapolated by a nominal growth rate of 3 per cent per annum for the years 3 to 10, whereafter a zero per cent growth rate has been assumed.

This long-term growth rate used does not exceed the expected long term average growth rate for the markets in which the cash-generating units operate. In some instances, such as recent acquisitions or start-up ventures, the valuation is expanded to reflect the medium term plan of management, spanning five years or beyond, with the cash flow beyond these years to year 10, extrapolated by the growth rate of 3 per cent, as above.

Pre-tax discount rates of between 7.9 per cent and 18.7 per cent (2006: 8.1 per cent to 17.9 per cent) were used, based on the Group's weighted average cost of capital, together with any premium applicable for country/area inflation and economical and political risks. The pre-tax discount rates used for the cash-generating units which are significant in comparison with the total carrying amount of goodwill are 12.1 per cent for South Africa (2006: 12.1 per cent), 9.3 per cent for Continental Europe (2006: 9.8 per cent), 10.0 per cent for Canada (2006: 10.0 per cent) and 10.7 per cent for Italy (2006: 10.7 per cent).

Aside from the amounts written off and shown as part of restructuring costs (see page 101 note 3(b)), no impairment charges were recognised in 2007 (2006: £nil). If discounted cash flows per cash-generating unit should fall by 10 per cent, or the discount rate was increased at an after-tax rate of 1 per cent, there would be no impairment.

10 Property, plant and equipment

	Freehold property £m	Leasehold property £m	Plant and equipment £m	Assets in the course of construction £m	Total £m
1 January 2007					
Cost	833	202	3,348	222	4,605
Accumulated depreciation and impairment	(317)	(64)	(2,017)		(2,398)
Net book value at 1 January 2007	516	138	1,331	222	2,207
Differences on exchange	33	7	78	17	135
Additions	15	3	197	245	460
Reallocations	19	7	219	(245)	
Depreciation	(16)	(13)	(269)		(298)
Impairment			(12)		(12)
Disposals	(21)		(28)		(49)
Disposal of subsidiaries	(23)		(12)		(35)
Reclassification as held for sale	(11)	(1)	(18)		(30)
31 December 2007					
Cost	810	212	3,573	239	4,834
Accumulated depreciation and impairment	(298)	(71)	(2,087)		(2,456)
Net book value at 31 December 2007	512	141	1,486	239	2,378

	Freehold property £m	Leasehold property £m	Plant and equipment £m	Assets in the course of construction £m	Total £m
1 January 2006					
Cost	909	212	3,602	194	4,917
Accumulated depreciation and impairment	(321)	(59)	(2,206)		(2,586)
Net book value at 1 January 2006	588	153	1,396	194	2,331
Differences on exchange	(35)	(8)	(100)	(15)	(158)
Additions	15	2	181	255	453
Reallocations	19		193	(212)	
Depreciation	(22)	(9)	(274)		(305)
Impairment	(8)		(40)		(48)
Disposals	(16)		(24)		(40)
Disposal of subsidiaries	(25)		(1)		(26)
31 December 2006					
Cost	833	202	3,348	222	4,605
Accumulated depreciation and impairment	(317)	(64)	(2,017)		(2,398)
Net book value at 31 December 2006	516	138	1,331	222	2,207
Assets held under finance leases					
31 December 2007					
Cost		3	106		109
Accumulated depreciation and impairment		(1)	(47)		(48)
Net book value at 31 December 2007		2	59		61
31 December 2006					
Cost		3	94		97
Accumulated depreciation and impairment		(1)	(37)		(38)
Net book value at 31 December 2006		2	57		59

Assets held under finance leases are secured under finance lease obligations on page 137 in note 21.

	2007 £m	2006 £m
Cost of freehold land within freehold property on which no depreciation is provided	63	70
Leasehold property comprises:		
– net book value of long leasehold	98	95
– net book value of short leasehold	43	43
	141	138
Contracts placed for future expenditure	34	31

Bank borrowings are secured by property, plant and equipment to the value of £8 million (2006: £15 million).

11 Investments in associates and joint ventures

	2007 £m	2006 £m
1 January	2,108	2,193
Differences on exchange	38	(254)
Share of profit after taxation <i>page 105 note 5</i>	442	431
Dividends <i>page 105 note 5</i>	(290)	(267)
Acquisitions		1
Other equity movements	(29)	4
31 December	2,269	2,108
Non-current assets	3,551	3,386
Current assets	1,733	1,603
Non-current liabilities	(1,697)	(1,635)
Current liabilities	(1,318)	(1,246)
	2,269	2,108
Reynolds American Inc. (market value £4,121 million (2006: £4,145 million))	1,544	1,499
Other listed associates (market value £3,245 million (2006: £2,473 million))	502	394
Unlisted	223	215
	2,269	2,108

On 25 April 2006, Reynolds American Inc. announced an agreement to acquire Conwood, the second largest manufacturer of smokeless tobacco products in the US, for US\$3.5 billion, and the acquisition was completed on 31 May 2006. The acquisition was funded principally with debt, and the fair value of the assets acquired and liabilities assumed were US\$4.1 billion and US\$0.6 billion, respectively. Included in the assets were US\$2.5 billion in respect of goodwill and US\$1.4 billion in respect of brands.

The Group's share of non-current assets above includes £529 million (2006: £540 million) of goodwill and £290 million (2006: £300 million) of brands arising from the Conwood acquisition. In addition, the non-current assets above include £1,187 million (2006: £1,207 million) of goodwill and £463 million (2006: £479 million) of brands arising from the Reynolds American transaction in 2004.

Details of the Group's contingent liabilities are set out on page 153 in note 30. In addition to US litigation involving Group companies, which is covered by the R.J. Reynolds Tobacco Company (RJRT) indemnity referred to in note 30, Reynolds American Inc. (RAI) group companies are named in litigation which does not involve Group companies. While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, it is not impossible that the results of operations or cash flows of RAI, in particular quarterly or annual periods, could be materially affected by this and by the final outcome of any particular litigation. However, having regard to the contingent liability disclosures on litigation made by RAI in its public financial reports, the Directors are satisfied with the carrying value included above for RAI.

The Group's share of the RAI results for the year to 31 December 2007 includes £18 million (2006: £24 million) in respect of external legal fees and other external product liability defence costs.

12 Retirement benefit schemes

The Group's subsidiary undertakings operate around 160 retirement benefit arrangements worldwide. These arrangements have been developed in accordance with local practices in the countries concerned. The majority of scheme members belong to defined benefit schemes, most of which are funded externally, although the Group also operates a number of defined contribution schemes.

The liabilities arising in the defined benefit schemes are determined in accordance with the advice of independent, professionally qualified actuaries, using the projected unit credit method. All schemes are formally valued at least every three years.

The principal pension schemes are in the UK, Germany, Canada, the Netherlands and Switzerland. Together these schemes account for over 88 per cent of the total obligations of the Group's defined benefit schemes.

In addition, the Group operates significant schemes in Canada which provide employees with certain other retirement benefits such as healthcare. The liabilities in respect of these benefits are also assessed by qualified independent actuaries, applying the projected unit credit method.

The amounts recognised in the Balance Sheet are determined as follows:

	Pension schemes		Healthcare schemes		Total	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Present value of funded scheme liabilities	(4,248)	(4,189)	(17)	(10)	(4,265)	(4,199)
Fair value of funded scheme assets	4,209	3,938	14	12	4,223	3,950
	(39)	(251)	(3)	2	(42)	(249)
Unrecognised funded scheme surpluses	(44)	(61)			(44)	(61)
	(83)	(312)	(3)	2	(86)	(310)
Present value of unfunded scheme liabilities	(111)	(107)	(121)	(115)	(232)	(222)
Net unrecognised actuarial (gains)/losses	(4)	111	14	14	10	125
Unrecognised past service cost	1	1			1	1
	(197)	(307)	(110)	(99)	(307)	(406)
The above net liability is recognised in the Balance Sheet as follows						
– retirement benefit scheme liabilities	(247)	(335)	(110)	(100)	(357)	(435)
– retirement benefit scheme assets	50	28		1	50	29
	(197)	(307)	(110)	(99)	(307)	(406)

In Jamaica, the pension scheme holds shares in Carreras Group Ltd. with a fair value of £7 million (2006: £6 million). In Switzerland, a pension scheme owns a property with a fair value of £11 million (2006: £10 million), part of which is occupied by British American Tobacco Switzerland SA.

The amounts recognised in the Income Statement are as follows:

	Pension schemes		Healthcare schemes		Total	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Defined benefit schemes						
– current service cost	73	90	1	3	74	93
– interest cost	216	207	7	7	223	214
– expected return on scheme assets	(264)	(237)	(1)	(1)	(265)	(238)
– net actuarial losses recognised	13	6			13	6
– past service cost	9	9			9	9
– settlements and curtailments	1	9			1	9
– surplus recognition movement	(14)	4			(14)	4
	34	88	7	9	41	97
Defined contribution schemes	19	15			19	15
	53	103	7	9	60	112

The above charges are recognised within employee benefit costs in 2007 and 2006 (page 101 note 3(a)) and include £13 million in 2006 in respect of pension schemes reported as part of the restructuring costs charged in arriving at profit from operations (page 103 note 3(e)).

The reduction in the amounts recognised in the Income Statement in 2007 is principally due to the change in the impact of costs related to the restructurings noted above and the effect on pension costs of restructurings in recent years, along with the recognition of previously restricted funded scheme surpluses and higher investment returns.

The movements in scheme liabilities are as follows:

	Pension schemes		Healthcare schemes		Total	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Present value at 1 January	4,296	4,494	125	136	4,421	4,630
Exchange differences	230	(162)	15	(18)	245	(180)
Current service cost	75	89	1	2	76	91
Interest cost	225	202	7	6	232	208
Past service costs – vested	9	8			9	8
Contributions by scheme members	4	4			4	4
Benefits paid	(281)	(253)	(9)	(7)	(290)	(260)
Settlements and curtailments	(5)	4			(5)	4
Disposals of subsidiaries	(5)	(1)			(5)	(1)
Scheme changes	(1)	(6)			(1)	(6)
Actuarial (gains)/losses	(188)	(83)	(1)	6	(189)	(77)
Present value at 31 December	4,359	4,296	138	125	4,497	4,421
Funded schemes	4,248	4,189	17	10	4,265	4,199
Unfunded schemes	111	107	121	115	232	222
	4,359	4,296	138	125	4,497	4,421

The actuarial gains in both years principally relate to increases in discount rates.

The movements in funded scheme assets are as follows:

	Pension schemes		Healthcare schemes		Total	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Fair value of scheme assets at 1 January	3,938	3,824	12	12	3,950	3,836
Exchange differences	224	(152)	(1)	(3)	223	(155)
Expected return on scheme assets	275	231	1	1	276	232
Company contributions	138	144	7	5	145	149
Contributions by scheme members	4	4			4	4
Benefits paid	(272)	(246)	(7)	(5)	(279)	(251)
Disposals of subsidiaries	(4)				(4)	
Scheme changes	2	(6)			2	(6)
Actuarial (losses)/gains	(96)	139	2	2	(94)	141
Fair value of scheme assets at 31 December	4,209	3,938	14	12	4,223	3,950

Contributions to defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes, taking into account regulatory requirements. Contributions in 2008 are expected to be £124 million for pension schemes and £8 million for healthcare schemes, compared to £138 million and £7 million respectively in 2007.

	Pension schemes		Healthcare schemes		Total	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Actual return on scheme assets	179	370	3	3	182	373

The movements in the unrecognised funded scheme surpluses are as follows:

	Pension schemes		Healthcare schemes		Total	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Unrecognised funded scheme surpluses at 1 January	(61)	(70)			(61)	(70)
Exchange differences	2	13			2	13
Movement in year	15	(4)			15	(4)
Unrecognised funded scheme surpluses at 31 December	(44)	(61)			(44)	(61)

In 2007, a surplus apportionment scheme in South Africa was approved by the relevant regulatory authority, resulting in the recognition of a previously restricted surplus.

The movements in the net unrecognised actuarial (gains)/losses are as follows:

	Pension schemes		Healthcare schemes		Total	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Net actuarial losses at 1 January	111	342	14	13	125	355
Exchange differences	(10)	(3)	3	(3)	(7)	(6)
Actuarial losses/(gains): scheme assets	96	(139)	(2)	(2)	94	(141)
Actuarial (gains)/losses: scheme liabilities	(188)	(83)	(1)	6	(189)	(77)
Actuarial (losses) recognised	(13)	(6)			(13)	(6)
Net actuarial (gains)/losses at 31 December	(4)	111	14	14	10	125

The principal actuarial assumptions (weighted to reflect individual scheme differences) used in the following principal countries are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2007					
Rate of increase in salaries	5.4	3.0	4.0	2.7	1.6
Rate of increase in pensions in payment	3.4	2.0	Nil	2.4	1.0
Rate of increase in deferred pensions	3.4	Nil	Nil	2.4	
Discount rate	5.8	5.5	4.9	5.5	3.3
General inflation	3.4	2.0	3.0	2.4	1.0

For healthcare inflation in Canada, the assumption is 10 per cent reducing to 5 per cent by 2013.

For the remaining pension schemes, typical assumptions are that real salary increases will be from 1 per cent to 4 per cent per annum and discount rates will be from 2 per cent to 5 per cent above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2006					
Rate of increase in salaries	5.1	2.5	4.0	2.4	1.6
Rate of increase in pensions in payment	3.1	2.0	Nil	2.0	1.0
Rate of increase in deferred pensions	3.1	Nil	Nil	2.0	
Discount rate	5.1	4.5	4.7	4.6	3.2
General inflation	3.1	2.0	3.0	2.0	1.0

For healthcare inflation in Canada, the assumption is 10 per cent reducing to 5 per cent by 2012.

For the remaining pension schemes, typical assumptions are that real salary increases will be from 2 per cent to 4 per cent per annum and discount rates will be from 2 per cent to 5 per cent above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

Discount rates are determined by reference to normal yields on high quality corporate bonds at the balance sheet date. For countries where there is not a deep market in such corporate bonds then the yield on government bonds is used.

Mortality assumptions are subject to regular review. In Canada, Germany and Switzerland the same tables were used for both years. In the UK, for post-retirement mortality assumptions at 31 December 2007 the table PXA92 (B=1965) rated up one year for active and deferred members and PXA92 (B=1935) table rated up three years for current pensioners, all with the medium cohort effect, have been used. At 31 December 2006, the same tables are used, along with the medium cohort effect, however active and deferred members are rated up two years and current pensioners are rated up four years. In the Netherlands at 31 December 2007 GBM/V 2006 – 2050 tables with an age setback of one year for both males and females have been used. In the Netherlands at 31 December 2006 GBM/V 1995 – 2000 tables with an age setback of two years for males and one year for females have been used. In Canada UP94 tables, in Germany Heubeck tables 2005G, and EVK 2000 mortality tables in Switzerland, have been used.

Based on the above, the weighted average life expectancy, in years, for mortality tables used to determine benefit obligations is as follows:

	UK		Germany		Canada		Netherlands		Switzerland	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
31 December 2007										
Member age 65 (current life expectancy)	18.9	21.7	17.9	22.0	19.0	21.6	17.7	20.9	17.8	20.6
Member age 45 (life expectancy at age 65)	22.2	25.0	20.6	24.6	19.0	21.6	19.5	21.7	20.6	23.3
	UK		Germany		Canada		Netherlands		Switzerland	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
31 December 2006										
Member age 65 (current life expectancy)	18.5	21.3	17.6	21.7	19.0	21.6	17.3	20.9	17.6	20.4
Member age 45 (life expectancy at age 65)	21.2	24.0	20.4	24.4	19.0	21.6	17.3	20.9	20.6	23.3

The expected rates of return on scheme assets in the following principal countries are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2007					
Equities	7.5	8.0	8.8	8.5	7.3
Bonds	5.2	5.5	5.5	4.6	3.5
Property	7.5	4.5		7.3	4.4
Other assets	8.0		Nil	3.6	5.2

For the remaining pension schemes, typical expected long term real rates of return ranged from 2 per cent to 8 per cent.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2006					
Equities	7.5	8.0	8.2	8.2	7.0
Bonds	4.8	5.5	5.5	4.1	4.5
Property	7.5	4.5		6.9	5.0
Other assets	8.1		Nil	3.2	2.0

For the remaining pension schemes, typical expected long term real rates of return ranged from 2 per cent to 7 per cent.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2005					
Equities	7.1	8.0	7.5	7.6	7.0
Bonds	4.3	5.5	6.5	3.8	4.5
Property	7.1	4.5		6.3	5.0
Other assets	7.0		Nil	2.0	2.0

For the remaining pension schemes, typical expected long term real rates of return ranged from 2 per cent to 7 per cent.

Expected rates of return are determined taking into account the current level of expected returns on risk-free investments, the historical level of risk premium associated with other invested assets, and the expectations for future returns on such assets.

The major categories of assets as a percentage of the total fair value of scheme assets are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %	Others %	Total %
31 December 2007							
Equities	53.8	38.8	47.9	37.0	31.9	25.0	44.1
Bonds	36.0	33.0	47.1	45.0	46.7	54.2	41.1
Property	4.8	28.2		8.3	9.9	1.5	7.8
Other assets	5.4		5.0	9.7	11.5	19.3	7.0
31 December 2006							
Equities	53.4	43.6	60.2	36.4	35.9	23.4	46.8
Bonds	36.5	28.8	34.7	44.9	48.7	54.4	38.7
Property	5.1	27.6		8.7	9.2	1.7	7.8
Other assets	5.0		5.1	10.0	6.2	20.5	6.7

Other assets principally comprise hedge funds, cash and reinsurance contracts.

Valuation of post-retirement schemes involves judgements about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 December 2007 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions such as salary increases. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation and the impacts may offset to some extent.

	1 year increase £m	1 year decrease £m	0.25 percentage point increase £m	0.25 percentage point decrease £m
Rate of mortality				
– (decrease)/increase in profit before taxation	(8)	7		
– increase/(decrease) of scheme liabilities	115	(115)		
Rate of inflation				
– (decrease)/increase in profit before taxation			(9)	8
– increase/(decrease) of scheme liabilities			107	(99)
Discount rate				
– increase/(decrease) in profit before taxation			1	(2)
– (decrease)/increase of scheme liabilities			(120)	130
Expected return on scheme assets				
– increase/(decrease) in profit before taxation			8	(8)

	2.5 percentage point increase £m	2.5 percentage point decrease £m
Market value of scheme assets		
– increase/(decrease) in profit before taxation	6	(6)
– increase/(decrease) of scheme assets	93	(93)

The effect on the profit before taxation reflects the impact on current service cost, interest cost and expected return on scheme assets where relevant, for 2008. The effect on scheme assets and liabilities is as at 31 December 2007.

A one percentage point change in healthcare inflation would have the following effects, which were similar in 2006:

	1 percentage point increase £m	1 percentage point decrease £m
31 December 2007		
Effect on total of current service cost and interest cost	1	(1)
Effect on healthcare scheme liabilities	17	(14)

The history of the present value of the scheme liabilities, fair value of the scheme assets, the scheme net deficits and experience gains and losses are as follows:

	2007 £m	2006 £m	2005 £m	2004 £m
Historical information				
Scheme liabilities	4,497	4,421	4,630	3,852
Scheme assets	4,223	3,950	3,836	3,339
Scheme net deficits	(274)	(471)	(794)	(513)
Experience losses/(gains) on scheme liabilities	6	35	(6)	68
Experience losses/(gains) on scheme assets	94	(141)	(253)	(64)

13 Deferred tax

Deferred tax assets comprise:

	Stock relief £m	Excess of depreciation over capital allowances £m	Tax losses £m	Retirement benefits £m	Fair value losses £m	Other temporary differences £m	Total £m
At 1 January 2007	43	13	32	112		188	388
Exchange differences (Charged)/credited to the Income Statement	4	(1)	3	11		10	27
Other	(13)		(20)	(22)		9	(46)
	1	(4)	7	(1)		(3)	
At 31 December 2007	35	8	22	100		204	369
At 1 January 2006	40	9	18	137		221	425
Exchange differences Credited/(charged) to the Income Statement	(3)	(1)	(1)	(10)		(21)	(36)
Other	1	(4)	34	(16)		(8)	7
	5	9	(19)	1		(4)	(8)
At 31 December 2006	43	13	32	112		188	388

Deferred tax liabilities comprise:

	Stock relief £m	Excess of capital allowances over depreciation £m	Undistributed earnings of associates and subsidiaries £m	Retirement benefits £m	Fairvalue gains £m	Other temporary differences £m	Total £m
At 1 January 2007	27	140	87	114	8	35	411
Exchange differences (Credited)/charged to the Income Statement	2	3	1	11		1	18
Credited to equity	(15)		20	(25)		1	(19)
Other		(4)	1	(1)	(6) (2)	3	(6) (3)
At 31 December 2007	14	139	109	99		40	401
At 1 January 2006	30	154	73	98	15	42	412
Exchange differences (1)	(1)	(12)	(3)	(2)	(2)	(9)	(29)
Charged/(credited) to the Income Statement	(4)	(8)	17	20	(2)	4	27
Credited to equity					(2)		(2)
Other	2	6		(2)	(1)	(2)	3
At 31 December 2006	27	140	87	114	8	35	411

	2007 £m	2006 £m
Net deferred tax liabilities	32	23

The net deferred tax liabilities are reflected in the Balance Sheet as follows, after offsetting assets and liabilities where there is a legally enforceable right to offset current tax assets and liabilities and where the deferred income taxes relate to the same fiscal authority.

	2007 £m	2006 £m
Deferred tax assets	(262)	(273)
Deferred tax liabilities	294	296
	32	23

Deferred tax expected to be recovered within 12 months:

	2007 £m	2006 £m
Deferred tax assets	(116)	(86)
Deferred tax liabilities	132	105
	16	19

At the balance sheet date, the Group has recognised and unrecognised deferred tax assets in respect of unused tax losses of £191 million (2006: £144 million) available for offset against future profits. A deferred tax asset has been recognised in respect of £22 million (2006: £32 million) of such losses, as realisation of the related tax benefit is probable.

Unrecognised deferred tax assets in respect of unused income tax losses of £101 million (2006: £67 million) have no expiry date and unused income tax losses of £64 million (2006: £35 million) expire after five years. Unrecognised deferred tax assets in respect of unused capital tax losses of £4 million (2006: £10 million) have no expiry date.

At the balance sheet date, the Group has unrecognised deferred tax assets in respect of deductible temporary differences of £158 million (2006: £183 million) and unused tax credits of £206 million (2006: £136 million). These unrecognised deferred tax assets have no expiry period.

At the balance sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was £5 billion in both years. No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences, and it is probable that such differences will not reverse in the foreseeable future.

14 Trade and other receivables

	2007	2006
	£m	£m
Trade receivables	1,272	1,083
Loans and other receivables	498	530
Prepayments and accrued income	198	147
	1,968	1,760
Analysed on the Balance Sheet as		
– current	1,845	1,568
– non-current	123	192
	1,968	1,760

Prepayments and accrued income include £53 million (2006: £48 million) in respect of dividends from associates and £11 million (2006: £1 million) in respect of interest.

Trade and other receivables have been reported in the Balance Sheet net of allowances as follows:

	2007	2006
	£m	£m
Gross trade and other receivables	2,019	1,803
Allowance account	(51)	(43)
Net trade and other receivables per Balance Sheet	1,968	1,760

The movements in the allowance account are as follows:

	2007	2006
	£m	£m
1 January	43	33
Differences on exchange	5	(2)
Provided in respect of the year	22	17
Amounts reversed during the year	(3)	
Amounts in respect of receivables written off	(16)	(5)
31 December	51	43

Impairment of trade receivables charged during the year is included as part of other operating expenses. For 2007, the net impairment charged was £37 million (2006: £17 million) of which £19 million (2006: £17 million), is reflected in the above table.

As at 31 December 2007, trade and other receivables of £63 million (2006: £42 million) were past due but not impaired. These relate to a number of external parties where there is no expectation of default.

The age analysis of these trade receivables is as follows:

	2007	2006
	£m	£m
Less than three months	38	25
Between three and six months	5	2
Between six months and one year	11	13
Greater than one year	9	2

The Group holds bank guarantees, other guarantees and credit insurance in respect of some of the past due debtor balances.

Trade and other receivables are predominantly denominated in the functional currencies of subsidiary undertakings apart from the following:

	2007	2006
	£m	£m
US dollar	144	106
UK sterling	12	4
Euro	25	22
Other currencies	33	24

Trade and other receivables also include certain interest bearing amounts and their effective interest rates are as follows:

	2007	2006	2007	2006
	£m	£m	%	%
US dollar*	13	64	5.5	4.6
Euro	1	1	4.0	3.6
Other currencies	21	36	12.0	10.6

*2006 includes US\$100 million (£51 million) collateral pledged representing a bond posted in connection with the Engle class action in the US (page 153 note 30).

There is no material difference between the above amounts for trade and other receivables and their fair value, due to the short term duration of the majority of trade and other receivables. There is no concentration of credit risk with respect to trade receivables as the Group has a large number of customers, internationally dispersed.

15 Available-for-sale investments

	2007	2006
	£m	£m
1 January	152	123
Differences on exchange	9	(1)
Additions and advances	99	85
Revaluations	1	(2)
Disposals and repayments	(164)	(54)
Other movements		1
31 December	97	152
Current	75	128
Non-current	22	24
	97	152

Investments have the following maturities:

	As per Balance Sheet		Contractual gross maturities	
	2007	2006	2007	2006
	£m	£m	£m	£m
Equity investments	24	25	24	25
Non-equity investments				
– within one year	67	73	67	75
– beyond one year and within two years	3	4	3	7
– beyond two years and within three years	1	21	1	23
– beyond three years and within four years	1	12	1	13
– beyond four years and within five years				1
– beyond five years	1	17	1	20
	97	152	97	164

The contractual gross maturities in each year include the investments maturing in that year together with forecast interest receipts on all investments which are due for all or part of that year.

Investments are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	2007 £m	2006 £m
Functional currencies	91	92
US dollar	3	56
Other currencies	3	4
	97	152

Non-equity investments are denominated in the following currencies:

	2007 £m	2006 £m
US dollar	1	56
UK sterling	72	71
	73	127

Effective interest rates applicable to non-equity investments are as follows:

	2007 %	2006 %
On US dollar	4.6	4.8
On UK sterling	6.1	5.3

The fair values of available-for-sale investments are principally based on readily observable market data with the exception of an equity investment in an unquoted entity which is valued at £18 million (2006: £17 million) using the discounted cash flows of estimated future dividends.

16 Derivative financial instruments

The fair values of derivatives are determined based on market data (primarily yield curves, implied volatilities and exchange rates) to calculate the present value of all estimated flows associated with each derivative at the balance sheet date. In the absence of sufficient market data, fair values would be based on the quoted market price of similar derivatives.

	2007		2006	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedges				
– interest rate swaps	14	14	25	19
– cross-currency swaps	85	31	24	4
Cash flow hedges				
– cross-currency swaps	29			
– forward foreign currency contracts	6	6	20	1
Net investment hedges				
– cross-currency swaps	57		53	
– forward foreign currency contracts	5	50	31	10
Trading				
– cross-currency swaps		53		43
– forward foreign currency contracts	7	85	29	13
– others	32	35	18	23
	235	274	200	113
Current	82	225	124	84
Non-current	153	49	76	29
	235	274	200	113

	2007		2006	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Current assets and liabilities include				
– trading derivatives that mature beyond one year	1	10		37
Derivatives				
– in respect of net debt	188	179	125	79
– other	47	95	75	34
	235	274	200	113

Some derivative financial instruments are not designated as hedges and have been classified as trading derivatives.

The maturity dates of all derivative financial instruments as recognised in the Balance Sheet are as follows:

	2007		2006 restated	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	81	215	124	47
Between one and two years	81	3	5	29
Between two and three years			46	3
Between three and four years	5			
Between four and five years	64		4	
Beyond five years	4	56	21	34
	235	274	200	113

The above maturity analysis for 2006 has been restated to enhance consistency of presentation with other financial instrument maturity analyses.

For cash flow hedges, the timing of expected cash flows is as follows:

	2007		2006	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	3	6	11	1
Between one and two years	32		2	
Between two and three years			7	
	35	6	20	1

The Group's cash flow hedges are in respect of sales or purchases of inventory and certain debt instruments. The timing of expected cash flows in respect of derivatives designated as cash flow hedges is broadly expected to be comparable to the timing of when the hedged item will affect profit or loss.

The tables below set out the maturities of the Group's derivative financial instruments on an undiscounted contractual basis, based on spot rates.

The maturity dates of all gross settled derivative financial instruments are as follows:

	2007				2006			
	Assets		Liabilities		Assets		Liabilities	
	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m
Within one year								
– forward contracts	1,108	(1,095)	4,266	(4,394)	3,293	(3,212)	1,943	(1,969)
– cross-currency swaps	66	(70)	249	(310)	59	(71)	73	(88)
– other	1,450	(1,396)	1,395	(1,451)	1,320	(1,281)	1,280	(1,321)
Between one and two years								
– forward contracts	62	(61)	70	(73)	66	(57)	17	(17)
– cross-currency swaps	876	(774)	18	(18)	59	(69)	254	(285)
Between two and three years								
– forward contracts							3	(3)
– cross-currency swaps	21	(22)	21	(22)	736	(688)	124	(122)
Between three and four years								
– forward contracts							3	(3)
– cross-currency swaps	21	(24)	18	(18)	19	(27)	18	(16)
Between four and five years								
– cross-currency swaps	572	(468)	18	(19)	19	(27)	18	(16)
Beyond five years								
– cross-currency swaps	19	(15)	397	(421)	542	(493)	414	(396)
	4,195	(3,925)	6,452	(6,726)	6,113	(5,925)	4,147	(4,236)

The maturity dates of net settled derivative financial instruments are as follows:

	2007		2006	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
	Within one year	(4)	6	3
Between one and two years	14	3		5
Between two and three years	1	3	13	5
Between three and four years	6	4	1	4
Between four and five years		3	5	3
Beyond five years	11	3	18	6
	28	22	40	28

The above analysis of derivatives settled on a net basis primarily relates to the Group's interest rate swaps.

In summary by type, the fair value of derivative financial instruments is as follows:

	2007		2006	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Interest rate swaps	14	14	25	19
Cross-currency swaps	171	84	77	47
Forward foreign currency contracts	18	141	80	24
Others	32	35	18	23
	235	274	200	113

(a) Interest rate swaps

	Maturity date	Principal currency	m	£m	Original	Interest rate %		2007	
						Swapped	Assets £m	Liabilities £m	
Fixed to floating	2009	EUR	550	404	4.9	note (a)	7		
	2009	EUR	250	184	4.1	note (a)	2		
	2013	EUR	400	294	5.1	note (a)			
	2013	GBP	350	350	5.8	note (a)			14
	2019	GBP	250	250	6.4	note (a)	5		
							14	14	

	Maturity date	Principal currency	m	£m	Original	Interest rate %		2006	
						Swapped	Assets £m	Liabilities £m	
Fixed to floating	2009	EUR	550	371	4.9	note (a)	10		
	2009	EUR	250	168	4.1	note (a)	4		
	2013	EUR	400	270	5.1	note (a)	7		
	2013	GBP	350	350	5.8	note (a)			19
	2019	GBP	250	250	6.4	note (a)	4		
Floating to fixed	2007	AUD	50	20	note (a)	5.5			
							25	19	

Note (a): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between nil and 137 basis points.

The fixed to floating swaps have been used to manage the interest rate profile of external borrowings and are reflected in the repricing table on page 138 in note 21. The floating to fixed swaps have been used to manage the interest rate profile of both internal and external financing arrangements, and those relating to external borrowings are also reflected in the repricing table on page 138 in note 21.

(b) Cross-currency swaps

	Maturity date	Original currency	Interest rate %	Principal original currency		Swapped currency	Interest rate %	Principal swapped currency		2007	
				m	£m			m	£m	Assets £m	Liabilities £m
Fixed to fixed	2009	EUR	4.9	500	367	USD	6.5	564	283	86	
Fixed to floating	2008	GBP	6.5	217	217	AUD	note (b)	607	268		53
	2009	EUR	4.9	150	110	GBP	note (b)	104	104	8	
	2012	EUR	3.6	750	551	USD	note (b)	907	456	74	
	2016	GBP	5.5	325	325	EUR	note (b)	473	347		31
	2019	EUR	4.6	20	15	USD	note (b)	22	11	3	
									171	84	

	Maturity date	Original currency	Interest rate %	Principal original currency		Swapped currency	Interest rate %	Principal swapped currency		Assets £m	Liabilities £m
				m	£m			m	£m		
Fixed to fixed	2007	USD	5.8	70	36	KRW	7.5	85,876	47		13
	2009	EUR	4.9	500	337	USD	6.5	564	288	53	
Fixed to floating	2008	GBP	6.5	217	217	AUD	note (b)	607	244		30
	2009	EUR	4.9	150	101	GBP	note (b)	104	104		1
	2012	EUR	3.6	750	505	USD	note (b)	907	463	22	
	2016	GBP	5.5	325	325	EUR	note (b)	473	319		3
	2019	EUR	4.6	20	13	USD	note (b)	22	11	2	
										77	47

Note (b): The floating rate interest rates are based on LIBOR plus a margin ranging between 66 and 127 basis points.

In 2006, the US dollar/South Korean won swaps were used to manage internal financing arrangements. The remaining swaps were used to manage the currency profile of external borrowings and are reflected in the currency table on page 138 in note 21. The fixed to floating swaps are also reflected in the repricing table on page 138 in note 21.

(c) Forward foreign currency contracts

Forward foreign currency contracts are denominated in the following currencies.

Fair values of assets

	2007							2006						
	Currencies purchased forward							Currencies purchased forward						
	EUR £m	GBP £m	USD £m	CHF £m	SGD £m	PLN £m	Total £m	EUR £m	GBP £m	USD £m	CHF £m	CAD £m	AUD £m	Total £m
Currencies sold forward														
AUD		1					1		1					1
CAD									15					15
CHF	1						1		5					5
CYP									1					1
EUR									19					19
GBP	2			2		1	5							
KRW	2						2							
JPY			4				4			20				20
USD		3			1		4		18					18
RUR	1						1							
ZAR									1					1
	6	4	4	2	1	1	18		60	20				80

Fair values of liabilities

	2007							2006						
	Currencies purchased forward							Currencies purchased forward						
	EUR £m	GBP £m	USD £m	CHF £m	SGD £m	PLN £m	Total £m	EUR £m	GBP £m	USD £m	CHF £m	CAD £m	AUD £m	Total £m
Currencies sold forward														
AUD		17					17		3	1				4
CAD		25	1				26							
CHF		14					14							
EUR		43	5				48	1	2					3
CZK		1					1							
DKK		1					1							
GBP											2	6		8
HKD		6					6							
HUF		1					1							
PLN		2					2							
NZD													2	2
SGD		1					1							
JPY			4				4							
USD	1	11					12		1					1
RUR			2				2			1				1
ZAR		6					6	1	4					5
	1	128	12				141	1	9	4	2	6	2	24

Forward foreign currency contracts have been used to hedge both internal and external forecast transactions as well as the hedging of internal and external assets and liabilities. Certain contracts were used to manage the currency profile of external borrowings and are reflected in the currency table on page 138 in note 21, and their nominal values are as follows:

	2007		2006	
	£m	£m	£m	£m
Forward contracts to purchase GBP, sell CHF	(115)	122	(74)	73
Forward contracts to purchase GBP, sell CAD	(338)	356	(308)	307
Forward contracts to purchase GBP, sell AUD	(569)	579	(525)	529

(d) Others

	2007		2006	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Others: Bund forwards <i>note i</i>	27	28	15	16
Interest derivative <i>note ii</i>		7		7
Sinking fund policy <i>note iii</i>	5	3		
	32	35	18	23

Notes:

- (i) Forward contracts to purchase and sell German government securities with a nominal value of €1.91 billion (2006: €1.86 billion) taken out to manage internal financing arrangements and maturing within one year.
- (ii) Remaining impact of an interest derivative with a nominal value of €1 billion maturing in 2013.
- (iii) Investment in sinking fund policy with a nominal value of ZAR73 million (2006: ZAR51 million).

17 Inventories

	2007	2006
	£m	£m
Raw materials and consumables	1,103	1,182
Finished goods and work in progress	707	721
Goods purchased for resale	175	153
	1,985	2,056

Inventories pledged as security for liabilities amount to £8 million (2006: £11 million). Write-offs taken to other operating expenses in the Income Statement comprise £46 million (2006: £26 million), including amounts relating to restructuring costs.

18 Income tax receivable and payable

Income tax balances shown on the Group Balance Sheet as current assets and current liabilities, while subject to some uncertainty as to the extent and timing of cash flows, are largely expected to be received or paid within 12 months of the balance sheet date for both 2007 and 2006.

19 Cash and cash equivalents

	2007	2006
	£m	restated £m
Cash and bank balances	651	717
Cash equivalents	607	739
	1,258	1,456

Cash equivalents mainly comprise short term deposits with an original maturity of three months or less. The carrying value of cash and cash equivalents approximates their fair value. The analysis of cash and cash equivalents has been restated so that all amounts accessible on demand or within one day are classified as cash and bank balances. Consequently, the 2006 amounts above for cash and bank balances have been restated from £484 million to £717 million, with a corresponding reduction in cash equivalents.

Cash and cash equivalents are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	2007	2006
	£m	£m
Functional currency	968	896
US dollar	159	352
UK sterling	5	7
Euro	104	179
Other currencies	22	22
	1,258	1,456

The currency in which cash and cash equivalents are held, together with the effective interest rates applicable to cash and cash equivalents are as follows:

	Values		Rates	
	2007	2006	2007	2006
	£m	£m	%	%
US dollar	231	354	3.6	4.5
UK sterling	146	153	5.1	4.9
Euro	158	222	3.2	3.0
Canadian dollar	32	17	4.2	4.2
Australian dollar	10	2	6.3	5.8
Other currencies	681	708	6.8	5.1
	1,258	1,456		

At 31 December 2007, cash and cash equivalents of £nil (2006: £4 million) were pledged as collateral principally in respect of excise creditors.

In the Group Cash Flow Statement, net cash and cash equivalents are shown after deducting bank overdrafts, as follows:

	2007	2006
	£m	£m
Cash and cash equivalents as above	1,258	1,456
<i>Less:</i>		
– accrued interest		(1)
– overdrafts	(78)	(179)
Net cash and cash equivalents	1,180	1,276

Cash and cash equivalents include restricted amounts of £54 million (2006: £65 million).

20 Capital and reserves – reconciliation of movement in total equity

	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Shareholders' funds £m	Minority interests £m	Total equity £m
1 January 2007	517	3,886	419	1,639	6,461	227	6,688
Differences on exchange			292		292	20	312
Cash flow hedges							
– net fair value gains			15		15		15
– reclassified and reported in profit for the year			(42)		(42)		(42)
Available-for-sale investments							
– net fair value gains			1		1		1
– reclassified and reported in profit for the year			2		2	(1)	1
Net investment hedges							
– net fair value losses			(35)		(35)		(35)
Tax on items recognised directly in equity <i>page 107 note 6(c)</i>			(15)		(15)	(4)	(19)
Profit for the year				2,130	2,130	157	2,287
Employee share options							
– value of employee services				37	37		37
– proceeds from shares issued		5		22	27		27
Dividends and other appropriations							
– ordinary shares				(1,198)	(1,198)		(1,198)
– to minority interests						(173)	(173)
Purchase of own shares							
– held in employee share ownership trusts				(41)	(41)		(41)
– share buy-back programme	(11)	11		(750)	(750)		(750)
Acquisition of minority interests						(9)	(9)
Other movements				(4)	(4)	1	(3)
31 December 2007	506	3,902	637	1,835	6,880	218	7,098

	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Shareholders' funds £m	Minority interests £m	Total equity £m
1 January 2006	524	3,874	981	1,251	6,630	247	6,877
Differences on exchange			(665)		(665)	(20)	(685)
Cash flow hedges							
– net fair value gains			13		13		13
– reclassified and reported in profit for the year			(15)		(15)		(15)
Available-for-sale investments							
– net fair value losses			(2)		(2)		(2)
Net investment hedges							
– net fair value gains			117		117		117
Tax on items recognised directly in equity <i>page 107 note 6(c)</i>			(10)		(10)	(2)	(12)
Profit for the year				1,896	1,896	152	2,048
Employee share options							
– value of employee services				41	41		41
– proceeds from shares issued		5		23	28		28
Dividends and other appropriations							
– ordinary shares				(1,008)	(1,008)		(1,008)
– to minority interests						(137)	(137)
Purchase of own shares							
– held in employee share ownership trusts				(77)	(77)		(77)
– share buy-back programme	(7)	7		(500)	(500)		(500)
Acquisition of minority interests						(13)	(13)
Other movements				13	13		13
31 December 2006	517	3,886	419	1,639	6,461	227	6,688

Details relating to the authorised and allotted share capital, and movements therein, are included on page 173 in note 4.

Share premium account, capital redemption reserves and merger reserves comprise:

	Share premium account £m	Capital redemption reserves £m	Merger reserves £m	Total £m
1 January 2006	43	83	3,748	3,874
31 December 2006	48	90	3,748	3,886
31 December 2007	53	101	3,748	3,902

The share premium account includes the difference between the value of shares issued and their nominal value. The increase of £5 million (2006: £5 million) relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration Report on pages 58 to 75.

On the purchase of own shares as part of the buy-back programme, a transfer is made from retained earnings to the capital redemption reserve equivalent to the nominal value of shares purchased. As described on page 173 in note 4, in 2006 a technical infringement of the Companies Act 1985 occurred in relation to £100 million of the £500 million shares purchased under the buy-back programme in the table on page 134, which remained in the share capital as at 31 December 2006 shown on page 134 and were excluded from the transfer to the capital redemption reserve in that year. As these payments were ratified by the shareholders in 2007, in the table on page 133 the share capital is adjusted with a consequent transfer to the capital redemption reserve.

Shareholders' funds are stated after deducting the cost of treasury shares which include £123 million (2006: £nil) for shares repurchased and not cancelled and £173 million (2006: £197 million) in respect of the cost of own shares held in employee share ownership trusts.

In 1999, shares were issued for the acquisition of the Rothmans International B.V. Group, and the difference between the fair value of shares issued and their nominal value was credited to merger reserves.

Movements in other reserves and retained earnings (which is after deducting treasury shares) shown above comprise:

	Translation reserve £m	Hedging reserve £m	Available- for-sale reserve £m	Other reserves £m	Total other reserves £m	Retained earnings	
						Treasury shares £m	Other £m
1 January 2007	(177)	10	13	573	419	(197)	1,836
Differences on exchange	292				292		
Cash flow hedges							
– net fair value gains		15			15		
– reclassified and reported in profit for the year		(42)			(42)		
Available-for-sale investments							
– net fair value gains			1		1		
– reclassified and reported in profit for the year			2		2		
Net investment hedges							
– net fair value losses	(35)				(35)		
Tax on items recognised directly in equity <i>page 107 note 6(c)</i>	(21)	6			(15)		
Profit for the year							2,130
Employee share options							
– value of employee services							37
– proceeds from shares issued						22	
Dividends and other appropriations							
– ordinary shares							(1,198)
Purchase of own shares							
– held in employee share ownership trusts						(41)	
– share buy-back programme						(123)	(627)
Other movements						43	(47)
31 December 2007	59	(11)	16	573	637	(296)	2,131

	Translation reserve £m	Hedging reserve £m	Available- for-sale reserve £m	Other reserves £m	Total other reserves £m	Retained earnings	
						Treasury shares £m	Other £m
1 January 2006	383	10	15	573	981	(182)	1,433
Differences on exchange	(665)				(665)		
Cash flow hedges							
– net fair value gains		13			13		
– reclassified and reported in profit for the year		(15)			(15)		
Available-for-sale investments							
– net fair value losses			(2)		(2)		
Net investment hedges							
– net fair value gains	117				117		
Tax on items recognised directly in equity <i>page 107 note 6(c)</i>	(12)	2			(10)		
Profit for the year							1,896
Employee share options							
– value of employee services							41
– proceeds from shares issued						23	
Dividends and other appropriations							
– ordinary shares							(1,008)
Purchase of own shares							
– held in employee share ownership trusts						(77)	
– share buy-back programme							(500)
Other movements						39	(26)
31 December 2006	(177)	10	13	573	419	(197)	1,836

The translation reserve is as explained in the accounting policy on foreign currencies on pages 92 and 93.

The hedging reserve and the available-for-sale reserve are as explained in the accounting policy on financial instruments on page 95.

Of the amounts released from the hedging reserve during the year, gains of £5 million (2006: £5 million) and £9 million (2006: £15 million) were reported within revenue and raw materials and consumables, respectively, together with a gain of £2 million reported in other operating expenses (2006: £1 million loss) and a gain of £26 million (2006: £4 million loss) reported within net finance costs.

Other reserves comprise:

- £483 million which arose in 1998 from merger accounting in a Scheme of Arrangement and Reconstruction whereby British American Tobacco p.l.c. acquired the entire share capital of B.A.T Industries p.l.c. and the share capital of that company's principal financial services subsidiaries were distributed, so effectively demerging them; and
- in the Rothmans transaction noted on page 135, convertible redeemable preference shares were issued as part of the consideration. The discount on these shares was amortised by crediting other reserves and charging retained earnings. The £90 million balance in other reserves comprises the accumulated balance in respect of the preference shares converted during 2004.

21 Borrowings

	Currency	Maturity dates	Interest rates	2007 £m	2006 £m
Eurobonds	Euro	2009 to 2019	3.6% to 5.4%	3,920	3,465
	UK sterling	2008 to 2019	5.5% to 6.5%	1,376	1,364
Floating rate notes	Euro	2010	floating rate	388	355
Other notes	Malaysian ringgit	2007 to 2012	3.7% to 7.9%	115	103
	US dollar	2008	6.9%	173	176
	Other currencies			97	93
Syndicated bank loans	US dollar	2012	floating rate	346	358
Bank loans				352	460
Other loans				13	11
Finance leases				65	62
Overdrafts				78	179
				6,923	6,626

The floating rate interest rates are based on EURIBOR or US LIBOR plus a margin ranging between 36 and 200 basis points.

	2007 £m	2006 £m
Current	861	1,058
Non-current	6,062	5,568
		6,923

Current borrowings include interest payable of £136 million at 31 December 2007 (2006: £133 million). Included within non-current borrowings are £2,466 million (2006: £2,340 million) of borrowings subject to fair value hedges where this amortised cost has been decreased by £49 million (2006: decreased £52 million) in the table above.

The fair value of borrowings is estimated to be £6,862 million (2006: £6,772 million) and has been determined using quoted market prices or discounted cash flow analysis.

	2007 £m	2006 £m
Amounts secured on Group assets	81	88

Amounts secured include finance leases of £65 million (2006: £62 million) and the remaining amounts are secured on certain property and inventory of the Group (page 111 note 10 and page 131 note 17).

Borrowings are repayable as follows:

	Per Balance Sheet		Contractual gross maturities	
	2007 £m	2006 £m	2007 £m	2006 £m
Within one year	861	1,058	1,029	1,240
Between one and two years	765	419	1,047	712
Between two and three years	397	1,240	636	1,504
Between three and four years	898	361	1,134	553
Between four and five years	927	828	1,151	1,013
Beyond five years	3,075	2,720	3,749	3,350
		6,923	8,746	8,372

The contractual gross maturities in each year include the borrowings maturing in that year together with forecast interest payments on all borrowings which are outstanding for all or part of that year.

Borrowings are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	Functional currency £m	US dollar £m	UK sterling £m	Euro £m	Canadian dollar £m	Australian dollar £m	Other currencies £m	Total £m
31 December 2007								
Total borrowings	3,275	599	327	2,722				6,923
Effect of derivative financial instruments								
– cross-currency swaps	(113)	750	(325)	(696)		268		(116)
– forward foreign currency contracts	(1,022)				356	579	122	35
	2,140	1,349	2	2,026	356	847	122	6,842
31 December 2006								
Total borrowings	3,128	809	327	2,362				6,626
Effect of derivative financial instruments								
– cross-currency swaps	(113)	762	(325)	(637)		244		(69)
– forward foreign currency contracts	(907)				307	529	73	2
	2,108	1,571	2	1,725	307	773	73	6,559

Details of the derivative financial instruments included in these tables are given in note 16 on page 125.

The exposure to interest rate changes when borrowings are repriced is as follows:

	Within 1 year £m	Between 1 – 2 years £m	Between 2 – 3 years £m	Between 3 – 4 years £m	Between 4 – 5 years £m	Beyond 5 years £m	Total £m
31 December 2007							
Total borrowings	1,593	765	12	898	582	3,073	6,923
Effect of derivative financial instruments							
– interest rate swaps	1,482	(588)				(894)	
– cross-currency swaps	918	(110)			(551)	(340)	(83)
	3,993	67	12	898	31	1,839	6,840
31 December 2006							
Total borrowings	1,505	419	1,240	8	735	2,719	6,626
Effect of derivative financial instruments							
– interest rate swaps	1,409		(539)			(870)	
– cross-currency swaps	1,141	(217)	(101)			(843)	(20)
	4,055	202	600	8	735	1,006	6,606

Details of the derivative financial instruments included in these tables are given in note 16 on page 125.

Effective interest rates are as follows:

	2007 £m	2006 £m	2007 %	2006 %
US dollar	653	866	6.8	6.6
UK sterling	1,393	1,382	6.1	5.4
Euro	4,305	3,814	4.5	4.5
Canadian dollar	22	13	5.8	5.8
Australian dollar		7		6.5
Other currencies	550	544	6.0	6.8
	6,923	6,626		

The values and rates shown above do not reflect the effect of the interest rate and cross-currency swaps detailed in note 16 on page 125.

Finance lease liabilities per the Balance Sheet and on a contractual gross maturity basis are payable as follows:

	2007			2006		
	Principal £m	Interest £m	Total £m	Principal £m	Interest £m	Total £m
Within one year	24	3	27	18	3	21
Between one and two years	20	2	22	17	2	19
Between two and three years	12	1	13	13	1	14
Between three and four years	5		5	8	1	9
Between four and five years	2		2	3		3
Beyond five years	2		2	3	1	4
	65	6	71	62	8	70

Borrowings facilities:

	2007 £m	2006 £m
Undrawn committed facilities expiring		
– within one year	1,416	85
– between one and two years		57
– between three and four years	99	
– between four and five years	1,651	1,750
	3,166	1,892

The facilities include undrawn amounts in respect of the Group's central banking facility of £1.75 billion (2006: £1.75 billion). In March 2007, a one year option was exercised with final maturity dates between March 2011 and March 2012.

As explained in the Director's Report on page 52, a new central banking facility of €1.8 billion was entered into in 2007.

Facility fees of £2 million were charged to the Income Statement in 2007 (2006: £2 million) in respect of undrawn committed borrowing facilities.

22 Other provisions for liabilities and charges

	Restructuring of existing businesses £m	Acquired businesses £m	Employee- related benefits £m	Other provisions £m	Total £m
1 January 2007	191	41	14	168	414
Differences on exchange	16	3	1	13	33
Provided in respect of the year	108		9	67	184
Utilised during the year	(132)	(21)	(4)	(44)	(201)
Other movements	(1)			(1)	(2)
31 December 2007	182	23	20	203	428
Analysed on the Balance Sheet as					
– current	106	14	5	138	263
– non-current	76	9	15	65	165
	182	23	20	203	428

	Restructuring of existing businesses £m	Acquired businesses £m	Employee- related benefits £m	Other provisions £m	Total £m
1 January 2006	222	76	25	172	495
Differences on exchange	(15)	(4)	(2)	(13)	(34)
Provided in respect of the year	99	(12)	1	38	126
Utilised during the year	(111)	(19)	(4)	(31)	(165)
Other movements	(4)		(6)	2	(8)
31 December 2006	191	41	14	168	414
Analysed on the Balance Sheet as					
– current	120	24	5	104	253
– non-current	71	17	9	64	161
	191	41	14	168	414

The restructuring provisions relate to the restructuring costs incurred and reported as exceptional items in the Income Statement. The principal restructurings provided in 2007 and 2006 are as described on page 103 in note 3(e). While some elements of the non-current provisions of £76 million will unwind over several years, as termination payments are made over extended periods in some countries, it is estimated that over 50 per cent will unwind in 2009 and approximately 80 per cent within five years.

Provisions in respect of acquired businesses mostly relate to those which were part of the integration of the Rothmans businesses in 1999, the transition of Imperial Tobacco Canada Ltd. to a subsidiary in 2000 and the reorganisation of the Italian business acquired in 2003. While some elements of the non-current provisions of £9 million will unwind over several years, it is estimated that around 50 per cent will unwind within five years.

Employee-related benefits mainly relate to long term employee benefits other than post-retirement benefits. As the principal components of these provisions are long service awards and 'Jubilee' payments due after a certain service period, they will unwind over several years. It is estimated that approximately 50 per cent of the non-current provisions of £15 million will unwind within five years.

Other provisions comprise balances set up in the ordinary course of general business that cannot be classified within the other categories, such as sales returns, onerous contracts and the age verification scheme in Japan, together with amounts in respect of supplier, excise and other disputes. The nature of the amounts provided in respect of disputes is such that the extent and timing of cash flows is difficult to estimate and the ultimate liability may vary from the amounts provided.

Amounts provided above are shown net of reversals of unused provisions which include £10 million (2006: £15 million) for restructuring of existing businesses, £3 million (2006: £12 million) for acquired businesses, £nil (2006: £2 million) for employee-related benefits and £24 million (2006: £12 million) for other provisions.

23 Trade and other payables

	2007 £m	2006 £m
Trade payables	633	611
Duty, excise and other taxes	1,605	1,467
Accrued charges and deferred income	610	553
Social security and other taxation	24	9
Sundry payables	253	272
	3,125	2,912
Analysed on the Balance Sheet as		
– current	2,976	2,766
– non-current	149	146
	3,125	2,912

Accrued charges and deferred income include £4 million (2006: £12 million) in respect of interest payable.

There is no material difference between the above amounts for trade and other payables and their fair value, due to the short term duration of the majority of trade and other payables.

Trade and other payables are predominantly denominated in the functional currencies of subsidiary undertakings with less than 6 per cent in other currencies.

24 Financial instruments

Management of financial risks

One of the principal responsibilities of Treasury is to manage the financial risks arising from the Group's underlying operations. Specifically, Treasury manages, within an overall policy framework, the Group's exposure to funding and liquidity, interest rate, foreign exchange and counterparty risks.

Derivative contracts are only entered into to facilitate the management of these risks. The Board reviews and agrees the overall treasury policies and procedures, delegating appropriate authority to the Finance Director, the Treasury function and the Boards of the central finance companies. The policies include a set of financing principles including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital base is managed and, in particular, the policies on dividends and share buy-back are decided.

The Group manages its financial risks in line with the classification of its financial assets and liabilities in the Group's Balance Sheet and related notes.

The Group's management of specific risks is dealt with as follows:

Liquidity risk

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group has a target average centrally managed debt maturity of 5 years with no more than 20 per cent of centrally managed debt maturing in a single year. As at 31 December 2007, the average centrally managed debt maturity was 5.4 years and the highest proportion of centrally managed debt maturing in a single year was 16.7 per cent. It is Group policy that short term sources of funds (including drawings under US dollar and euro commercial paper programmes) are backed by undrawn committed lines of credit and cash.

During 2007, the Group's central banking facility at £1.75 billion was extended on existing terms under a one year extension option with final maturity dates between March 2011 and March 2012.

As explained in the Director's Report on page 52, a new central banking facility of €1.8 billion was entered into in 2007.

The Group utilises cash pooling and zero balancing bank account structures in addition to inter-company loans and borrowings to ensure that there is the maximum mobilisation of cash within the Group. The amount of debt issued by the Group is determined by forecasting the net debt requirement after the mobilisation of cash.

The Group continues to target investment-grade credit ratings; as at 31 December 2007, the ratings from Moody's and S&P were Baa1/BBB+ (2006: Baa1/BBB+). The strength of the ratings has underpinned the debt issuance during 2006 and 2007 and, despite the impact of the turbulence in the financial markets, the Group is confident of its ability to successfully access the debt capital markets.

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

Currency risk

The Group is subject to exposure on the translation of the net assets of foreign currency subsidiaries and associates into its reporting currency, sterling. The Group's primary balance sheet translation exposures are to the US dollar, Canadian dollar, euro and South African rand. These exposures are kept under continuous review. The Group's policy on borrowings is to broadly match the currency of these borrowings with the currency of cash flows arising from the Group's underlying operations. Within this overall policy, the Group

aims to minimise all balance sheet translation exposure where it is practicable and cost effective to do so through matching currency assets with currency borrowings. At 31 December 2007, the currency profile of the Group's gross debt, after taking into account derivative contracts, was 20 (2006: 25) per cent US dollar, 53 (2006: 48) per cent euro, 5 (2006: 5) per cent Canadian dollar, nil (2006: 1) per cent sterling, 12 (2006: 12) per cent Australian dollar and 10 (2006: 9) per cent other currencies.

The Group faces currency exposures arising from the translation of profits earned in foreign currency subsidiaries and associates; these exposures are not normally hedged. Exposures also arise from:

- (i) foreign currency denominated trading transactions undertaken by subsidiaries. These exposures comprise committed and highly probable forecast sales and purchases, which are offset wherever possible. The remaining exposures are hedged within the Treasury policies and procedures with forward foreign exchange contracts and options, which are designated as hedges of the foreign exchange risk of the identified future transactions; and
- (ii) forecast dividend flows from subsidiaries to the centre. To ensure cash flow certainty, the Group hedges such flows using forward foreign exchange contracts designated as net investment hedges of the foreign exchange risk arising from the investments in these subsidiaries.

IFRS7 requires a sensitivity analysis that shows the impact on the Income Statement and on items recognised directly in equity of hypothetical changes of exchange rates in respect of non-functional currency financial assets and liabilities held across the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. All financial assets and liabilities held in the functional currency of the Group's subsidiaries, as well as non-financial assets and liabilities and translation risk, are not included in the analyses. The Group considers a 10 per cent strengthening or weakening of the functional currency against the non-functional currency of its subsidiaries as a reasonably possible change. The impact is calculated with reference to the financial asset or liability held as at the year end, unless this is unrepresentative of the position during the year.

A 10 per cent strengthening of functional currencies against non-functional currencies would result in pre-tax profit being £21 million higher (2006: £9 million lower) and items recognised directly in equity being £211 million higher (2006: £168 million higher). A 10 per cent weakening of functional currencies against non-functional currencies would result in pre-tax profit being £21 million lower (2006: £12 million higher) and items recognised directly in equity being £243 million lower (2006: £204 million lower).

The exchange sensitivities on items recognised directly in equity relates to hedging of certain net asset currency positions in the Group, where the compensating effect is not included above as it arises on non-financial assets, as well as cash flow hedges in respect of future transactions and debt.

Interest rate risk

The objectives of the Group's interest rate risk management policy are to lessen the impact of adverse interest rate movements on the earnings, cash flow and economic value of the Group, and to safeguard against any possible breach of its financial covenants. Additional objectives are to minimise the cost of hedging and the associated counterparty risk.

The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of 4.5. The Group targets gross interest cover to be between 5 and 9.

In order to manage its interest rate risk, the Group maintains both floating rate and fixed rate debt. The Group sets targets (within overall guidelines) for the desired ratio of floating to fixed rate debt on both a gross (50:50 +/- 10) and net (at least 50 per cent fixed in the short to medium term) basis as a result of regular reviews of market conditions and strategy by Treasury and the Board of the main central finance company. At 31 December 2007, the relevant ratios of floating to fixed rate borrowings were 53:47 (2006: 58:42) on a gross basis and 33:67 (2006: 34:66) on a net basis. Underlying borrowings are arranged on both a fixed rate and a floating rate basis and, where appropriate, the Group uses derivatives, primarily interest rate swaps, to vary the fixed and floating mix. The interest rate profile of liquid assets is taken into account in determining the net interest rate exposure.

IFRS7 requires a sensitivity analysis that shows the impact on the Income Statement and on items recognised directly in equity of hypothetical changes of interest rates in respect of financial assets and liabilities of the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. For the purposes of these sensitivity analyses, financial assets and liabilities with fixed interest

rates are not included. The Group considers a 100 basis point change in interest rates a reasonably possible change. The impact is calculated with reference to the financial asset or liability held as at the year end, unless this is unrepresentative of the position during the year.

A 100 basis point increase in interest rates would result in pre-tax profit being £28 million lower (2006: £26 million lower) and items recognised directly in equity being £1 million higher (2006: £1 million lower). A 100 basis point decrease in interest rates would result in pre-tax profit being £28 million higher (2006: £26 million higher) and items recognised directly in equity being £1 million lower (2006: £1 million higher).

Credit risk

The Group has no significant concentrations of customer credit risk. Subsidiaries have policies in place requiring appropriate credit checks on potential customers before sales commence. The process for monitoring and managing credit risk once sales to customers have been made varies depending on local practice in the countries concerned.

Certain territories have bank guarantees, other guarantees and credit insurance provided in the Group's favour in respect of Group trade receivables, the issuance and terms of which are dependent on local practices in the countries concerned.

Cash deposits and other financial instruments give rise to credit risk on the amounts due from the related counterparties. Generally the Group targets a long term counterparty credit rating of at least A/A2 however the Group recognises that due to the need to operate over a large geographic footprint, sovereign risk can be the determining factor on the suitability of a counterparty. From time to time the Group may invest in short dated corporate commercial paper; for this the Group has identified specific counterparties with a minimum short term rating of A1/P1.

Counterparty credit risk is managed on a global basis by limiting the aggregate amount and duration of exposure to any one counterparty, taking into account its credit rating. The credit ratings of all counterparties are reviewed regularly.

The Group ensures that it has sufficient counterparty credit capacity of requisite quality to undertake all anticipated transactions throughout its geographic footprint while at the same time ensuring that there is no geographic concentration in the location of counterparties.

The maximum exposure to the credit risk of financial assets at the balance sheet date is reflected by the carrying values included in the Group's Balance Sheet. In addition, the Group has issued guarantees to third parties, part of which has been recognised on the Balance Sheet in accordance with IAS39. The unrecognised portion of these guarantees amounts to £61 million (2006: £61 million).

Price risk

The Group is exposed to equity price risk on equity investments held by the Group, which are included in available-for-sale investments on the consolidated Balance Sheet, but the quantum of such is not material.

Hedge accounting

In order to qualify for hedge accounting, the Group is required to document prospectively the relationship between the item being hedged and the hedging instrument. The Group is also required to demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is reperformed periodically to ensure that the hedge has remained, and is expected to remain highly effective.

Fair value estimation

Derivative financial instruments

The fair values of derivatives are determined based on market data (primarily yield curves, implied volatilities and exchange rates) to calculate the present value of all estimated flows associated with each derivative at the balance sheet date. In the absence of sufficient market data, fair values would be based on the quoted market price of similar derivatives.

Other financial instruments

The fair values of financial assets and liabilities with maturities of less than one year are assumed to approximate to their book values. For financial assets and liabilities with maturities of more than one year, fair values are based on quoted market prices, market prices of comparable instruments at the balance sheet date or discounted cash flow analysis.

25 Cash flow

Cash generated from operations

	2007 £m	2006 £m
Profit before taxation	3,078	2,764
Adjustments for		
– share of post-tax results of associates and joint ventures	(442)	(431)
– net finance costs	269	289
– gains on disposal of businesses and brands	(75)	(60)
– depreciation and impairment of property, plant and equipment	293	367
– amortisation and write off of intangible assets	43	34
– decrease in inventories	170	21
– increase in trade and other receivables	(83)	(105)
– increase in trade and other payables	61	57
– decrease in net retirement benefit liabilities	(120)	(69)
– decrease in provisions for liabilities and charges	(16)	(68)
– other	3	17
Cash generated from operations	3,181	2,816

Profit before taxation includes charges in respect of Group restructuring costs referred to on page 103 in note 3(e). These are also reflected in the movements in depreciation, amortisation, inventories, receivables, payables and provisions above, and in the proceeds on disposal of property, plant and equipment shown on page 90. The cash outflow in respect of the Group restructuring costs was £170 million (2006: £177 million), of which £190 million (2006: £220 million) is included in cash generated from operations above.

Cash flows from investing activities

(a) Proceeds on disposals of intangibles

The cash inflow in 2007 reflects the sale of the pipe tobacco trademarks, while the cash inflow in 2006 reflects the trademark transfer agreements with Philip Morris (page 103 note 3(f)).

(b) Purchases and disposals of investments

Purchases and disposals of investments (which comprise available-for-sale investments and loans and receivables) include an inflow in respect of current investments of £65 million for the year to 31 December 2007 (2006: £41 million outflow) and £6 million sales proceeds from non-current investments for the year to 31 December 2007 (2006: £4 million).

(c) Purchases of subsidiaries and minority interests

In 2007, the cash outflow reflects the acquisition of minority interests in the Group's subsidiaries in Africa and Middle East, Europe and Asia-Pacific. In 2006, the cash outflow principally reflects the cost of acquiring minority interests in the Group's Chilean subsidiary (page 109 note 9).

(d) Proceeds on disposal of subsidiaries

In 2007, the cash inflow principally reflects the proceeds on the Group's disposal of its Belgian cigar factory and associated brands. In 2006, the proceeds principally reflect the sale of Toscano in Italy (page 103 note 3(f)).

Cash flows from financing activities

(a) In 2007, reductions in borrowings principally reflect the repayment of MYR450 million medium term notes along with repayment of bank loans, whilst new borrowings principally reflect MYR400 million medium term notes and MYR100 million commercial papers. In addition, €800 million of €1.7 billion bonds with a maturity of 2009 were replaced by €1 billion bonds with a maturity of 2017.

In 2006, reductions in borrowing principally reflect repayment of €1 billion floating rate notes, a deutschmark 1 billion Eurobond and a €500 million Eurobond, whilst new borrowings principally reflected €600 million Eurobonds with a 2014 maturity, £325 million Eurobonds with a 2016 maturity and €525 million floating rate notes with a 2010 maturity.

(b) The movement relating to derivative financial instruments is in respect of derivatives taken out to hedge cash and cash equivalents and external borrowings, derivatives taken out to hedge inter-company loans and derivatives treated as net investment hedges. Derivatives taken out as cash flow hedges in respect of financing activities are also included in the movement relating to derivative financial instruments, while other such derivatives in respect of operating and investing activities are reflected along with the underlying transactions.

26 Disposals of businesses and assets

(a) As described on page 103 in note 3(f), the Group agreed to sell its pipe tobacco trademarks on 20 February 2007, sold its Belgian cigar factory and associated brands on 3 September 2007, and on 1 October 2007 agreed to terminate its Chesterfield license agreement with Philip Morris in a number of countries in Southern Africa. During 2006, the Group's Italian subsidiary sold its cigar business on 19 July, while a cigarette trademark transfer agreement with Philip Morris for some brands in certain countries was completed on 29 November.

(b) At 31 December 2007, the Group had non-core assets in various locations being actively marketed for sale, comprising plant, property and equipment of £30 million, inventories of £3 million and other assets of £3 million. These assets are expected to be sold during 2008. Trade and other payables of £2 million have been shown as liabilities directly associated with assets held for sale. The effect of the reclassification of these assets and liabilities on reported segments is shown on page 98 note 2.

27 Share-based payments

During the period ended 31 December 2007, the following material share-based payment arrangements existed, which are described below:

Type of arrangement	Long Term Incentive Plan	Deferred Share Bonus Scheme	Sharesave Scheme	Share Option Scheme	Share Reward Scheme
Timing of grant	2007 – March and May (2006: March)	Annually in March	Annually in November	See note (a)	Annually in April
Number of options/shares granted in 2007	March – 2,123,478 May – 658,054	2,315,410	3 year – 108,351 5 year – 142,511	n/a	240,641
Number of options/shares granted in 2006	2,712,841	1,835,223	3 year – 126,844 5 year – 154,664	n/a	334,738
Fair value per share for 2007 grant	March – £10.47 May – £10.72	£13.82	3 year – £4.25 5 year – £4.57	n/a	£15.76
Fair value per share for 2006 grant	£10.10	£13.00	3 year – £3.65 5 year – £3.91	n/a	£13.85
Method of settlement	Both equity and cash-settled grants	Both equity and cash-settled grants	Both equity and cash-settled Equity	grants	Equity
Contractual life	10 years	3 years	3.5 or 5.5 years	10 years	3 years
Vesting conditions	See note (b)	See note (c)	See note (d)	See note (e)	See note (f)

Notes:

(a) The granting of options under this scheme ceased with the last grant made in March 2004. Eligible individuals are entitled to participate in the Long Term Incentive Plan and Deferred Share Bonus Scheme.

(b) Nil-cost options exercisable three years from date of grant, with payout subject to performance conditions based on earnings per share relative to inflation (50 per cent of grant) and total shareholder return, combining the share price and dividend performance of the Company by reference to two comparator groups (50 per cent of grant). Participants are not entitled to dividends prior to the exercise of the options. For grants made in 2005 and thereafter, a cash equivalent dividend will accrue through the vesting period and will be paid on vesting.

(c) Free shares released three years from date of grant and may be subject to forfeit if participant leaves employment before the end of the three year holding period. Participants receive a separate payment equivalent to a proportion of the dividend during the holding period.

(d) Options granted by invitation at a 20 per cent discount to the market price. Options are exercisable at the end of a three year or five year savings contract. Participants are not entitled to dividends prior to the exercise of the options.

(e) Options exercisable three years from date of grant and subject to earnings per share performance condition relative to inflation. Participants are not entitled to receive dividends in the period prior to the exercise of the options.

(f) Free shares granted (maximum £3,000 in any year) subject to a three year holding period and may be subject to forfeit if the employee leaves within this period. Participants are entitled to receive dividends during the holding period which are reinvested to buy further shares.

During the period, the Company operated a Partnership Share Scheme, which was open to all eligible employees, where employees can allocate part of their pre-tax salary to purchase shares in British American Tobacco p.l.c. The maximum amount that can be allocated in this way to any individual is £1,500 in any tax year. The shares purchased are held in a UK-based trust and are normally capable of transfer to participants tax free after a five year holding period.

Further details on the operation of share-based payment arrangements can be found in the Remuneration Report.

Share option schemes

Details of the movements for equity-settled share option schemes during the years ended 31 December 2007 and 31 December 2006 covering the Share Option and Sharesave Schemes were as follows:

	2007		2006	
	Number of options	Weighted average exercise price per share £	Number of options	Weighted average exercise price per share £
Outstanding at start of year	8,449,681	6.86	12,648,695	6.39
Granted during the period	250,862	14.35	281,508	11.52
Exercised during the period	(3,806,566)	6.73	(4,234,650)	5.75
Forfeited during the period	(297,967)	7.85	(245,872)	7.01
Outstanding at end of year	4,596,010	7.32	8,449,681	6.86
Exercisable at end of year	3,440,746	6.44	3,626,882	5.55

In addition to the above options, the movement in nil-cost equity-settled options from the Long Term Incentive Plan was as follows:

	2007	2006
	Number of options	Number of options
Outstanding at start of year	8,108,255	9,403,252
Granted during the period	2,324,409	2,224,313
Exercised during the period	(2,439,044)	(2,478,316)
Forfeited during the period	(316,591)	(1,040,994)
Changed to cash-settled share-based payment arrangement*	(354,984)	
Outstanding at end of year	7,322,045	8,108,255
Exercisable at end of year	921,841	922,014

*During 2007, equity-settled awards in respect of 300,107 options were modified to a cash-settled basis, while a further 54,877 options were replaced by cash-settled awards.

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the period was £16.03 (2006: £13.94). A detailed breakdown of the range of exercise prices for options outstanding for the years ended 31 December 2007 and 31 December 2006 is shown in the table below:

Range of exercise prices	2007			2006		
	Number outstanding at end of year	Weighted average contractual life in years	Weighted average exercise price per share £	Number outstanding at end of year	Weighted average contractual life in years	Weighted average exercise price per share £
Nil-cost	7,322,045	7.8	n/a	8,108,255	7.8	n/a
£2.53 to £4.99	287,606	2.0	3.16	389,805	2.0	3.19
£5.00 to £6.99	1,960,056	3.6	5.84	3,908,880	4.1	5.74
£7.00 to £8.99	1,588,218	5.0	7.72	3,488,622	6.4	7.83
£9.00 to £12.49	509,268	3.0	10.61	662,374	3.9	10.51
£12.50 to £14.49	250,862	4.6	14.35			
	11,918,055	6.2	2.82	16,557,936	6.4	3.50

The weighted average fair value of equity-settled share option schemes' shares granted during 2007 was £9.94 (2006: £9.39).

Assumptions used in the Black-Scholes models to determine the fair value of share options at grant date were as follows:

	2007		2006	
	Long Term Incentive Plan*	Sharesave Schemes**	Long Term Incentive Plan	Sharesave Schemes**
Share price at date of grant (£)	15.41/15.69	17.94	14.34	14.40
Exercise price (£)	nil-cost	14.35	nil-cost	11.52
Expected volatility (%)	21/20	18	23	21
Average expected term to exercise (years)	3.5	3.2/5.2	3.5	3.2/5.2
Risk-free rate (%)	5.1/5.5	4.4/4.5	4.4	4.9/4.8
Expected dividend yield (%)	4.1/4.0	3.5	3.3	3.4

*Where two figures have been quoted for the Long Term Incentive Plan, the first number represents the March 2007 award and the second number the May 2007 award.

**Where two figures have been quoted for the Sharesave Schemes, the first number represents the assumptions for the three year savings contract and the second number for the five year savings contract.

Market condition features were incorporated into the Monte-Carlo models for the total shareholder return elements of the Long Term Incentive Plan, in determining fair value at grant date. Assumptions used in these models were as follows:

	2007	2006
	%	%
Average share price volatility FTSE 100 comparator group	28	31
Average share price volatility FMCG comparator group	21	23
Average correlation FTSE 100 comparator group*	27/28	26
Average correlation FMCG comparator group	18	18

*Where two figures have been quoted for the Long Term Incentive Plan, the first number represents the March 2007 award and the second number the May 2007 award.

The expected British American Tobacco p.l.c. share price volatility was determined taking account of the daily share price movements over a five year period. The respective FMCG and FTSE 100 share price volatility and correlations were also determined over the same periods. The average expected term to exercise used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural conditions, forfeiture and historical experience.

The risk-free rate has been determined from market yield curves for government gilts with outstanding terms equal to the average expected term to exercise for each relevant grant. The expected dividend yield was determined by calculating the yield from the last two declared dividends divided by the grant share price, adjusted for the Group's announced change in dividend policy.

For grants containing earnings per share performance conditions, the payout calculation is based on the expectations published in analysts' forecasts.

Other equity share-based payment arrangements (other than share options)

Details of the movements of other equity share-based payment arrangements during the years ended 31 December 2007 and 31 December 2006, covering the Deferred Share Bonus and Share Reward Schemes, were as follows:

	2007	2006
	Number of	Number of
	shares	shares
Outstanding at start of year	5,833,871	7,001,271
Granted during the period	2,302,001	1,959,868
Exercised during the period	(2,162,432)	(3,037,981)
Forfeited during the period	(68,004)	(89,287)
Changed to cash-settled share-based payment arrangement*	(292,276)	
Outstanding at end of year	5,613,160	5,833,871
Exercisable at end of year	437,703	383,294

*During 2007, equity-settled awards in respect of 235,819 shares were modified to a cash-settled basis, while a further 56,457 shares were replaced by cash-settled awards.

The shares outstanding for the year ended 31 December 2007 had a weighted average contractual life of 1.2 years (2006: 1.1 years).

The fair value for other equity share-based payment arrangements granted during the period was determined using the Black-Scholes model with the following input assumptions at their grant date:

	2007		2006	
	Deferred Share Bonus Scheme	Share Reward Scheme	Deferred Share Bonus Scheme	Share Reward Scheme
Grant price (£)	15.41	15.76	14.34	13.85
Expected volatility (%)	21	21	23	23
Average expected term to exercise (years)	3.0	5.0	3.0	5.0
Risk-free rate (%)	5.1	5.0	4.4	4.5
Expected dividend yield (%)	4.1	4.0	3.3	3.4

The weighted average fair value of other equity share-based payment arrangements granted during 2007 was £14.02 (2006: £13.14).

Cash-settled share-based payment arrangements

The Group issues to certain employees cash-settled share-based payments that require the Group to pay the intrinsic value of these share-based payments to the employee at the date of exercise. The Group has recorded liabilities at the end of 2007 of £28 million (2006: £14.3 million) of which £6.3 million (2006: £3.5 million) was in respect of vested grants. Fair value was determined from the Black-Scholes and Monte-Carlo models, using assumptions revised at the balance sheet date for cash-settled share-based payment arrangements. The Group recorded total expenses of £23.9 million in 2007 (2006: £9.3 million).

Details of movements for cash-settled arrangements in respect of the Share Option Scheme during the years ended 31 December 2007 and 31 December 2006, were as follows:

	2007		2006	
	Number of options	Weighted average exercise price per share £	Number of options	Weighted average exercise price per share £
Outstanding at start of year	431,280	6.69	1,057,496	6.40
Granted during the period	n/a	n/a	n/a	n/a
Exercised during the period	(129,317)	6.86	(605,634)	6.19
Forfeited during the period	(6,632)	6.39	(20,582)	6.69
Outstanding at end of year	295,331	6.63	431,280	6.69
Exercisable at end of year	295,331	6.63	313,101	6.17

In addition to the above, the movement in other nil-cost cash-settled arrangements during the years ended 31 December 2007 and 31 December 2006, covering the Long Term Incentive Plan and Deferred Share Bonus Scheme, were as follows:

	2007	2006
	Number of shares	Number of shares
Outstanding at start of year	1,614,706	1,215,861
Granted during the period	711,173	698,621
Exercised during the period	(591,471)	(239,513)
Forfeited during the period	(102,840)	(60,263)
Changed from equity-settled share-based arrangement*	647,260	
Outstanding at end of year	2,278,828	1,614,706
Exercisable at end of year	125,406	63,934

*As explained in the sections for share option schemes and other equity share-based payment arrangements above, during 2007 awards in respect of 647,260 shares were changed from an equity-settled to a cash-settled basis.

Assumptions used to determine the fair value of cash-settled share-based payment arrangements at date of grant, can be found in the sections relating to share option schemes and other equity share-based payment arrangements.

The weighted average British American Tobacco p.l.c. share price at the date of exercise for cash-settled share-based arrangements exercised during the period was £16.37 (2006: £14.05). A detailed breakdown of the range of exercise prices for cash-settled share-based payment arrangements outstanding for the years ended 31 December 2007 and 31 December 2006 are shown in the table below:

Range of exercise prices	2007			2006		
	Number outstanding at end of year	Weighted average contractual life in years	Weighted average exercise price per share £	Number outstanding at end of year	Weighted average contractual life in years	Weighted average exercise price per share £
Nil-cost	2,278,828	5.6	n/a	1,614,706	6.1	n/a
£5.60 to £5.98	120,844	5.0	5.96	163,481	6.1	5.97
£6.39 to £8.09	174,487	5.0	7.09	267,799	6.0	7.14
	2,574,159	5.5	0.76	2,045,986	6.1	1.41

Share-based payment expense

The amounts recognised in the Income Statement in respect of share-based payments were as follows:

	2007 £m	2006 £m
Equity-settled share-based payments	37	41
Cash-settled share-based payments	24	9
Total amount recognised in the Income Statement <i>page 101 note 3(a)</i>	61	50

As explained in the sections for share option schemes and other equity share-based payment arrangements, during 2007 certain awards were changed from an equity-settled to a cash-settled basis. The fair value of the old and new awards were calculated using the valuation basis set out in the relevant sections of this note and the British American Tobacco p.l.c. share price at the date of the change. This resulted in a net incremental charge of £3.2 million, which was reflected in a £6.4 million increase in the expense for cash-settled payments and a £3.2 million decrease in the expense for equity-settled payments. The other main cause of the higher charge for cash-settled payments in 2007 is the increase in the British American Tobacco p.l.c. share price over the year.

28 Group employees

The average number of persons employed by the Group and its associates during the year, including Directors, was 97,696 (2006: 97,431).

	2007 Number	2006 Number
Europe	18,913	18,953
Asia-Pacific	10,334	10,128
Latin America	15,009	14,941
Africa and Middle East	7,807	8,993
America-Pacific	1,844	2,130
Subsidiary undertakings	53,907	55,145
Associates	43,789	42,286
	97,696	97,431

Details of Directors' remuneration, share options and retirement benefits are given in the Remuneration Report on pages 58 to 75.

Included within the employee numbers for Europe are certain employees in the UK in respect of central functions. Some of the costs of these employees are allocated or charged to the various regions and markets in the Group.

29 Related party disclosures

The Group has a number of transactions and relationships with related parties, as defined in IAS 24 on related party disclosures, all of which are undertaken in the normal course of trading. Details of these are set out below.

Transactions and balances with associates relate mainly to the sale and purchase of cigarettes and tobacco leaf. Amounts receivable from associates in respect of dividends included in the table below were £53 million (2006: £48 million). The Group's share of dividends from associates included in other net income in the table below, was £290 million (2006: £267 million). Legal fees recovered from Reynolds American Inc. included in other net income amounted to £1 million (2006: £2 million).

	2007	2006
	£m	£m
Transactions		
– revenue	32	35
– purchases	(275)	(292)
– other net income	292	272
Amounts receivable at 31 December	67	58
Amounts payable at 31 December	(37)	(24)

As discussed on page 103 in note 3(f), the Group completed the sale of its Belgian cigar factory and associated brands to the cigars division of Skandinavisk Tobakskompagni AS on 3 September 2007. The gain on disposal is not included in the above table.

The key management personnel of British American Tobacco consist of the members of the Board of Directors of British American Tobacco p.l.c. and the members of the Management Board. No such person had any material interest during the year in a contract of significance (other than a service contract) with the Company or any subsidiary company. The term key management personnel in this context includes the respective members of their households.

	2007	2006
	£m	£m
The total compensation for key management personnel, including Directors, was:		
– salaries and other short term employee benefits	14	14
– post-employment benefits	4	3
– share-based payments	7	6
	25	23

There were no other long term benefits applicable in respect of key personnel. The above table includes termination benefits paid during the year of £1.2 million (2006: £0.9 million).

Other than in their capacity as shareholders, there have been no material transactions with Compagnie Financière Richemont SA and Remgro Limited, who together indirectly own 29.95 per cent (2006: 29.2 per cent) of the ordinary share capital of British American Tobacco p.l.c. at 31 December 2007.

30 Contingent liabilities and financial commitments

The Group is subject to contingencies pursuant to requirements that it complies with relevant laws, regulations and standards. Failure to comply could result in restrictions in operations, damages, fines, increased tax, increased cost of compliance, reputational damage, or other sanctions. These matters are inherently difficult to quantify.

In cases where the Group has an obligation as a result of a past event existing at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and the amount of the obligation can be reliably estimated, a provision would be recognised based on best estimates and management judgement.

There are, however, contingent liabilities in respect of litigation, taxes in some countries and guarantees for which no provisions were made.

The Group has exposures in respect of the payment or recovery of a number of taxes. The Group is and has been subject to a number of tax audits covering amongst others, excise tax, value added taxes, sales taxes, corporate taxes, withholding taxes and payroll taxes.

The estimated costs of known tax obligations have been provided in these accounts in accordance with the Group's accounting policies. In some countries, tax law requires that full or part payment of disputed tax assessments be made pending resolution of the dispute. To the extent that such payments exceed the estimated obligation, they would not be recognised as an expense. In some cases disputes are proceeding to litigation.

While the amounts that may be payable or receivable could be material to the results or cash flows of the Group in the period in which they are recognised, the Board does not expect these amounts to have a material effect on the Group's financial condition.

Product liability litigation

Group companies, notably Brown & Williamson Holdings, Inc. (formerly Brown & Williamson Tobacco Corporation) (B&W), as well as other leading cigarette manufacturers, are defendants, principally in the US, in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

Indemnity

On 30 July 2004, B&W completed transactions combining its US tobacco business assets, liabilities and operations with R.J. Reynolds Tobacco Company. A new company called R.J. Reynolds Tobacco Company (RJRT) was created as a result of the combination transactions. These transactions (the Business Combination) were accomplished through Reynolds American Inc. (RAI), which is a publicly traded holding company and the indirect parent corporation of RJRT. As a result of the Business Combination: (a) B&W discontinued the active conduct of any tobacco business in the US; (b) B&W contributed to RJRT all of its assets other than the capital stock of certain subsidiaries engaged in non-US businesses and other limited categories of assets; (c) RJRT assumed all liabilities of B&W (except liabilities to the extent relating to businesses and assets not contributed by B&W to RJRT and other limited categories of liabilities) and contributed subsidiaries or otherwise to the extent related to B&W's tobacco business as conducted in the US on or prior to 30 July 2004; and (d) RJRT agreed to indemnify B&W and each of its affiliates (other than RAI and its subsidiaries) against, among other matters, all losses, liabilities, damages, expenses, judgments, attorneys' fees, etc, to the extent relating to or arising from such assumed liabilities or the assets contributed by B&W to RJRT (the RJRT Indemnification). The scope of the RJRT Indemnification includes all expenses and contingent liabilities in connection with litigation to the extent relating to or arising from B&W's US tobacco business as conducted on or prior to 30 July 2004, including smoking and health tobacco litigation, whether the litigation is commenced before or after 30 July 2004 (the tobacco litigation).

Pursuant to the terms of the RJRT Indemnification, RJRT is liable for any possible judgments, the posting of appeal bonds or security, and all other expenses of and responsibility for managing the defence of the tobacco litigation. RJRT has assumed control of the defence of the tobacco litigation involving B&W and RJRT is also a party in most (but not all) of the same cases. Accordingly, RJRT uses or plans to use the same law firm or firms to represent both B&W and RJRT in any single or similar case (except in certain limited circumstances) as RJRT's interests are typically aligned with B&W's interests, and RJRT has substantial experience in managing recognised external legal counsel in defending the tobacco litigation, and external counsel have independent professional responsibilities to represent the interests of B&W. In addition, in accordance with the terms of the RJRT Indemnification, affiliates of B&W have retained control of the defence in certain tobacco litigation cases with respect to which such affiliates are entitled to indemnification.

US litigation

The total number of US product liability cases pending at 31 December 2007 involving B&W and/or other Group companies was approximately 3,323 (2006: 3,492). At 31 December 2007, UK-based Group companies have been named as co-defendants in six of those cases (2006: seven). In 2007, only one case was tried against B&W, and it resulted in a defence verdict. That case, Menchinini, was an individual case

brought by a flight attendant who was a member of the Broin class action (see below). No US cases involving the UK-based Group companies were tried in 2007. Approximately six cases where B&W is a defendant are currently scheduled for trial in 2008, some involving amounts ranging possibly into the hundreds of millions and even billions of dollars. No case in which a UK-based Group company is a defendant is currently scheduled for trial in 2008.

Since many of these pending cases seek unspecified damages, it is not possible to quantify the total amounts being claimed, but the aggregate amounts involved in such litigation are significant. The cases fall into four broad categories:

(a) Medical reimbursement cases

These civil actions seek to recover amounts spent by government entities and other third party providers on healthcare and welfare costs claimed to result from illnesses associated with smoking. Although B&W continues to be a defendant in healthcare cost recovery cases involving plaintiffs such as hospitals and Native American tribes, the vast majority of such cases have been dismissed on legal grounds. At 31 December 2007, one reimbursement suit was pending against B&W by an Indian tribe in Indian tribal court in South Dakota, and no suits were pending against B&W by county or other political subdivisions of the states. The Master Settlement Agreement (MSA) with the 46 states includes a credit for any amounts paid in suits brought by the states' political subdivisions; nevertheless, RJRT intends to defend and is defending these cases vigorously. Based on somewhat different theories of claim are two non-governmental medical reimbursement cases and health insurers' claims. One third party reimbursement case (City of St. Louis), consists of more than 60 public and non-profit hospitals in Missouri seeking reimbursement of past and future alleged smoking related healthcare costs. A trial date for this case has been set for 11 January 2010.

B&W was named as a defendant in two cases brought by foreign government entities in a single US court (Republic of Panama and State of São Paulo) seeking reimbursement of medical costs which they incurred for treatment for persons in their own countries who are alleged to have smoked imported cigarettes, including those manufactured by B&W. These two cases, originally filed in state court in Louisiana, were consolidated and then dismissed by the trial court on the basis that Louisiana was the inappropriate forum. These plaintiffs filed new cases in the Superior Court for the State of Delaware on 19 July 2005. On 13 July 2006, the Delaware Superior Court granted defendants' motion to dismiss. Plaintiffs filed notices of appeal to the Supreme Court of Delaware on 19 July 2006, and that Court affirmed the dismissal of plaintiffs' claims on 23 February 2007.

(b) Class actions

At 31 December 2007, B&W was named as a defendant in some 12 (2006: 15) separate actions attempting to assert claims on behalf of classes of persons allegedly injured or financially impacted through smoking or where classes of tobacco claimants have been certified. Even if the classes remain certified and the possibility of class-based liability is eventually established, it is likely that individual trials will still be necessary to resolve any actual claims. Class-action suits have been filed in a number of states against individual cigarette manufacturers and their parent corporations, alleging that the use of the terms 'lights' and 'ultralights' constitutes unfair and deceptive trade practices. A class action complaint (Schwab) was filed in the US District Court for the Eastern District of New York on 11 May 2004 against several defendants, including B&W and certain UK-based Group companies. The complaint challenges the defendants' practices with respect to the marketing, advertising, promotion and sale of 'light' cigarettes. The court granted plaintiffs' motion for class certification on 25 September 2006. By order dated 17 November 2006, the Second Circuit Court of Appeals granted defendants' motion to stay the district court proceedings in this case, and further granted defendants' petition for leave to appeal the district court's class certification order. Briefing on the appeal was completed on 31 January 2007, and oral argument was heard on 10 July 2007. A decision on the appeal remains pending. Other types of class-action suits assert claims on behalf of classes of individuals who claim to be addicted, injured, or at greater risk of injury by the use of tobacco or exposure to environmental tobacco smoke, or the legal survivors of such persons.

In Engle (Florida), one jury awarded a total of US\$12.7 million to three class representatives, and in a later stage of this three phase trial process, a jury assessed US\$17.6 billion in punitive damages against B&W. In November 2000, B&W posted a surety bond in the amount of US\$100 million (the amount required by Florida law) to stay execution of this punitive damages award. On 21 May 2003, the intermediate appellate court reversed the trial court's judgment and remanded the case to the trial court with instructions to decertify the class. On 16 July 2003, plaintiffs filed a motion for rehearing which was denied on 22 September 2003. On 12 May 2004, the Florida Supreme Court agreed to review this case and, on 6 July 2006, it upheld the

intermediate appellate court's decision to decertify the class, and vacated the jury's punitive damages award. By an order dated 17 April 2007, the surety bond for the punitive damages was released and the US\$100 million collateral securing that bond was returned to B&W. Further, the Florida Supreme Court permitted the judgments entered for two of the three Engle class representatives to stand, but dismissed the judgment entered in favour of the third Engle class representative. Finally, the Court has permitted putative Engle class members to file individual lawsuits against the Engle defendants within one year of the Court's decision (subsequently extended to 11 January 2008). The Court's order precludes defendants from litigating certain issues of liability against the putative Engle class members in these individual actions. On 7 August 2006, defendants filed a motion for rehearing before the Florida Supreme Court, which was granted in part, and denied in part, on 21 December 2006. The Florida Supreme Court's 21 December 2006 ruling did not amend any of the earlier decisions' major holdings, which included decertifying the class, vacating the punitive damages judgment, and permitting individual members of the former class to file separate suits. Instead, the ruling addressed the claims on which the Engle jury's phase one verdict will be applicable to the individual lawsuits that were permitted to stand. On 1 October 2007, the United States Supreme Court denied defendants' request for certiorari review of the Florida Supreme Court's decision. At 31 December 2007, more than 1,700 plaintiffs had filed lawsuits as purported Engle class members, and 43 of these suits name B&W as a defendant. All 43 suits against B&W, however, are individual smoker lawsuits that were pending in Florida before the Florida Supreme Court's 6 July 2006 decision, which have been re-classified as individual Engle lawsuits. No lawsuits by purported Engle class members have been filed against B&W after the Florida Supreme Court's 6 July 2006 decision. However, at 31 December 2007, approximately 360 suits named RJRT individually and as successor in interest to B&W, four suits named RJRT only as successor in interest to B&W, and approximately 197 suits named RJRT only in its individual capacity.

In the first 'phase three' trial of an individual Engle class member (Lukacs), the jury awarded the plaintiff US\$37.5 million in compensatory damages (B&W's share: US\$8.4 million). On 1 April 2003, the jury award was reduced to US\$25.125 million (B&W's share: US\$5.65 million) but no final judgment has been entered to date because the Court postponed the entry of final judgment until the Engle appeal was fully resolved. On 12 October 2007, plaintiff filed notice of completion of all appellate review to the trial court. Once final judgment is entered, defendants intend to pursue an appeal.

In a Louisiana medical monitoring case brought on behalf of Louisiana smokers (Scott), on 28 July 2003, the jury returned a verdict in defendants' favour on the medical monitoring claim but made findings against defendants with respect to claims relating to fraud, conspiracy, marketing to minors and smoking cessation. On 21 May 2004, the jury returned a verdict in the amount of US\$591 million on the class's claim for a smoking cessation programme. On 1 July 2004, the court upheld the jury's verdict and entered final judgment. On 29 September 2004, defendants posted a US\$50 million bond (legislation in Louisiana limits the amount of a bond to prevent execution upon such a judgment to US\$50 million collectively for signatories to the MSA). RJRT posted US\$25 million (i.e. the portions for RJRT and B&W) towards the bond. On 12 April 2006, the Louisiana Fourth Circuit Court of Appeal heard argument on defendants' appeal. The appellate court issued a decision on 7 February 2007 that affirmed class certification and upheld the smoking cessation programme for certain smokers who began smoking before 1988, but reduced the US\$591 million jury award by US\$312 million and rejected any award of prejudgement interest. The decision also remanded the case to re-determine damages in light of its holding that no class members who started smoking before 1988 were entitled to any monetary damages. All further proceedings in the trial court have been stayed, however, pending further appellate review. Defendants (on 2 April 2007) and plaintiffs (on 13 April 2007) both filed petitions for review by the Louisiana Supreme Court, which the Court denied on 7 January 2008.

(c) Individual cases

Approximately 3,307 cases were pending against B&W at 31 December 2007 (2006: 3,471) filed by or on behalf of individuals in which it is contended that diseases or deaths have been caused by cigarette smoking or by exposure to environmental tobacco smoke (ETS). Of these cases: (a) approximately 75 per cent are ETS cases brought by flight attendants who were members of a class action (Broin) that was settled on terms that allow compensatory but not punitive damages claims by class members; (b) approximately 20 per cent of the individual cases against B&W are cases brought in consolidated proceedings in West Virginia, where the first phase of trial is scheduled to begin on 17 March 2008 and (c) only about 5 per cent are cases filed by other individuals.

Of the individual cases that were decided or remained on appeal during 2007, 3 resulted in verdicts against B&W:

In December 2003, a New York jury (Frankson) awarded US\$350,000 compensatory damages against B&W and two industry organisations. In January 2004, the same jury awarded US\$20 million punitive damages. On 22 June 2004, the trial judge granted a new trial unless the parties agreed to an increase in compensatory damages to US\$500,000 and a decrease in punitive damages to US\$5 million, of which US\$4 million would be assigned to B&W. Plaintiffs agreed to a decrease in punitive damages, but B&W has not agreed to an increase in compensatory damages. On 25 January 2005, B&W appealed to an intermediate New York State appellate court. Oral argument was heard on 8 May 2006. The appellate court affirmed the judgment on 5 July 2006. B&W filed a motion for leave to reargue, or in the alternative, for leave to appeal to the New York Court of Appeals, on 3 August 2006. The intermediate appellate court denied this motion on 5 October 2006. On 8 December 2006, the trial judge granted plaintiff's application for entry of judgment, and granted plaintiff's motion to vacate that part of the 2004 order granting a new trial unless the parties agreed to an increase in compensatory damages to US\$500,000. RJRT posted a bond in the approximate amount of US\$8,018,000 on 3 July 2007. B&W appealed from final judgment on 3 July 2007 to an intermediate New York State appellate court, and its initial appellate brief was submitted on 3 January 2008.

On 1 February 2005, a Missouri jury (Smith) awarded US\$500,000 in compensatory damages against B&W and then, on 2 February 2005, awarded US\$20 million in punitive damages, also against B&W. On 1 June 2005, B&W filed its notice of appeal. B&W filed its opening appellate brief on 28 April 2006. Oral argument was heard on 31 August 2006. On 31 July 2007, an intermediate Missouri appellate court affirmed the compensatory damages award, but it reversed the punitive damages award, reasoning that plaintiff failed to produce sufficient evidence to justify the verdict. The court remanded the case for a second trial, limited to punitive damages.

On 18 March 2005, a New York jury (Rose) awarded US\$1.7 million in compensatory damages against B&W. On 18 August 2005, B&W filed its notice of appeal. RJRT posted a bond in the approximate amount of US\$2.058 million on 7 February 2006. Oral argument on this appeal was heard on 12 December 2006 by an intermediate New York appellate court, which has not yet rendered a decision.

(d) Other claims

The Flintkote Company (Flintkote), a US asbestos production and sales company, was included in the acquisition of Genstar Corporation by Imasco in 1986 and became a Group subsidiary following the restructuring of Imasco Limited (now Imperial Tobacco Canada Limited (Imperial)) in 2000. Soon after this acquisition, and as part of the acquisition plan, Genstar began to sell most of its assets, including the non-asbestos related operations and subsidiaries of Flintkote. The liquidation of Flintkote assets produced cash proceeds and, having obtained advice that sufficient assets would remain to satisfy liabilities, Flintkote and Imasco authorised the payment of two dividends. In 2003, Imperial divested Flintkote and then, in 2004, Flintkote filed for bankruptcy in the United States Bankruptcy Court for the District of Delaware. In 2006, Flintkote, certain representatives of both the present and future asbestos claimants as well as certain individual asbestos claimants were permitted by the bankruptcy court to file a complaint against Imperial and numerous other defendants for the recovery of the dividends and other compensation under various legal theories. The parties are presently engaged in case management discussions to establish the scope and manner of discovery in this case. This litigation is at a preliminary stage and is expected to take a number of years to proceed to trial.

In Wisconsin, the authorities have identified potentially responsible parties to fund the clean up of the Fox River, Wisconsin. The pollution was caused by discharges of toxic material from paper mills operating close to the river. The cost of the clean up work has been estimated to be in the order of US\$600 million. Among the potentially responsible parties are NCR Corporation (NCR) and Appleton Papers Inc. (Appleton) who may be liable for a proportion of the clean up costs. B.A.T Industries p.l.c. (Industries) purchased what was then NCR's Appleton Papers Division from NCR in 1978 and spun off this business in 1990, obtaining full indemnities from Appleton for past and future environmental claims. Disputes between NCR, Appleton and Industries as to the indemnities given and received under the purchase agreement in 1978 have been the subject of arbitration in 1998 and 2006. Under the terms of the arbitration awards, Industries and Appleton have an obligation to share the costs of environmental claims with NCR, but Industries has never been required to pay any sums in this regard because Appleton has paid any sums demanded to date. It is believed that all future environmental liabilities will continue to be met directly by Appleton by self-funding or insurance cover and no demand will be made upon Industries.

Settlement of State Health Care Reimbursement Cases

During 2003, agreement was reached on certain disputed MSA payments relating to MSA calculations based on 1999 and 2000 sales. This agreement resulted in a benefit of £27 million which is excluded from the 2003

costs shown in the consolidated audited annual accounts of the Company for the financial year ended 31 December 2004. In other developments, after an Independent Auditor found that the terms of the MSA were a 'significant factor' in market share losses experienced by signatories to the MSA in 2003, several US tobacco companies, including B&W, asserted their rights under the NPM (or Non-Participating Manufacturer) Adjustment provision of the MSA to recover a payment credit or offset – against their April 2006 payment obligations – for MSA payments made in April 2004 in respect of cigarettes shipped or sold in the US in 2003. The amount at stake exceeds US\$1 billion. The settling states oppose these MSA payment reduction claims and, in late April 2006, began filing motions in MSA courts across the country seeking enforcement of certain MSA provisions and a declaration of the parties' rights under the NPM Adjustment provision of the MSA. Defendants have opposed these motions, arguing that their NPM Adjustment claims must go instead to arbitration. To date, the overwhelming majority of MSA courts to decide these motions have ruled in defendants' favour.

UK-based Group companies

At 31 December 2007, Industries was a defendant in the US in one class action, the Schwab case mentioned previously. In that case, Industries was substituted for the Company as a defendant. British American Tobacco (Investments) Limited (Investments) had been served in one reimbursement case (City of St. Louis), the Department of Justice case (see below), one anti-trust case (Smith, see below), two class actions (Cleary and Schwab) and two individual actions (Eiser and Perry).

Conduct-based claims

On 22 September 1999, the US Department of Justice brought an action in the US District Court for the District of Columbia against various industry members, including RJRT, B&W, Industries and Investments. Industries was dismissed for lack of personal jurisdiction on 28 September 2000. The government sought to recover federal funds expended in providing healthcare to smokers who have developed diseases and injuries alleged to be smoking-related, and, in addition, sought, pursuant to the federal Racketeer Influenced and Corrupt Organizations Act (RICO), disgorgement of profits the government contends were earned as a consequence of a RICO 'enterprise'. On 28 September 2000, the portion of the claim which sought recovery of federal funds expended in providing healthcare to smokers who have developed diseases and injuries alleged to be smoking-related was dismissed. The bench (non-jury) trial of the RICO portion of the claim began on 21 September 2004, and ended on 9 June 2005. On 17 November 2004, the Washington DC Circuit Court of Appeals heard an appeal by the defendants against an earlier district court decision that disgorgement of profits is an appropriate remedy to the RICO violations alleged by the government. On 4 February 2005, the Court of Appeals allowed the appeal, ruling that the government could not claim disgorgement of profits. On 17 October 2005, the US Supreme Court declined to hear the government's appeal in respect of the claim for disgorgement of US\$280 billion of past profits from the US tobacco industry. The disgorgement claim was a centrepiece of the government's claim.

On 17 August 2006, the district court issued its final judgment, consisting of some 1,600 pages of factual findings and legal conclusions. The court found in favour of the government, and against certain defendants, including B&W and Investments. The court also ordered a wide array of injunctive relief, including a ban on the use of 'lights' and other similar descriptors beginning 1 January 2007. Compliance with the court-ordered remedies may cost RJRT and Investments millions of dollars. In addition, the government is seeking the recovery of roughly US\$1.9 million in litigation costs. Defendants filed a motion to stay enforcement of the judgment shortly after the judgment was issued. The court denied defendants' stay motion on 28 September 2006. Defendants, including B&W and Investments, filed their notices of appeal to the Washington DC Circuit Court of Appeals on 11 September 2006, and filed an emergency motion to stay the judgment before the same court on 29 September 2006. On 31 October 2006, the Court of Appeals granted defendants' motion to stay enforcement of the judgment pending the outcome of the appeal. On 10 August 2007, defendants filed their initial appellate briefs to the Court of Appeals. All defendants filed a joint appellate brief, and Investments also filed its own brief which raised the issue of whether Congress intended for RICO to apply to extraterritorial conduct by a foreign defendant. On 19 November 2007, the government filed its opposition/cross-appeal brief. Appellate briefing will be completed in May 2008, but a date for oral argument has not yet been scheduled.

In the Daric Smith case, purchasers of cigarettes in the State of Kansas brought a class action in the Kansas State Court against B&W, Investments and certain other tobacco companies seeking injunctive relief, treble damages, interest and costs. The allegations are that the defendants participated in a conspiracy to fix or maintain the price of cigarettes sold in the US, including the State of Kansas, in violation of the Kansas Restraint of Trade Act. The matter will be defended vigorously.

Product liability outside the United States

At 31 December 2007, active claims against Group companies existed in 18 (2006: 18) countries outside the US but the only countries with more than five active claims were Argentina, Australia, Brazil, Canada, Chile, Italy, and the Republic of Ireland. Recoupment actions are being brought in Argentina, Brazil, Israel, Nigeria, Spain and Saudi Arabia, and there are also three class actions being brought in Brazil.

At 31 December 2007, there were some 3,478 (2006: 1,113) filed individual 'lights' cases in Italy. This is a significant increase from last year due to the filing of 2,230 cases by a single plaintiffs' counsel in one jurisdiction (Pescopagano). Of the 2,230 Pescopagano cases, plaintiffs' lawyer has withdrawn 472 claims currently before the Court, although the Court has not yet confirmed the withdrawal of those cases. Plaintiffs' lawyer has also stated his intention to withdraw the remaining 1,758 cases not yet formally registered. Almost all of the individual 'lights' cases filed in Italy, including Pescopagano, are pending before Justices of the Peace courts. Because of the type of court involved, the most that any individual plaintiff can recover is €1,033. To date, more than 950 (2006: 678) of these cases (not including Pescopagano cases) have been suspended or resulted in decisions given in favour of British American Tobacco Italia S.p.A. There are around 33 (2006: 27) smoking and health cases pending before Italian Civil Courts, filed by or on behalf of individuals in which it is contended that diseases or deaths have been caused by cigarette smoking. There are two (2006: two) labour cases for alleged occupational exposure pending in Italy.

In Canada, the government of the Province of British Columbia brought a claim pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2000 against domestic and foreign 'manufacturers' seeking to recover the plaintiff's costs of health care benefits. The constitutionality of the 2000 Act was challenged by certain defendants and, on 5 June 2003, the British Columbia Supreme Court found the Act to be beyond the competence of the British Columbia legislature and, accordingly, dismissed the government's claim. The government appealed that decision to the British Columbia Court of Appeal which, on 20 May 2004, overturned the lower court's decision and declared the Act to be constitutionally valid. Defendants appealed to the Supreme Court of Canada in June 2004 and that court gave its judgment in September 2005 dismissing the appeals and declaring the Act to be constitutionally valid. The action is now set down for trial in September 2010. The federal government has been enjoined by a Third Party Notice, and has presented a Motion to Strike the claim. The hearing will take place during the week of 3 March 2008. Non-Canadian defendants challenged the personal jurisdiction of the British Columbia Court and those motions were heard in the Supreme Court of British Columbia. On 23 June 2006, the court dismissed all defendants' motions, finding that there is a 'real and substantial connection' between British Columbia and the foreign defendants. Subsequently, defendants were granted leave to appeal. The appeal was dismissed on 15 September 2006. Defendants have filed leave to appeal to the Supreme Court on 10 November 2006. Similar legislation has been enacted, but not yet brought into force, in some other Canadian provinces, and is also being considered by other Canadian provinces. In June 2006, the government of New Brunswick passed the Tobacco Damages and Health Care Costs Recovery Act. It has recently announced that it has hired a consortium of law firms from Canada and the US to represent the Province and file suit.

In addition, there are five class actions and four individual cases in Canada. In the Knight class action, the Supreme Court of British Columbia certified a class of all consumers of cigarettes bearing 'light' or 'mild' descriptors since 1974 manufactured in British Columbia by Imperial. Imperial filed an appeal against the certification which was heard in February 2006. The Appeal Court confirmed the certification of the class but has limited any financial liability, if proved, to the period from 1997. This is a 'lights' class action in which plaintiff alleges that the marketing of light and mild cigarettes is deceptive because it conveys a false and misleading message that those cigarettes are less harmful than regular cigarettes. Although the claim arises from health concerns, it does not seek compensation for personal injury. Instead it seeks compensation for amounts spent on 'light and mild' products and a disgorgement of profits from Imperial. The motion of the federal government to strike out the third party notice issued against them by Imperial was heard in February 2006 and was granted but is currently under appeal by Imperial. A similar 'lights' and 'mild' class action claim has been filed in Newfoundland. Imperial has filed a third party notice against the federal government. The certification hearing took place in September 2007 and is now under advisement.

There are currently two class actions in Quebec. On 21 February 2005, the Quebec Superior Court granted certification. The court certified two classes, which include residents of Quebec who suffered from lung, throat and laryngeal cancer or emphysema, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. In Quebec, there is no right of appeal for a defendant upon certification. Plaintiffs have served a Statement of Claim. This litigation is expected to take several years to proceed to trial. The other class action is an attempt to establish a class claiming for personal injury or damage to property from fires caused by cigarettes that did not automatically extinguish on being dropped or left unattended. Certification of such a class was denied in October 2005. Plaintiffs' appeal was heard on 28/29 January 2008 and judgment is awaited.

In 2007, four Nigerian states (Lagos, Kano, Gombe, and Oyo) and the federal government of Nigeria filed separate health care recoupment actions, each seeking the equivalent of billions of US dollars for costs allegedly incurred by the state and federal governments in treating smoking-related illnesses. The actions are still in the preliminary stages. British American Tobacco (Nigeria) Limited, the Company, and Investments have all been named as defendants in these suits. At 31 December 2007, the British American Tobacco defendants had filed preliminary objections in each of the state cases. British American Tobacco (Nigeria) Limited raised preliminary objections based on, inter alia, lack of standing by plaintiffs, lack of jurisdiction of the courts over plaintiffs' claims, a failure by plaintiffs to prove that defendants' purported misconduct was the proximate cause of plaintiffs' damages and constitutional arguments relating to separation of powers and federalism. Both the Company and Investments raised preliminary objections to personal jurisdiction and service. The courts in Kano and Gombe are scheduled to hear oral argument on defendants' jurisdiction and service objections in early 2008. It is possible that other Nigerian states will file similar lawsuits in the near future.

In Saudi Arabia, there are reports that the Ministry of Health is pursuing a health-care recoupment action in the Riyadh General Court against Saudi tobacco distributors, seeking damages of billions of Saudi Riyals. The identity of the defendants is unclear at this time. At 31 December 2007, no Group company had been served with process. In addition, a separate recoupment action was reportedly filed by the King Faisal Hospital on 30 September 2007 in the Riyadh General Court, naming 'BAT Company Limited' as a defendant. At 31 December 2007, no Group company had been served with process in the action.

Other litigation outside the US

In November 2004, the Royal Canadian Mounted Police (the RCMP) obtained a warrant to search and seize business records and documents at the head office of Imperial in Montreal. The affidavit filed by the RCMP to obtain the search warrant made allegations in relation to the smuggling of cigarettes in Canada between 1989 and 1994, naming Imperial, the Company, Industries and certain former directors and employees. No charges have yet been laid. Imperial believes that it has conducted itself appropriately at all times, but cannot predict the outcome of any such investigation, or whether additional investigations will occur.

Two actions were started in Russia by a minority shareholder in OJSC Company British American Tobacco-Yava (BAT-Yava), a Russian incorporated subsidiary of British American Tobacco Holdings (Russia) B.V. The minority shareholder, Branston Holdings (Branston), issued a claim in Moscow seeking to have a contract between BAT-Yava and its sister company invalidated, and issued another claim in the Stavropol region alleging that certain of the directors of BAT-Yava, and other parties, took various unlawful steps. At first instance, the Moscow Court dismissed the claim and the Stavropol Court ordered the transfer of the case filed there to Moscow. The Stavropol case was duly transferred and after a hearing on the merits on 3 October 2007, the Court dismissed all Branston's claims in full. Branston has now appealed the first instance judgment and there is a hearing scheduled before the Moscow Court of Appeal on 9 April 2008. The Group considers the claim to be without merit and will continue to defend it strenuously.

Conclusion

While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, the Company believes that the defences of the Group companies to all these various claims are meritorious both on the law and the facts, and a vigorous defence is being made everywhere. If an adverse judgment is entered against any of the Group companies in any case, an appeal will be made. Such appeals could require the appellants to post appeal bonds or substitute security in amounts which could in some cases equal or exceed the amount of the judgment. In any event, with regard to US litigation, the Group has the benefit of the RJRT Indemnification. At least in the aggregate, and despite the quality of defences available to the Group, it is not impossible that the results of operations or cash flows of the Group in particular quarterly or annual periods could be materially affected by this and by the final outcome of any particular litigation.

Having regard to all these matters, the Directors (i) do not consider it appropriate to make any provision in respect of any pending litigation and (ii) do not believe that the ultimate outcome of this litigation will significantly impair the financial condition of the Group.

Guarantees

Performance guarantees given to third parties in respect of Group companies were £1 million (2006: £157 million).

Operating leases

Total future minimum lease payments under non-cancellable operating leases comprise leases where payments fall due:

	2007	2006
	£m	£m
Property		
Within one year	55	50
Between one and five years	100	112
Beyond five years	147	167
	302	329
Plant and equipment		
Within one year	21	17
Between one and five years	29	19
	50	36

31 Post balance sheet events

(a) On 22 February 2008, the Group announced that it had won the public tender for Tekel, the Turkish state-owned tobacco company, with a bid of US\$1,720 million. The transaction, financed with a committed bank facility, is subject to regulatory approvals and is expected to be completed later this year. The privatisation only relates to the cigarette assets of Tekel, which principally comprise brands, six factories and tobacco leaf stocks. The privatisation does not include employees and an announcement on employment by the Group is planned nearer to the completion of the transaction, after dialogue with employees and unions.

(b) On 27 February 2008, the Group agreed to acquire 100 per cent of Skandinavisk Tobakskompagni's (ST) cigarette and snus business in exchange for its 32.35 per cent holding in ST and payment of DKK11,384 million in cash. This transaction, which is subject to approval by the European Commission, is being financed through a committed bank facility and completion is anticipated later this year.

(c) On 21 February 2008, the Group's associated company Reynolds American announced that it would receive a payment from Gallaher Limited resulting from the termination of a joint venture agreement. While the payment will be received over a number of years, in the first quarter of 2008 Reynolds American will recognise a pre-tax gain of US\$300 million.

Independent Auditors' Report to the Members of British American Tobacco, p.l.c

We have audited the Group Financial Statements of British American Tobacco p.l.c. for the year ended 31 December 2006 which comprise the Group income statement, the Group statement of changes in total equity, the Group balance sheet, the Group cash flow statement, and the related notes including the principal subsidiary undertakings and the principal associate undertakings. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent Company financial statements of British American Tobacco p.l.c. for the year ended 31 December 2006 and on the information in the Remuneration Report that is described as having been audited.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and Accounts, including the Group financial statements, in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, are set out in the statement of Directors' responsibility in relation to the Financial Statements, included in the Directors' Report.

Our responsibility is to audit the Group Financial Statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the Group Financial Statements give a true and fair view and whether the Group Financial Statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether, in our opinion, the information given in the Directors' Report is consistent with the Group Financial Statements. The information given in the Directors' Report includes that specific information presented in the Operating and Financial Review that is cross referred from the Business review section of the Directors' Report.

In addition, we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the Combined Code 2003 specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and Accounts and consider whether it is consistent with the audited Group Financial Statements. The other information comprises only the Annual Review, the Directors' Report, the Remuneration Report, the Corporate Governance Statement, the five year summary, the quarterly analyses of profit and the parent company Financial Statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group Financial Statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group Financial Statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Group Financial Statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group Financial Statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the Group Financial Statements.

Opinion

In our opinion

- the Group Financial Statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2006 and of its profit and cash flows for the year then ended;
- the Group Financial Statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the Group Financial Statements.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
1 Embankment Place, London

1 March 2007

Group Income Statement for the years ended 31 December 2006 and 31 December 2005

	Notes	2006 £m	2005 restated £m
Gross turnover (including duty, excise and other taxes of £15,427 million (2005: £14,659 million))		25,189	23,984
Revenue	2	9,762	9,325
Raw materials and consumables used		(2,861)	(2,760)
Changes in inventories of finished goods and work in progress		(11)	(2)
Employee benefit costs	3a	(1,554)	(1,557)
Depreciation and amortisation costs	3b	(401)	(383)
Other operating income	3c	181	179
Other operating expenses	3d	(2,494)	(2,382)
Profit from operations	2	2,622	2,420
after (charging)/crediting			
– restructuring costs	3e	(216)	(271)
– (losses)/gains on disposal of a business, brands and joint venture	3f	41	72
Finance income		110	118
Finance costs		(399)	(346)
Net finance costs	4	(289)	(228)
Share of post-tax results of associates and joint ventures	5	431	392
after (charging)/crediting			
– restructuring costs	5		(13)
– US Federal tobacco buy-out	5		(12)
– brand impairments	5	(13)	(29)
– exceptional tax credits and other impairments	5	17	57
Profit before taxation		2,764	2,584
Taxation on ordinary activities	6	(716)	(690)
Profit for the year		2,048	1,894
Attributable to:			
Shareholders' equity		1,896	1,767
Minority interests		152	127
Earnings per share			
Basic	7	92.08p	84.34p
Diluted	7	91.33p	83.66p

All of the activities during both years are in respect of continuing operations. The effect of changes in the Group is given in note 26.

Prior year results have been restated in accordance with the amendment to IAS21 as detailed in note 4.

Notes are shown on pages 78 to 136 and pages 140 to 142.

**Group Statement of Changes in Total Equity for the years ended 31 December 2006 and
31 December 2005**

	Notes	2006 £m	2005 restated £m
Differences on exchange		(685)	425
Cash flow hedges			
– net fair value gains		13	17
– reclassified and reported in net profit		(15)	38
– reclassified as basis adjustments			3
Available-for-sale investments			
– net fair value losses		(2)	(1)
– reclassified and reported in net profit			1
Net investment hedges			
– net fair value gains/(losses)		117	(52)
Tax on items recognised directly in equity	6c	(12)	(41)
Net (losses)/gains recognised directly in equity		(584)	390
Profit for the year <i>page 74</i>		2,048	1,894
Total recognised income for the year		1,464	2,284
– shareholders' equity		1,334	2,128
– minority interests		130	156
Employee share options			
– value of employee services	27	41	42
– proceeds from shares issued		28	30
Dividends and other appropriations			
– ordinary shares	8	(1,008)	(910)
– to minority interests		(137)	(112)
Purchase of own shares			
– held in employee share ownership trusts		(77)	(48)
– share buy-back programme		(500)	(501)
Acquisition of minority interests		(13)	
Other movements		13	17
		(189)	802
Balance 1 January	20	6,877	6,117
Change in accounting policy	24		(42)
		6,877	6,075
Balance 31 December	20	6,688	6,877

The decrease in total equity of £189 million (2005: £802 million increase) comprised £169 million decrease (2005: £754 million increase) in respect of shareholders' funds and £20 million decrease (2005: £48 million increase) in respect of minority interests.

The £42 million charge in the prior year for the change in accounting policy (page 120 note 24) comprised £44 million for the retained earnings and £26 million for hedging reserves less £16 million for available-for-sale reserves, £1 million of which is in respect of minority interests, and £12 million for translation reserves.

The change to the translation reserve and to retained earnings (page 112 note 20) due to the amendment to IAS21 as detailed in note 4 was £3 million at 31 December 2005. Differences on exchange for 2005 have been restated by £4 million, with a corresponding change in net finance costs and consequently profit for the year as shown above.

Notes are shown on pages 78 to 136 and pages 140 to 142.

Group Balance Sheet as at 31 December 2006 and 31 December 2005

	Notes	2006 £m	2005 restated £m
Assets			
Non-current assets			
Intangible assets	9	7,476	7,987
Property, plant and equipment	10	2,207	2,331
Investments in associates and joint ventures	11	2,108	2,193
Retirement benefit assets	12	29	35
Deferred tax assets	13	273	290
Trade and other receivables	14	192	197
Available-for-sale investments	15	24	27
Derivative financial instruments	16	76	87
Total non-current assets		12,385	13,147
Current assets			
Inventories	17	2,056	2,274
Income tax receivable	18	59	81
Trade and other receivables	14	1,568	1,577
Available-for-sale investments	15	128	96
Derivative financial instruments	16	124	86
Cash and cash equivalents	19	1,456	1,790
Total current assets		5,391	5,904
Total assets		17,776	19,051

	Notes	2006 £m	2005 restated £m
Equity			
Capital and reserves			
Share capital		517	524
Share premium, capital redemption and merger reserves		3,886	3,874
Other reserves		419	981
Retained earnings		1,639	1,251
Shareholders' funds		6,461	6,630
after deducting			
– cost of own shares held in employee share ownership trusts		(197)	(182)
Minority interests		227	247
Total equity	20	6,688	6,877
Liabilities			
Non-current liabilities			
Borrowings	21	5,568	5,058
Retirement benefit liabilities	12	435	543
Deferred tax liabilities	13	296	277
Other provisions for liabilities and charges	22	161	261
Trade and other payables	23	146	180
Derivative financial instruments	16	29	19
Total non-current liabilities		6,635	6,338
Current liabilities			
Borrowings	21	1,058	2,202
Income tax payable	18	292	374
Other provisions for liabilities and charges	22	253	234
Trade and other payables	23	2,766	2,883
Derivative financial instruments	16	84	143
Total current liabilities		4,453	5,836
Total equity and liabilities		17,776	19,051

On behalf of the Board

Jan du Plessis, Chairman

1 March 2007

Notes are shown on pages 78 to 136 and pages 140 to 142. The prior year balance sheet has been restated in accordance with the amendment to IAS21 as detailed in note 4 and IFRIC Interpretation 4 as detailed in note 10.

Group Cash Flow Statement for the years ended 31 December 2006 and 31 December 2005

	Notes	2006 £m	2005 £m
Cash flows from operating activities			
Cash generated from operations	25	2,816	2,893
Dividends received from associates		259	193
Tax paid		(713)	(762)
Net cash from operating activities		2,362	2,324
Cash flows from investing activities			
Interest received		119	109
Dividends received from investments		2	1
Purchases of property, plant and equipment		(425)	(381)
Proceeds on disposal of property, plant and equipment		64	41
Purchases of intangibles		(58)	(38)
Proceeds on disposal of intangibles	25	60	74
Purchases and disposals of investments	25	(37)	22
Purchases of subsidiaries and minority interests	25	(101)	(25)
Proceeds on disposal of subsidiaries	25	62	
Purchases of associates	25	(1)	(95)
Net cash from investing activities		(315)	(292)
Cash flows from financing activities			
Interest paid		(389)	(371)
Interest element of finance lease rental payments		(3)	(4)
Capital element of finance lease rental payments		(19)	(41)
Proceeds from issue of shares to Group shareholders		5	6
Proceeds from the exercise of options over own shares held in employee share ownership trusts		23	24
Proceeds from increases in and new borrowings	25	1,365	742
Movements relating to derivative financial instruments	25	142	(33)
Purchases of own shares		(500)	(501)
Purchases of own shares to be held in employee share ownership trusts		(77)	(48)
Reductions in and repayments of borrowings	25	(1,739)	(878)
Dividends paid to shareholders	8	(1,008)	(910)
Dividends paid to minority interests		(139)	(133)
Net cash from financing activities		(2,339)	(2,147)
Net cash flows from operating, investing and financing activities			
		(292)	(115)
Differences on exchange		(96)	49
Decrease in net cash and cash equivalents in the year			
Net cash and cash equivalents at 1 January		1,664	1,730
Net cash and cash equivalents at 31 December	19	1,276	1,664

Notes are shown on pages 78 to 136 and pages 140 to 142.

Notes on the Accounts

1 Accounting policies

Basis of Accounting

The Group accounts have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS.

The 2005 Financial Statements were the Group's first consolidated Financial Statements prepared under IFRS, with a transition date of 1 January 2004. However, as permitted under IFRS, IAS32 and IAS39 on financial instruments were applied from 1 January 2005.

The Financial Statements have been prepared under the historical cost convention except as described in the accounting policy below on financial instruments.

The preparation of the Group accounts requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities at the date of the Financial Statements. The key estimates and assumptions are set out in the accounting policies below, together with the related notes to the accounts.

The most significant items include:

- the exemptions taken under IFRS1 on the first time adoption of IFRS at 1 January 2004 and, in particular, those relating to retirement benefit costs and goodwill on business combinations;
- the review of asset values, especially goodwill, and impairment testing;
- estimation of and accounting for retirement benefit costs;
- estimation of provisions including taxation; and
- definitions of exceptional items and adjusted earnings.

Such estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable in the circumstances and constitute management's best judgement at the date of the Financial Statements. In the future, actual experience may deviate from these estimates and assumptions, which could affect the Financial Statements as the original estimates and assumptions are modified, as appropriate, in the year in which the circumstances change.

Basis of consolidation

The consolidated financial information includes the accounts of British American Tobacco p.l.c. and its subsidiary undertakings, together with the Group's share of the results of its associates and joint ventures.

A subsidiary is an entity controlled by the Group, where control is the power to govern the financial and operating policies of the entity so as to obtain benefit from its activities.

Associates and joint ventures comprise investments in undertakings, which are not subsidiary undertakings, where the Group's interest in the equity capital is long term and over whose operating and financial policies the Group exercises a significant influence and, in the case of joint ventures, has joint control. They are accounted for using the equity method.

The results of Group undertakings acquired during the period are included from the date of acquisition of a controlling interest at which date, for the purposes of consolidation, the purchase consideration is allocated between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair value.

The results of Group undertakings which have been sold during the year are included up to the date of disposal. The profit or loss on sale is calculated by reference to the net asset value at the date of disposal, adjusted for purchased goodwill previously consolidated in the balance sheet.

Where accumulated losses applicable to a minority exceed the minority's interest in the equity of a subsidiary, the excess is allocated to the Group's interest in the subsidiary, except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Inter company balances and transactions, and any unrealised gains arising from inter company transactions, are eliminated in preparing the consolidated Financial Statements.

Goodwill

Goodwill arising on acquisitions is capitalised and is considered to have an indefinite life subject to impairment reviews. Goodwill represents the excess of the cost of acquisition of a subsidiary, associate or joint venture over the Group's share of the fair value of identifiable net assets acquired. Goodwill is stated at cost less accumulated impairment losses and amortisation prior to 1 January 2004.

The Group's policy up to and including 1997 was to eliminate goodwill against reserves. Goodwill acquired from 1998 to 31 December 2003 was capitalised and amortised over its useful economic life. As permitted under IFRS1, in respect of acquisitions prior to 1 January 2004, the classification and accounting treatment of business combinations was not amended on transition to IFRS. Goodwill previously written off direct to reserves is not recycled to the income statement on the disposal of the subsidiary or associate to which it relates.

Goodwill in respect of subsidiaries is included in intangible assets. In respect of associates, goodwill is included in the carrying value of the investment in the associated company.

Foreign currencies

The income and cash flow statements of Group undertakings expressed in currencies other than sterling are translated to sterling at average rates of exchange in each year, provided that the average rate approximates the exchange rate at the date of the underlying transactions. Assets and liabilities of these undertakings are translated at rates of exchange at the end of each year. For high inflation countries, the translation from local currencies to sterling makes allowance for the impact of inflation on the local currency results.

The differences between retained profits of overseas subsidiary and associated undertakings translated at average and closing rates of exchange are taken to reserves, as are differences arising on the retranslation to sterling (using closing rates of exchange) of overseas net assets at the beginning of the year. Any differences that have arisen since 1 January 2004 are presented as a separate component of equity. As permitted under IFRS1, any differences prior to that date are not included in this separate component of equity. On the disposal of an overseas undertaking, the cumulative amount of the related exchange differences deferred in the separate component of equity are recognised in the income statement when the gain or loss on disposal is recognised.

Foreign currency transactions are initially recorded at the exchange rate ruling at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of foreign currency assets and liabilities at year end rates of exchange are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges, qualifying net investment hedges and on inter company quasi-equity loans. Foreign exchange gains or losses recognised in the income statement are included in profit from operations or net finance costs depending on the underlying transactions that gave rise to these exchange differences.

Revenue

Revenue principally comprises sales of cigarettes, cigars, leaf and other tobacco products to external customers. Revenue excludes duty, excise and other taxes and is after deducting rebates, returns and other similar discounts. Revenue is recognised when the significant risks and rewards of ownership are transferred to a third party.

Retirement benefit costs

The Group operates both defined benefit and defined contribution schemes. The net deficit or surplus for each defined benefit pension scheme is calculated in accordance with IAS19, based on the present value of the defined benefit obligation at the balance sheet date, less the fair value of the scheme assets.

As permitted under IFRS1, all actuarial gains and losses as at 1 January 2004, the date of transition to IFRS, were recognised. In respect of actuarial gains and losses that arise subsequent to that date, to the extent that cumulatively they exceed 10 per cent of the greater of the present value of the defined benefit obligation and the fair value of the scheme assets, that portion is recognised in the income statement over the expected average remaining working lives of the employees participating in the plan.

Otherwise, the accumulated actuarial gains and losses are not recognised, except where there are unrecognised scheme surpluses. In such instances, the actuarial gains and losses are recognised as they occur.

Where the actuarial valuation of the scheme demonstrates that the scheme is in surplus, the recognised asset is limited to that for which the Group expects to benefit in future, for example by refunds or a reduction in contributions.

Past service costs resulting from enhanced benefits are expensed over the period to vesting and if they vest immediately, then they are recognised at that time in the income statement.

The Group also has certain post-retirement healthcare schemes and they are accounted for on a similar basis to the defined benefit pension schemes.

For defined benefit schemes, the actuarial cost charged to profit from operations consists of current service cost, interest cost, expected return on plan assets, past service cost and the impact of any settlements or curtailments, as well as actuarial gains or losses to the extent they are recognised, and changes in unrecognised scheme surpluses.

Some benefits are provided through defined contribution schemes and payments to these are charged as an expense as they fall due.

Share-based payments

The Group has equity-settled and cash-settled share-based compensation plans.

Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed over the vesting period, based on the Group's estimate of awards that will eventually vest. For plans where vesting conditions are based on total shareholder returns, the fair value at date of grant reflects these conditions, whereas earnings per share vesting conditions are reflected in the calculation of awards that will eventually vest over the vesting period. For cash-settled share-based payments, a liability equal to the portion of the services received is recognised at its current fair value determined at each balance sheet date. Fair value is measured by the use of the Black-Scholes option pricing model, except where vesting is dependent on market conditions, when the Monte Carlo option pricing model is used. The expected life used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

Research and development

Research expenditure is charged to income in the year in which it is incurred. Development expenditure is charged to income in the year it is incurred, unless it meets the recognition criteria of IAS38 Intangible Assets.

Taxation

Taxation is that chargeable on the profits for the period, together with deferred taxation.

Deferred taxation is provided in full using the liability method for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for taxation purposes. Deferred tax is provided on temporary differences arising on investments in Group undertakings, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that it will not reverse in the foreseeable future. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. As required under IAS12, deferred tax assets and liabilities are not discounted.

Deferred tax is determined using the tax rates that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or deferred tax liability is settled.

Tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Intangible assets other than goodwill

These intangible assets shown on the Group balance sheet consist mainly of computer software which is carried at cost less accumulated amortisation and impairment, and is amortised on a straight-line basis over a period ranging from three to five years.

The investments in associates shown in the Group balance sheet include brand names arising from the combination of Brown & Williamson (B&W) and R J Reynolds (RJR) in 2004 to form Reynolds American Inc. (RAI), as well as those arising on the acquisition of Conwood by RAI in 2006. As the combination of B&W and RJR for the Group involved the partial disposal of B&W and an investment in RAI, fair values were assigned to brands formerly owned by RJR but not to those formerly owned by B&W. Most of the carrying value of the brands relates to brands which are deemed to have indefinite lives and each brand is subject to an annual impairment test. Certain minor brands are being amortised over their remaining lives consistent with the pattern of economic benefits expected to be received. Any impairments of brands are recognised in the income statement but increases in brand values are not recognised.

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and impairment. Depreciation is calculated on a straight-line basis to write off the assets over their useful economic life. No depreciation is provided on freehold land. Freehold and long leasehold property are depreciated at rates between 2.5 per cent and 4 per cent per annum, and plant and equipment at rates between 7 per cent and 25 per cent per annum. In accordance with the benchmark treatment under IAS23, borrowing costs associated with expenditure on property, plant and equipment are not capitalised.

Leased assets

Assets held under finance leases are included as part of property, plant and equipment. Finance lease assets are initially recognised at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, then depreciated over the shorter of the lease term and their estimated useful lives. Leasing payments consist of capital and finance charge elements and the finance element is charged to the income statement.

Rental payments under operating leases are charged to the income statement on a straight-line basis over the lease term.

Where arrangements are entered into which, while they are not in the legal form of a lease, are in substance a lease under IFRIC Interpretation 4, then they are recognised on the same basis as the leased assets above.

Impairment of assets

Assets are reviewed for impairment whenever events indicate that the carrying amount of a cash-generating unit may not be recoverable. In addition, assets that have indefinite useful lives are tested annually for impairment. An impairment loss is recognised to the extent that the carrying value exceeds the higher of the asset's fair value less costs to sell and its value in use.

A cash-generating unit is the smallest identifiable group of assets that generates cash flows which are largely independent of the cash flows from other assets or groups of assets. At the acquisition date, any goodwill acquired is allocated to the relevant cash-generating unit or group of cash-generating units expected to benefit from the acquisition for the purpose of impairment testing of goodwill.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is based on the average cost incurred in acquiring inventories and bringing them to their existing location and condition, which will include raw materials, direct labour and overheads, where appropriate. Net realisable value is the estimated selling price less costs to completion and sale. Tobacco inventories which have an operating cycle that exceeds 12 months are classified as current assets, consistent with recognised industry practice.

Financial instruments

Financial assets and financial liabilities are recognised when the Group becomes a party to the contractual provisions of the relevant instrument and derecognised when it ceases to be a party to such provisions. Such assets and liabilities are classified as current if they are expected to be realised or settled within 12 months after the balance sheet date or if they are derivative financial instruments not designated as hedges in accordance with IAS39. If not, they are classified as non-current.

Non-derivative financial assets are classified as either available-for-sale investments, loans and receivables or cash and cash equivalents. Apart from available-for-sale investments, they are stated at amortised cost using the effective interest method, subject to reduction for allowances for estimated irrecoverable amounts. For interest-bearing assets, their carrying value includes accrued interest receivable.

Available-for-sale investments are stated at fair value, with changes in fair value being recognised directly in equity. When such investments are derecognised (e.g. through disposal) or become impaired, the accumulated gains and losses, previously recognised in equity, are recognised in the income statement.

Cash and cash equivalents include cash in hand and deposits held on call, together with other short term highly liquid investments. Cash equivalents normally comprise instruments with maturities of three months or less at date of acquisition. In the cash flow statement, cash and cash equivalents are shown net of bank overdrafts, which are included as current borrowings in the liabilities on the balance sheet.

Non-derivative financial liabilities are stated at amortised cost using the effective interest method. For borrowings, their carrying value includes accrued interest payable, as well as unamortised issue costs.

Derivative financial assets and liabilities are stated at fair value, which includes accrued interest receivable and payable where relevant. Changes in their fair values are recognised as follows:

- for derivatives that are designated as cash flow hedges, the changes in their fair values are recognised directly in equity, to the extent that they are effective, with the ineffective portion being recognised in the income statement. Where the hedged item results in a non-financial asset, the accumulated gains and losses, previously recognised in equity, are included in the initial carrying value of the asset (basis adjustment) and recognised in the income statement in the same periods as the hedged item. Where the underlying transaction does not result in such an asset, the accumulated gains and losses are immediately recognised in the income statement;
- for derivatives that are designated as fair value hedges, the carrying value of the hedged item is adjusted for the fair value changes attributable to the risk being hedged, with the corresponding entry being made in the income statement. The changes in fair value of these derivatives are also recognised in the income statement;

- for derivatives that are designated as hedges of net investments in foreign operations, the changes in their fair values are recognised directly in equity, to the extent that they are effective, with the ineffective portion being recognised in the income statement. Where non-derivatives such as foreign currency borrowings are designated as net investment hedges, the relevant exchange differences are similarly recognised. The accumulated gains and losses are recognised in the income statement when the foreign operation is disposed of; and
- for derivatives that do not qualify for hedge accounting or are not designated as hedges, the changes in their fair values are recognised in the income statement in the period in which they arise.

Hedge accounting is discontinued when a hedging instrument is derecognised (e.g. through expiry or disposal), or no longer qualifies for hedge accounting. Where the hedged item is a highly probable forecast transaction, the related gains and losses remain in equity until the transaction takes place, when they are removed from equity in the same manner as for cash flow hedges as described above. When a hedged future transaction is no longer expected to occur, any related gains and losses, previously recognised in equity, are immediately recognised in the income statement.

Derivative fair value changes recognised in the income statement are either reflected in arriving at profit from operations (if the hedged item is similarly reflected) or in finance costs.

Dividends

Final dividend distributions to the Company's shareholders are recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders at the Annual General Meeting, while interim dividend distributions are recognised in the period in which the dividends are declared and paid.

Segmental analysis

A segment is a distinguishable component of the Group that is engaged in providing products or services within a particular economic environment, and the Group's geographical segments form the focus of the Group's internal reporting systems. The Group is a single product business providing cigarettes and other tobacco products. While the Group has clearly differentiated brands, global segmentation between a wide portfolio of brands is not part of the regular internally reported financial information. It is not feasible to segment global results by brand without a high degree of estimation, especially given that geographically the same operations are used to produce the different brands, and brand results are managed in the context of the geographic markets in which they are sold.

The prices agreed between Group companies for intra-group sales of materials, manufactured goods, charges for royalties, commissions, services and fees, are based on normal commercial practices which would apply between independent businesses. Royalty income, less related expenditure, is included in the region in which the licensor is based.

Exceptional items

Exceptional items are items in the profit from operations and the Group share of the post-tax results of associates which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's financial performance. These items are separately disclosed as memorandum information on the face of the income statement and in the segmental analyses.

Provisions

Provisions are recognised when either a legal or constructive obligation as a result of a past event exists at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and a reasonable estimate can be made of the amount of the obligation.

Contingent liabilities

Subsidiaries and associate companies are defendants in tobacco-related litigation. Provision for this litigation would be made at such time as an unfavourable outcome became probable and the amount could be reasonably estimated.

The Group records its external legal fees and other external defence costs for tobacco-related litigation as these costs fall due.

Repurchase of share capital

When share capital is repurchased the amount of consideration paid, including directly attributable costs, is recognised as a deduction from equity. Repurchased shares which are not cancelled, or shares purchased for the employee share ownership trusts, are classified as treasury shares and presented as a deduction from total equity.

Future changes to accounting policies

Certain changes to IFRS will be applicable for the Group accounts in future years. To the extent that the Group has not adopted these early in the accounts to 31 December 2006, they will not affect the Group reported profit or equity but they will affect disclosures.

The requirements, which have been endorsed by the EU, are effective from 1 January 2007 and are considered to affect the Group, relate to disclosures under IFRS 7 Financial Instruments: disclosures and amendments to IAS1 – Capital disclosures. In addition, IFRS8 Operating Segments will be effective from 1 January 2009 if, as expected, it is endorsed by the EU. However, once endorsed, it would be possible to adopt IFRS8 before 2009.

2 Segmental analyses

Segmental analyses of revenue, profit, assets and liabilities for the year ended 31 December:

	Europe		Asia-Pacific	
	2006	2005	2006	2005
	£m	£m	£m	£m
Revenue				
External sales	3,495	3,456	1,755	1,646
Inter-segment sales	526	569	27	3
Revenue	4,021	4,025	1,782	1,649
Results				
Segment result before restructuring costs and (losses)/gains on disposal of a business, brands and joint venture	781	784	616	531
Restructuring costs	(132)	(160)	(7)	(14)
(Losses)/gains on disposal of a business, brands and joint venture	27	72		
Segmental result	676	696	609	517
Unallocated costs				
Profit from operations				
Net finance costs				
Share of post-tax results of associates and joint ventures				
Profit on ordinary activities before taxation				
Taxation on ordinary activities				
Profit for the year				
Attributable to:				
Shareholders' equity				
Minority interests				
Unallocated costs represent net corporate costs not directly attributable to individual segments.				
Other segment items				
Capital expenditure	232	199	59	69
Depreciation and amortisation	126	137	48	64
Impairment and accelerated depreciation	49	44		4
Assets				
Segment assets before goodwill	2,653	2,678	1,056	1,149
Goodwill	3,295	3,389	1,244	1,317
Segment assets including goodwill <i>page 86</i>	5,948	6,067	2,300	2,466
Investments in associates and joint ventures	203	206	394	382
Unallocated assets				
Total assets <i>page 76</i>				
Liabilities				
Segment liabilities <i>page 86</i>	1,797	1,899	532	573
Unallocated liabilities				
Total liabilities <i>page 76</i>				

The restructuring costs and (losses)/gains on disposal of a business, brands and joint venture are explained on pages 88 and 89 in note 3.

The impact of acquisitions made during the year is given on page 123 in note 26.

Latin America		Africa and Middle East		America-Pacific		Elimination		Consolidated	
2006	2005	2006	2005 restated	2006	2005	2006	2005	2006	2005 restated
£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
1,780	1,541	1,063	964	1,090	1,108			9,183	8,715
2	4	24	34					579	610
1,782	1,545	1,087	998	1,090	1,108			9,762	9,325
611	530	468	434	424	436			2,900	2,715
	(6)	(24)	(9)	(53)	(82)			(216)	(271)
				14				41	72
611	524	444	425	385	354			2,725	2,516
								(103)	(96)
								2,622	2,420
								(289)	(228)
								431	392
								2,764	2,584
								(716)	(690)
								2,048	1,894
								1,896	1,767
								152	127
102	78	69	68	51	50			513	464
64	59	39	30	35	35			312	325
	2	3	1	37	7			89	58
1,191	1,165	1,004	1,104	560	676	(439)	(324)	6,025	6,448
186	123	803	1,018	1,822	2,040			7,350	7,887
1,377	1,288	1,807	2,122	2,382	2,716	(439)	(324)	13,375	14,335
2	2	10	8	1,499	1,595			2,108	2,193
								2,293	2,523
								17,776	19,051
564	568	546	472	580	725	(625)	(510)	3,394	3,727
								7,694	8,447
								11,088	12,174

Segment assets and segment liabilities include inter-company balances with entities reported as corporate liabilities and corporate assets on page 86.

(a) Segment revenue

The segmental analysis of revenue is based on location of manufacture. Figures based on external sales by subsidiaries in each segment are as follows:

	2006	2005
	£m	£m
Europe	3,545	3,497
Asia-Pacific	1,839	1,758
Latin America	1,791	1,555
Africa and Middle East	1,489	1,405
America-Pacific	1,098	1,110
Segment revenue <i>pages 84 and 85</i>	9,762	9,325

(b) Segment assets

	2006	2005
	£m	restated £m
Total assets <i>page 76</i>	17,776	19,051
<i>Less</i>		
– investments in associates and joint ventures	2,108	2,193
– available-for-sale investments <i>note 15</i>	152	123
– deferred tax assets	273	290
– interest receivable <i>note 14</i>	1	1
– income tax receivable	59	81
– dividends receivable from associates <i>note 14</i>	48	45
– derivatives in respect of net debt <i>note 16</i>	125	133
– loans	85	98
– cash equivalents <i>note 19</i>	972	1,272
– corporate assets	578	480
Segment assets <i>pages 84 and 85</i>	13,375	14,335

(c) Segment liabilities

	2006	2005
	£m	restated £m
Total current and non-current liabilities <i>page 76</i>	11,088	12,174
<i>Less</i>		
– borrowings <i>note 21</i>	6,626	7,260
– deferred tax liabilities	296	277
– derivatives in respect of net debt <i>note 16</i>	79	116
– dividends payable	4	8
– income tax payable	292	374
– interest payable <i>note 23</i>	12	17
– corporate liabilities	385	395
Segment liabilities <i>pages 84 and 85</i>	3,394	3,727

(d) Segmental analysis of the Group's share of the revenue and post-tax results of associates and joint ventures

External revenue

	2006	2005
	£m	£m
Europe	771	642
Asia-Pacific	456	371
Latin America	1	1
Africa and Middle East	20	15
America-Pacific	1,942	1,927
	3,190	2,956

Post-tax results

	Segment result		Adjusted segment result*	
	2006	2005	2006	2005
	£m	£m	£m	£m
Europe	46	39	46	39
Asia-Pacific	92	107	92	81
Africa and Middle East	4	2	4	2
America-Pacific	289	244	285	267
	431	392	427	389

* Excluding restructuring costs, US Federal tobacco buy-out, brand impairments and exceptional tax credits and other impairments (page 90 note 5).

3 Profit from operations

(a) Employee benefit costs

	2006	2005
	£m	£m
Wages and salaries	1,233	1,228
Social security costs	159	152
Other pension and retirement benefit costs <i>page 98 note 12</i>	112	123
Share-based payments <i>page 124 note 27</i>	50	54
	1,554	1,557

(b) Depreciation and amortisation costs

	2006	2005
	£m	£m
Intangibles other than goodwill – amortisation	34	35
Property, plant and equipment – depreciation	278	290
– impairment and accelerated depreciation	89	58
	401	383

Impairment and accelerated depreciation in respect of property, plant and equipment arose in relation to the restructuring costs (see note (e) below) and in respect of the impairment of a business (see note (f) below).

(c) Other operating income

This represents income arising from the Group's activities which falls outside the definition of revenue and includes gains on the disposals of subsidiaries, joint venture and brands, property disposals, service fees and other shared costs charged to third parties, manufacturing fees and trademark income.

(d) Other operating expenses include:

	2006	2005
	£m	£m
Research and development expenses (excluding employee benefit costs and depreciation)	36	29
Exchange differences	7	(23)
Loss on net monetary position		1
Rent of plant and equipment (operating leases)		
– minimum lease payments	25	26
– contingent rents	1	1
Rent of property (operating leases)		
– minimum lease payments	61	61
– sublease payments	2	2
Audit fees payable to PricewaterhouseCoopers LLP	1.3	1.3
Fees for other services payable to PricewaterhouseCoopers firms and associates		
– other services pursuant to statutory legislation	6.3	5.6
– tax advisory services	4.3	2.4
– tax compliance	0.4	0.5
– services relating to information technology	0.1	0.1
– other non-audit services	0.3	0.8

Fees for other services pursuant to statutory legislation payable to PricewaterhouseCoopers firms and associates include £6.1 million (2005: £5.3 million) for local statutory and Group reporting audits. In addition, the Group paid £0.6 million (2005: £0.5 million) in audit fees to other audit firms, which are excluded from the table above.

Total research and development costs including employee benefit costs and depreciation were £76 million (2005: £66 million).

(e) Restructuring costs

These were the costs incurred as a result of a review of the Group's manufacturing operations and organisational structure, including the initiative to reduce overheads and indirect costs, and are included in the profit from operations under the following headings:

	2006	2005
	£m	£m
Employee benefit costs	100	165
Depreciation and amortisation costs	74	58
Other operating expenses	62	48
Other operating income	(20)	
	216	271

The restructuring costs in 2006 principally relate to manufacturing rationalisation in the Netherlands, with further costs for the earlier restructurings in the UK and Ireland and in Canada. The initial recognition of these earlier restructurings comprised the main costs in 2005. Other operating income relates to gains on property disposals arising from the restructuring exercises.

(f) (Losses)/gains on disposal of a business, brands and joint venture

In April 2005, the Group sold its Benson & Hedges and Silk Cut trademarks in Malta and Cyprus to Gallaher Group plc (Gallaher), together with the Silk Cut trademark in Lithuania, resulting in a gain on disposal of £68 million included in other operating income in the profit from operations. The transactions were in accordance with contracts of 1993 and 1994 in which Gallaher agreed to acquire these trademarks in European Union states and the accession of Malta, Cyprus and Lithuania necessitated the sale.

As described on page 123 in note 26, on 4 October 2005, the Group announced that it had agreed the sale of its 55 per cent shareholding in BARH Ltd to Honda and the sale was completed on 20 December 2005. As a result of these transactions a gain of £5 million was included in other operating income in the profit from operations for 2005.

On 10 March 2006, the Group's Italian subsidiary signed an agreement to sell its cigar business, Toscano, to Maccaferri for €95 million. The sale was subject to regulatory and governmental approval and was completed on 19 July 2006.

This resulted in the recognition of a loss of £19 million, including an impairment charge of £15 million, which is included in depreciation and amortisation costs in the profit from operations.

On 29 September 2006, the Group signed a trademark transfer agreement with Philip Morris International. Under this arrangement the Group agreed to sell its Muratti Ambassador brand in certain markets, as well as the L&M and Chesterfield trademarks in Hong Kong and Macao, while acquiring the Benson & Hedges trademark in certain African countries, which resulted in a net payment to the Group of US\$115 million. The agreement was subject to regulatory approval which was received, and the transactions completed on 29 November 2006, resulting in a gain of £60 million included in other operating income in the profit from operations.

4 Net finance costs

	2006		2005 restated	
	£m	£m	£m	£m
Finance costs				
– interest payable		410		373
– fair value changes		(212)		218
– exchange differences		197		(246)
– loss on net monetary position		4		1
		399		346
Finance income				
– interest and dividend income		(122)		(106)
– exchange differences		12		(12)
		(110)		(118)
Net finance costs		289		228
Net finance costs comprise:				
Interest payable bank borrowings	94		59	
– finance leases	3		4	
– other	313		310	
		410		373
Interest receivable	(120)		(105)	
Dividend income	(2)		(1)	
		(122)		(106)
Fair value changes on derivatives:				
– cash flow hedges transferred from equity	4		29	
– fair value changes on hedged items	(111)		14	
– fair value hedges	39		28	
– ineffective portion of cash flow hedges			(1)	
– instruments not designated as hedges	(144)		148	
	(212)		218	
Exchange differences	209		(258)	
Loss on net monetary position	4		1	
		1		(39)
		289		228

Other interest payable includes interest on the bonds and notes detailed in note 21.

In December 2005, the International Accounting Standards Board issued an amendment to IAS21 on foreign exchange rates. The amendment to IAS21 allowed inter company balances that form part of a reporting

entity's net investment in a foreign operation to be denominated in a currency other than the functional currency of either the ultimate parent or the foreign operation itself. This means that certain exchange differences previously taken to the income statement are instead reflected directly in changes in total equity. However, this amendment was only adopted by the EU in 2006. Therefore the previously published results for 2005 have been restated accordingly, which has resulted in an increase in net finance costs above of £4 million and a corresponding reduction in differences on exchange in equity movements (page 112 note 20).

The £40 million movement to a charge of £1 million for net fair value changes and exchange differences is principally due to:

- £19 million of gains in 2005 which distort net finance costs as described on page 92 in note 7;
- the impact of interest rate movements on the fair value of derivatives to be recognised in the accounts.

5 Associates and joint ventures

	Total 2006 £m	Group's share 2006 £m	Total 2005 £m	Group's share 2005 £m
Gross turnover including duty, excise and other taxes	11,831	4,384	11,441	4,077
Duty, excise and other taxes	(3,349)	(1,194)	(3,351)	(1,121)
Revenue	8,482	3,190	8,090	2,956
Profit from operations	1,765	677	1,546	566
Net finance costs	(61)	(26)	(17)	(8)
Profit on ordinary activities before taxation	1,704	651	1,529	558
Taxation on ordinary activities	(564)	(216)	(452)	(163)
Profit on ordinary activities after taxation	1,140	435	1,077	395
after (charging)/crediting				
– restructuring costs			(32)	(13)
– US Federal tobacco buy-out			(28)	(12)
– brand impairments	(30)	(13)	(68)	(29)
– exceptional tax credits and other impairments	40	17	154	57
Attributable to:				
British American Tobacco's shareholders <i>page 74</i>		431		392
Minority interests		4		3
Dividends				
– listed investments		(222)		(175)
– unlisted investments		(45)		(27)
		(267)		(202)

The share of post-tax results of associates and joint ventures is after restructuring costs, the US Federal tobacco buy-out, brand impairments, exceptional tax credits and other impairments.

In 2006, Reynolds American benefited from the favourable resolution of tax matters of which the Group's share was £17 million (2005: £31 million). Reynolds American also modified the previously anticipated level of support between certain brands and the projected net sales of certain brands, resulting in a brand impairment charge of which the Group's share amounted to £13 million (net of tax) (2005: £29 million).

In 2005, Reynolds American also incurred restructuring costs and a one-off charge related to the stabilisation inventory pool losses associated with the US tobacco quota buy-out programme. The Group's share (net of tax) of these amounted to £13 million and £12 million, respectively.

In 2005, the contribution from ITC Limited in India included a benefit of £26 million (net of tax), principally related to the write back of provisions for taxes offset by the impairment of a non-current investment.

6 Taxation on ordinary activities

(a) Summary of tax on ordinary activities

	2006 £m	2005 £m
UK corporation tax	14	42
comprising:		
– current year tax expense	768	591
– double taxation relief	(754)	(549)
Overseas tax	681	693
comprising:		
– current year tax expense	743	705
– adjustments in respect of prior periods	(62)	(12)
Total current tax	695	735
Deferred tax	21	(45)
comprising:		
– deferred tax relating to origination and reversal of temporary differences	16	(2)
– deferred tax relating to a previously unrecognised tax loss	(14)	(42)
– deferred tax relating to changes in tax rates	19	(1)
	716	690

(b) Factors affecting the tax charge

The taxation charge differs from the standard 30 per cent rate of corporation tax in the UK. The major causes of this difference are listed below:

	2006		2005 restated	
	£m	%	£m	%
Profit before tax	2,764		2,584	
Less: share of associates post-tax profit	(431)		(392)	
	2,333		2,192	
Tax at 30% (2005: 30%) on the above	700	30.0	658	30.0
Factors affecting the tax rate:				
Tax at standard rates other than UK corporation tax rate	(56)	(2.4)	(45)	(2.1)
National tax rate relief	(15)	(0.6)	(24)	(1.1)
State and local taxes	50	2.1	58	2.6
Permanent differences	9	0.5	(30)	(1.4)
Overseas withholding taxes	50	2.1	50	2.3
Double taxation relief on UK profits	(13)	(0.6)	(9)	(0.4)
Unutilised tax losses	13	0.6	13	0.6
Adjustments in respect of previous periods	(62)	(2.7)	(12)	(0.5)
Deferred tax charges at other tax rates	21	0.9	32	1.5
Deferred tax attributable to an increase in the rate of domestic income tax	19	0.8	(1)	(0.0)
	716	30.7	690	31.5

(c) Tax on items recognised directly in equity

	2006 £m	2005 £m
Current tax	14	19
Deferred tax	(2)	22
Charged to equity	12	41

7 Earnings per share

Basic earnings per share are based on equity earnings of £1,896 million (2005 restated: £1,767 million, as explained on page 89 in note 4) and 2,059 million (2005: 2,095 million) ordinary shares of 25p each, being the weighted average number of shares in issue during the year (excluding shares held to satisfy the Group's employee share schemes).

For the calculation of diluted earnings per share, the weighted average number of shares in issue is increased to 2,076 million (2005: 2,112 million) to reflect the potential dilutive effect of employee share schemes.

	2006			2005 restated		
	Earnings £m	Weighted average number of shares £m	Earnings per share pence	Earnings £m	Weighted average number of shares £m	Earnings per share pence
Basic earnings per share	1,896	2,059	92.08	1,767	2,095	84.34
Share options and convertible redeemable preference shares		17	(0.75)		17	(0.68)
Diluted earnings per share	1,896	2,076	91.33	1,767	2,112	83.66

Earnings have been affected by a number of exceptional items. To illustrate the impact of these, an alternative earnings per share is shown below:

Alternative earnings per share calculation

	2006		Diluted 2005 restated		2006		Basic 2005 restated	
	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence
Unadjusted earnings per share	1,896	91.33	1,767	83.66	1,896	92.08	1,767	84.34
Restructuring costs per income statement	216	10.40	271	12.83	216	10.49	271	12.93
Tax and minority interests on restructuring costs	(48)	(2.31)	(57)	(2.70)	(48)	(2.33)	(57)	(2.72)
Losses/(gains) on disposal of a business, brands and joint venture per income statement	(41)	(1.98)	(72)	(3.41)	(41)	(1.99)	(72)	(3.44)
Tax on losses/(gains) on disposal of a business, brands and joint venture	18	0.87			18	0.87		
Associates: restructuring costs, US Federal tobacco buy-out, brand impairments, exceptional tax credits and other impairments per income statement	(4)	(0.19)	(3)	(0.14)	(4)	(0.19)	(3)	(0.14)
Net finance costs adjustment per note below			(19)	(0.90)			(19)	(0.91)
Adjusted earnings per share	2,037	98.12	1,887	89.34	2,037	98.93	1,887	90.06

IFRS requires fair value changes for derivatives, which do not meet the tests for hedge accounting under IAS39, to be included in the income statement. In addition, certain exchange differences are required to be in

the income statement under IFRS and, as they are subject to exchange rate movements in the period, they can be a volatile element of net finance costs, and one which does not always reflect an economic gain or loss for the Group. Consequently, in calculating the adjusted earnings per share, the following items are excluded:

- (a) £nil million (2005: £8 million gain) relating to derivatives for which hedge accounting was obtained during 2005; and
- (b) £nil million (2005: £11 million gain) relating to exchange gains in net finance costs where there is a compensating exchange loss reflected in differences in exchange taken directly to changes in total equity.

8 Dividends and other appropriations

	2006		2005	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim				
2006 paid 13 September 2006	15.70	323		
2005 paid 14 September 2005			14.00	293
Final				
2005 paid 4 May 2006	33.00	685		
2004 paid 4 May 2005			29.20	617
	48.70	1,008	43.20	910

The Directors have recommended to shareholders a final dividend of 40.20 pence per share for the year ended 31 December 2006. If approved, this dividend will be paid to shareholders on 3 May 2007. This dividend is subject to approval by shareholders at the Annual General Meeting and therefore, in accordance with IAS10, it has not been included as a liability in these Financial Statements. The total estimated dividend to be paid is £821 million which takes the total dividends declared in respect of 2006 to £1,144 million (2005: £977 million) representing 55.90 pence per share (2005: 47.00 pence per share).

As described on page 146 in note 3, while the 2006 interim dividend did not comply with the technical requirements of the Companies Act 1985, the payment has been presented as a dividend payment above.

9 Intangible assets

	Goodwill £m	Computer software £m	Trademarks brands and licences £m	Assets in the course of development £m	Total £m
1 January 2006					
Cost	7,887	228	16	31	8,162
Accumulated amortisation and impairment		(162)	(13)		(175)
Net book value at 1 January 2006	7,887	66	3	31	7,987
Differences on exchange	(617)	(4)		(1)	(622)
Additions					
– internal development		9		12	21
– acquisitions of subsidiaries and minority interests	80		5		85
– separately acquired		23	2	14	39
Reallocations		17		(17)	
Amortisation charge		(33)	(1)		(34)
31 December 2006					
Cost	7,350	258	23	39	7,670
Accumulated amortisation and impairment		(180)	(14)		(194)
Net book value at 31 December 2006	7,350	78	9	39	7,476

	Goodwill £m	Computer software £m	Trademarks brands and licences £m	Assets in the course of development £m	Total £m
1 January 2005					
Cost	7,607	210	14	17	7,848
Accumulated amortisation and impairment		(136)	(12)		(148)
Net book value at 1 January 2005	7,607	74	2	17	7,700
Differences on exchange	271	8		(1)	278
Additions					
– internal development		6		21	27
– acquisitions of subsidiaries	9				9
– separately acquired		11	2	1	14
Reallocations		7		(7)	
Disposals		(5)			(5)
Amortisation charge		(35)	(1)		(36)
31 December 2005					
Cost	7,887	228	16	31	8,162
Accumulated amortisation and impairment		(162)	(13)		(175)
Net book value at 31 December 2005	7,887	66	3	31	7,987

Included in computer software and assets in the course of development above are internally developed assets with a carrying value of £80 million (2005: £64 million). The costs of internally developed assets include capitalised expenses of third party consultants as well as software licence fees from third party suppliers.

Impairment testing for intangible assets with indefinite lives including goodwill

Goodwill of £7,350 million (2005: £7,887 million) included in intangible assets in the balance sheet is mainly the result of the following acquisitions: Rothmans Group £3,889 million (2005: £4,206 million); Imperial Tobacco Canada £1,768 million (2005: £2,004 million); and ETI (Italy) £1,113 million (2005: £1,135 million). The principal allocations of goodwill in the Rothmans' acquisition are to the cash-generating units of Continental Europe and South Africa, with the remainder mainly relating to operations in the domestic and export market in the United Kingdom and operations in Asia-Pacific.

Goodwill has been allocated for impairment testing purposes to 13 (2005: 12) individual cash-generating units – four in Europe, one in Africa and Middle East, three in Asia-Pacific, three (2005: two) in Latin America and two in America-Pacific. The carrying amounts of goodwill allocated to the cash-generating units of South Africa (£803 million, 2005: £1,017 million), Continental Europe (£1,020 million, 2005: £1,040 million), Canada (£1,768 million, 2005: £2,004 million) and Italy (£1,119 million, 2005: £1,141 million) are considered significant in comparison with the total carrying amount of goodwill. A further cash-generating unit was established in 2006 with the purchase of minority interests in Chile (page 123 note 26).

The recoverable amount of all cash-generating units has been determined on a value-in-use basis. The key assumptions for the recoverable amount of all units are the long term growth rate and the discount rate. The long term growth rate is a nominal rate used purely for the impairment testing of goodwill under IAS36 Impairment of Assets and does not reflect long term planning assumptions used by the Group for investment proposals or for any other assessments. The discount rate is based on the weighted average cost of capital, taking into account the cost of capital and borrowings, to which specific market-related premium adjustments are made. These assumptions have been applied to the individual cash flows of each unit as compiled by local management in the different markets.

The valuation uses cash flow projections based on detailed financial budgets approved by management covering a two year period, with cash flow beyond two years extrapolated by a nominal growth rate of 3 per cent per annum for the years three to 10, whereafter a zero per cent growth rate has been assumed (2005: 3 per cent growth rate in perpetuity). This long term growth rate used does not exceed the expected long term average growth rate for the markets in which the cash-generating units operate. In some instances, such as recent acquisitions or start-up ventures, the valuation is expanded to reflect the medium term plan of management, spanning five years or beyond, with the cash flow beyond these years to year 10, extrapolated by the growth rate of 3 per cent, as above.

Pre-tax discount rates of between 8.1 per cent and 17.9 per cent (2005: 8.1 per cent to 15.7 per cent) were used, based on the Group's weighted average cost of capital, together with any premium applicable for country/area inflation and economical and political risks. The pre-tax discount rates used for the cash-generating units which are significant in comparison with the total carrying amount of goodwill are 12.1 per cent for South Africa (2005: 12.1 per cent), 9.8 per cent for Continental Europe (2005: 9.8 per cent), 10 per cent for Canada (2005: 11 per cent) and 10.7 per cent for Italy (2005: 10.7 per cent).

No impairment charges were recognised in 2006 (2005: £nil). If discounted cash flows per cash-generating unit should fall by 10 per cent, or the discount rate was increased at an after tax rate of 1 per cent, there would be no impairment.

10 Property, plant and equipment

	Freehold property £m	Leasehold property £m	Plant and equipment £m	Assets in the course of construction £m	Total £m
1 January 2006 as restated					
Cost	909	212	3,602	194	4,917
Accumulated depreciation and impairment	(321)	(59)	(2,206)		(2,586)
Net book value at 1 January 2006	588	153	1,396	194	2,331
Differences on exchange	(35)	(8)	(100)	(15)	(158)
Additions	15	2	181	255	453
Reallocations	19		193	(212)	
Depreciation	(22)	(9)	(274)		(305)
Impairment	(8)		(40)		(48)
Disposals	(16)		(24)		(40)
Disposal of subsidiaries	(25)		(1)		(26)
31 December 2006					
Cost	833	202	3,348	222	4,605
Accumulated depreciation and impairment	(317)	(64)	(2,017)		(2,398)
Net book value at 31 December 2006	516	138	1,331	222	2,207
1 January 2005					
Cost	854	195	3,267	138	4,454
Accumulated depreciation and impairment	(287)	(48)	(1,957)		(2,292)
Net book value at 1 January 2005	567	147	1,310	138	2,162
Differences on exchange	27	16	79	6	128
Additions	9	3	163	248	423
Acquisitions of subsidiaries			7		7
Reallocations	30	4	164	(198)	
Depreciation	(29)	(15)	(257)		(301)
Impairment		(2)	(56)		(58)
Disposals	(16)		(14)		(30)
31 December 2005					
Cost	909	212	3,602	194	4,917
Accumulated depreciation and impairment	(321)	(59)	(2,206)		(2,586)
Net book value at 31 December 2005 as restated	588	153	1,396	194	2,331
Assets held under finance leases					
31 December 2006					
Cost		3	94		97
Accumulated depreciation and impairment		(1)	(37)		(38)
Net book value at 31 December 2006		2	57		59
31 December 2005					
Cost		3	110		113
Accumulated depreciation and impairment			(49)		(49)
Net book value at 31 December 2005 as restated		3	61		64

Assets held under finance leases are secured under finance lease obligations on page 116 in note 21.

The International Accounting Standard Board issued IFRIC Interpretation 4 which is applicable for annual reporting periods beginning on or after 1 January 2006. This interpretation is to determine whether an arrangement, which is not in the legal form of a lease, is in substance a lease and should be accounted for in accordance with IAS17 Leases. Consequently, the previously published results for 2005 have been restated to increase additions to property, plant and equipment and assets held under finance leases at 31 December 2005 shown above by £4 million. Borrowings in respect of finance lease obligations have been increased by a similar amount (page 116 note 21). At the end of 2006, assets held under finance leases of £7 million were recognised on a similar basis.

	2006	2005
	£m	£m
Cost of freehold land within freehold property on which no depreciation is provided	70	84
Leasehold property comprises		
– net book value of long leasehold	95	106
– net book value of short leasehold	43	47
	138	153
Contracts placed for future expenditure	31	34

Bank borrowings are secured by property, plant and equipment to the value of £15 million (2005: £nil).

11 Investments in associates and joint ventures

	2006	2005
	£m	£m
1 January	2,193	1,717
Differences on exchange	(254)	186
Share of profit after taxation <i>page 90 note 5</i>	431	392
Dividends <i>page 90 note 5</i>	(267)	(202)
Acquisitions	1	95
Other equity movements	4	5
31 December	2,108	2,193
Non-current assets	3,386	2,889
Current assets	1,603	1,724
Non-current liabilities	(1,635)	(1,053)
Current liabilities	(1,246)	(1,367)
	2,108	2,193
Reynolds American Inc. (market value £4,145 million (2005: £3,440 million))	1,499	1,595
Other listed associates (market value £2,473 million (2005: £2,250 million))	394	382
Unlisted	215	216
	2,108	2,193

On 25 April 2006, Reynolds American Inc. announced an agreement to acquire Conwood, the second largest manufacturer of smokeless tobacco products in the USA, for US\$3.5 billion, and the acquisition was completed on 31 May 2006. The acquisition was funded principally with debt, and the fair value of the assets acquired and liabilities assumed were US\$4.1 billion and US\$0.6 billion respectively. The Group's share of non-current assets above includes £540 million of goodwill and £300 million of brands arising from the Conwood acquisition.

In addition, the non-current assets above include £1,207 million (2005: £1,376 million) of goodwill and £479 million (2005: £569 million) of brands arising from the Reynolds American transaction in 2004.

Details of the Group's contingent liabilities are set out on page 130 in note 30. In addition to US litigation involving Group companies, which is covered by the R.J. Reynolds Tobacco Company (RJRT) indemnity referred to in note 30, Reynolds American Inc. (RAI) group companies are named in litigation which does not

involve Group companies. While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, it is not impossible that the results of operations or cash flows of RAI, in particular quarterly or annual periods, could be materially affected by this and by the final outcome of any particular litigation. However, having regard to the contingent liability disclosures on litigation made by RAI in its public financial reports, the Directors are satisfied with the carrying value included above for RAI.

The Group's share of the RAI results for the year to 31 December 2006 includes £24 million (2005: £35 million) in respect of external legal fees and other external product liability defence costs.

On 21 October 2005, the Group announced the exercise of its pre-emption rights over shares in Skandinavisk Tobakskompagni AS (STK), and the transaction was completed on 12 December 2005. As a result, the Group's shareholding in STK increased from 26.6 per cent to 32.3 per cent, at a purchase price of £95 million, giving rise to £69 million of goodwill.

12 Retirement benefit schemes

The Group's subsidiary undertakings operate over 120 active retirement benefit arrangements worldwide. These arrangements have been developed in accordance with local practices in the countries concerned. The majority of scheme members belong to defined benefit schemes, most of which are funded externally, although the Group also operates a number of defined contribution schemes.

The liabilities arising in the defined benefit schemes are determined in accordance with the advice of independent, professionally qualified actuaries, using the projected unit credit method. All schemes are formally valued at least every three years.

The principal pension schemes are in the UK, Germany, Canada, the Netherlands and Switzerland. Together these schemes account for over 88 per cent of the total obligations of the Group's defined benefit schemes.

In addition, the Group operates significant schemes in Canada which provide employees with certain other retirement benefits such as healthcare. The liabilities in respect of these benefits are also assessed by qualified independent actuaries, applying the projected unit credit method.

The amounts recognised in the balance sheet were determined as follows:

	Pension schemes		Healthcare schemes		Total	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Present value of funded scheme facilities	(4,189)	(4,379)	(10)	(7)	(4,199)	(4,386)
Fair value of funded scheme assets	3,938	3,824	12	12	3,950	3,836
	(251)	(555)	2	5	(249)	(550)
Unrecognised funded scheme liabilities	(61)	(70)			(61)	(70)
	(312)	(625)	2	5	(310)	(620)
Present value of unfunded scheme liabilities	(107)	(115)	(115)	(129)	(222)	(244)
Net unrecognised actuarial losses	111	342	14	13	125	355
Unrecognised past service cost	1	1			1	1
	(307)	(397)	(99)	(111)	(406)	(508)

The above net liability was recognised in the balance sheet as follows

– retirement benefit scheme liabilities	(335)	(427)	(100)	(116)	(435)	(543)
– retirement benefit scheme assets	28	30	1	5	29	35
	(307)	(397)	(99)	(111)	(406)	(508)

In Jamaica, the pension scheme holds shares in Carreras Group Ltd. with a fair value of £6 million (2005: £5 million). In Switzerland, a pension scheme owns a property with a fair value of £10 million (2005: £11 million), part of which is occupied by British American Tobacco Switzerland SA.

The amounts recognised in the income statement were as follows:

	Pension schemes		Healthcare schemes		Total	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Defined benefit schemes						
– current service cost	90	79	3	2	93	81
– interest cost	207	201	7	7	214	208
– expected return on scheme assets	(237)	(216)	(1)	(1)	(238)	(217)
– net actuarial losses/(gains) recognised	6	(1)			6	(1)
– past service cost	9	8		2	9	10
– settlements and curtailments	9	18		2	9	20
– surplus recognition movement	4	7			4	7
	88	96	9	12	97	108
Defined contribution schemes	15	15			15	15
	103	111	9	12	112	123

The above charges were recognised within employee benefit costs in 2006 and 2005 (page 87 note 3(a)) and include £13 million (2005: £23 million) in respect of pension schemes and £nil million (2005: £2 million) in respect of healthcare schemes reported as part of the restructuring costs charged in arriving at profit from operations (page 88 note 3(e)).

The reduction in the amounts recognised in the Income Statement in 2006 is principally due to the change in the impact of costs related to the restructurings noted above.

	Pension schemes		Healthcare schemes		Total	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Actual return on scheme assets	370	474	3	1	373	475

The movements in scheme liabilities were as follows:

	Pension schemes		Healthcare schemes		Total	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Present value at 1 January	4,494	3,746	136	106	4,630	3,852
Exchange differences	(162)	86	(18)	12	(180)	98
Current service cost	89	81	2	2	91	83
Interest cost	202	206	6	8	208	214
Past service costs – vested	8	9		1	8	10
Past service costs – unvested		1		1		2
Contributions by scheme members	4	5			4	5
Benefits paid	(253)	(228)	(7)	(11)	(260)	(239)
Settlements and curtailments	4	20		2	4	22
Acquisitions of subsidiaries		11				11
Disposals of subsidiaries	(1)				(1)	
Scheme changes	(6)				(6)	
Actuarial (gains)/losses	(83)	557	6	15	(77)	572
Present value at 31 December	4,296	4,494	125	136	4,421	4,630
Funded schemes	4,189	4,379	10	7	4,199	4,386
Unfunded schemes	107	115	115	129	222	244
	4,296	4,494	125	136	4,421	4,630

The actuarial gains in 2006 principally relate to increases in discount rates. The actuarial losses in 2005 are principally due to reductions in discount rates generally, and improved life expectancies in the UK and Germany.

The movements in funded scheme assets were as follows:

	Pension schemes		Healthcare schemes		Total	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Fair value of scheme assets at 1 January	3,824	3,328	12	11	3,836	3,339
Exchange differences	(152)	77	(3)	1	(155)	78
Expected return on scheme assets	231	221	1	1	232	222
Company contributions	144	146	5	5	149	151
Contributions by scheme members	4	5			4	5
Benefits paid	(246)	(219)	(5)	(6)	(251)	(225)
Acquisitions of subsidiaries		13				13
Scheme changes	(6)				(6)	
Actuarial gains	139	253	2		141	253
Fair value of scheme assets at 31 December	3,938	3,824	12	12	3,950	3,836

Contributions to defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes, taking into account regulatory requirements. Contributions in 2007 are expected to be £131 million for pension schemes and £6 million for healthcare schemes, compared to £144 million and £5 million, respectively, in 2006.

The movements in the unrecognised funded scheme surpluses were as follows:

	Pension schemes		Healthcare schemes		Total	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Unrecognised funded scheme surpluses at 1 January	(70)	(60)			(70)	(60)
Exchange differences	13	(2)			13	(2)
Movement in year	(4)	(8)			(4)	(8)
Unrecognised funded scheme surpluses at 31 December	(61)	(70)			(61)	(70)

The movements in the net unrecognised actuarial losses/(gains) were as follows:

	Pension schemes		Healthcare schemes		Total	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Net actuarial losses/(gains) at 1 January	342	43	13	(2)	355	41
Exchange differences	(3)	(6)	(3)		(6)	(6)
Actuarial (gains): scheme assets	(139)	(253)	(2)		(141)	(253)
Actuarial (gains)/losses: scheme liabilities	(83)	557	6	15	(77)	572
Actuarial (losses)/gains recognised	(6)	1			(6)	1
Net actuarial losses/(gains) at 31 December	111	342	14	13	125	355

The principal actuarial assumptions (weighted to reflect individual scheme differences) used in the following principal countries were as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2006					
Rate of increase in salaries	5.1	2.5	4.0	2.4	1.6
Rate of increase in pensions in payment	3.1	2.0	Nil	2.0	1.0
Rate of increase in deferred pensions	3.1	Nil	Nil	2.0	
Discount rate	5.1	4.5	4.7	4.6	3.2
General inflation	3.1	2.0	3.0	2.0	1.0

For healthcare inflation in Canada, the assumption was 10 per cent reducing to 5 per cent by 2012.

For the remaining pension schemes, typical assumptions were that real salary increases will be from 2 per cent to 4 per cent per annum and discount rates will be from 2 per cent to 5 per cent above inflation. Pension increases, where allowed for, were generally assumed to be in line with inflation.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2005					
Rate of increase in salaries	5.0	2.5	4.0	2.3	1.6
Rate of increase in pensions in payment	3.0	1.6	Nil	2.0	1.0
Rate of increase in deferred pensions	3.0	Nil	Nil	2.0	
Discount rate	4.7	4.0	4.7	4.2	3.2
General inflation	3.0	1.6	3.0	2.0	1.0

For healthcare inflation in Canada, the assumption was 10 per cent reducing to 5 per cent by 2011.

For the remaining pension schemes, typical assumptions were that real salary increases will be from 2 per cent to 4 per cent per annum and discount rates will be from 2 to 5 per cent above inflation. Pension increases, where allowed for, were generally assumed to be in line with inflation.

Mortality assumptions are subject to regular review. In the UK, Canada, Germany, the Netherlands and Switzerland the same tables were used for both years. In the UK, for post-retirement mortality assumptions at 31 December 2006 and 31 December 2005, the table PXA92 (B=1965) rated up two years for active and deferred members and PXA92 (B=1935) tables rated up four years for current pensioners, all with the medium cohort effect, have been used. In Canada UP94 tables, in Germany Heubeck tables 2005G, in the Netherlands GBM/V 1995-2000 tables, with an age setback of two years for males and one year for females, and EVK 2000 mortality tables in Switzerland, have been used.

Based on the above, the weighted average life expectancy, in years, for mortality tables used to determine benefit obligations is as follows:

	UK		Germany		Canada		Netherlands		Switzerland	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
Member age 65 (current life expectancy)	18.5	21.3	17.6	21.7	19.0	21.6	17.3	20.9	17.6	20.4
Member age 45 (life expectancy at age 65)	21.2	24.0	20.4	24.4	19.0	21.6	17.3	20.9	20.6	23.3

A one percentage point change in healthcare inflation would have the following effects, which were similar in 2005:

	1 percentage point increase £m	1 percentage point decrease £m
31 December 2006		
Effect on total of current service cost and interest cost	1	(1)
Effect on healthcare scheme liabilities	16	(13)

The expected rates of return on scheme assets in the following principal countries were as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2006					
Equities	7.5	8.0	8.2	8.2	7.0
Bonds	4.8	5.5	5.5	4.1	4.5
Property	7.5	4.5		6.9	5.0
Other assets	8.1		Nil	3.2	2.0

For the remaining pension schemes, typical expected long term real rates of return ranged from 2 per cent to 7 per cent.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2005					
Equities	7.1	8.0	7.5	7.6	7.0
Bonds	4.3	5.5	6.5	3.8	4.5
Property	7.1	4.5		6.3	5.0
Other assets	7.0		Nil	2.0	2.0

For the remaining pension schemes, typical expected long term real rates of return ranged from 2 per cent to 7 per cent.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2004					
Equities	7.5	8.0	7.8	7.1	7.0
Bonds	4.9	6.0	6.5	3.7	4.5
Property	7.5	4.5		6.4	5.5
Other assets	7.0		Nil	2.0	2.0

For the remaining pension schemes, typical expected long term real rates of return ranged from 2 per cent to 5 per cent.

Expected rates of return were determined taking into account the current level of expected returns on risk free investments, the historical level of risk premium associated with other invested assets, and the expectations for future returns on such assets.

The major categories of assets as a percentage of the total fair value of scheme assets were as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %	Others %	Total %
31 December 2006							
Equities	53.4	43.6	60.2	36.4	35.9	23.4	46.8
Bonds	36.5	28.8	34.7	44.9	48.7	54.4	38.7
Property	5.1	27.6		8.7	9.2	1.7	7.8
Other assets	5.0		5.1	10.0	6.2	20.5	6.7
31 December 2005							
Equities	57.9	38.7	59.6	40.3	41.3	24.4	48.4
Bonds	33.0	31.9	35.0	45.0	45.8	54.1	37.8
Property	4.4	29.4		8.0	6.7	1.7	7.4
Other assets	4.7		5.4	6.7	6.2	19.8	6.4

The history of the present value of the scheme liabilities, fair value of the scheme assets, the scheme net deficits and experience gains and losses were as follows:

	2006	2005	2004
	£m	£m	£m
Historical information			
Scheme liabilities	4,421	4,630	3,852
Scheme assets	3,950	3,836	3,339
Scheme net deficits	(471)	(794)	(513)
Experience losses/(gains) on scheme liabilities	35	(6)	68
Experience gains on scheme assets	(141)	(253)	(64)

13 Deferred tax

Deferred tax assets comprise:

	Stock relief £m	Excess of depreciation over capital allowances £m	Tax losses £m	Retirement benefits £m	Fair value losses £m	Other temporary differences £m	Total £m
At 1 January 2006	40	9	18	137		221	425
Exchange differences	(3)	(1)	(1)	(10)		(21)	(36)
Credited/(charged) to the income statement	1	(4)	34	(16)		(8)	7
Other	5	9	(19)	1		(4)	(8)
At 31 December 2006	43	13	32	112		188	388
At 1 January 2005	32	14	36	123		167	372
Change in accounting policy <i>page 120 note 24</i>					10		10
At 1 January 2005	32	14	36	123	10	167	382
Exchange differences	3	1	1	5		14	24
Credited/(charged) to the income statement	5	(4)	31	1		24	57
Charged to equity					(10)		(10)
Other		(2)	(50)	8		16	(28)
At 31 December 2005	40	9	18	137		221	425

Deferred tax liabilities comprise:

	Stock relief £m	Excess of capital allowances over depreciation £m	Undistributed earnings of associates and subsidiaries £m	Retirement benefits £m	Fair value gains £m	Other temporary differences £m	Total £m
At 1 January 2006	30	154	73	98	15	42	412
Exchange differences Charged/(credited) to the income statement	(1)	(12)	(3)	(2)	(2)	(9)	(29)
Credited to equity	(4)	(8)	17	20	(2)	4	27
Other	2	6		(2)	(1)	(2)	3
At 31 December 2006	27	140	87	114	8	35	411
At 1 January 2005	37	138	49	91		44	359
Change in accounting policy <i>page 120 note 24</i>					3		3
At 1 January 2005	37	138	49	91	3	44	362
Exchange differences Charged/(credited) to the income statement	(1)	12	1	1			13
Charged to equity	(7)	5	20	5		(13)	10
Acquisitions of subsidiaries	1	1		1	12		12
Other		(2)	3			11	3
At 31 December 2005	30	154	73	98	15	42	412

	2006 £m	2005 £m
Net deferred tax liabilities/(assets)	23	(13)

The net deferred tax liabilities/(assets) are reflected in the Balance Sheet as follows, after offsetting assets and liabilities where there is a legally enforceable right to offset current tax assets and liabilities and where the deferred income taxes relate to the same fiscal authority.

	2006 £m	2005 £m
Deferred tax assets	(273)	(290)
Deferred tax liabilities	296	277
	23	(13)

Deferred tax expected to be recovered within 12 months:

	2006 £m	2005 £m
Deferred tax assets	(86)	(126)
Deferred tax liabilities	105	87
	19	(39)

At the Balance Sheet date, the Group has recognised and unrecognised deferred tax assets in respect of unused tax losses of £144 million (2005: £137 million) available for offset against future profits. A deferred tax asset has been recognised in respect of £32 million (2005: £18 million) of such losses, as realisation of the related tax benefit is probable.

Unrecognised deferred tax assets in respect of unused income tax losses of £67 million (2005: £69 million) have no expiry date and unused income tax losses of £35 million (2005: £40 million) expire after five years. Unrecognised deferred tax assets in respect of unused capital tax losses of £10 million (2005: £10 million) have no expiry date.

At the Balance Sheet date, the Group has unrecognised deferred tax assets in respect of deductible temporary differences of £183 million (2005: £179 million) and unused tax credits of £136 million (2005: £133 million). £nil million (2005: £10 million) of these unrecognised deferred tax assets expire after five years, whilst the remainder have no expiry period.

At the Balance Sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was £5 billion (2005: £5 billion). No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences, and it is probable that such differences will not reverse in the foreseeable future.

14 Trade and other receivables

	2006	2005
	£m	£m
Trade receivables	1,083	1,093
Loans and other receivables	530	511
Prepayments and accrued income	147	170
	1,760	1,774
Analysed on the balance sheet as:		
– current	1,568	1,577
– non-current	192	197
	1,760	1,774

Impairment of trade receivables charged in the year as part of other operating expenses was £17 million (2005: £7 million).

Prepayments and accrued income include £48 million (2005: £45 million) in respect of dividends from associates and £1 million (2005: £1 million) in respect of interest.

Trade and other receivables are predominantly denominated in the functional currencies of subsidiary undertakings apart from the following:

	2006	2005
	£m	£m
US dollar	106	140
UK sterling	4	1
Euro	22	35
Other currencies	24	32

Trade and other receivables also include certain interest bearing amounts and their effective interest rates as follows:

	2006	2005	2006	2005
	£m	£m	%	%
US dollar*	64	78	4.6	3.7
Euro	1	3	3.6	3.4
Other currencies	36	33	10.6	11.4

*Includes US\$100 million (£51 million) (2005: £58 million) representing a bond posted in connection with the Engle class action in the US (page 131 note 30).

There is no material difference between the above amounts for trade and other receivables and their fair value, due to the short term duration of the majority of trade and other receivables. There is no concentration of credit risk with respect to trade receivables as the Group has a large number of customers, internationally dispersed.

15 Available-for-sale investments

	2006 £m	2005 £m
1 January	123	100
Change in accounting policy <i>page 120 note 24</i>		16
	123	116
Differences on exchange	(1)	1
Additions and advances	85	179
Revaluations	(2)	(1)
Disposals and repayments	(54)	(173)
Other movements	1	1
31 December	152	123
Current	128	96
Non-current	24	27
	152	123

Investments have the following maturities:

	2006 £m	2005 £m
Equity investments	25	26
Non-equity investments:		
– within one year	73	24
– beyond one year and within two years	4	18
– beyond two years and within three years	21	6
– beyond three years and within four years	12	21
– beyond four years and within five years		14
– beyond five years	17	14
	152	123

Investments are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	2006 £m	2005 £m
Functional currencies	92	118
US dollar	56	2
Other currencies	4	3
	152	123

Non-equity investments are denominated in the following currencies:

	2006 £m	2005 £m
US dollar	56	2
UK sterling	71	89
Other currencies		6
	127	97

Effective interest rates applicable to non-equity investments are as follows:

	2006 %	2005 %
On US dollar	4.8	5.8
On UK sterling	5.3	5.6
On other currencies		18.7

16 Derivative financial instruments

	2006		2005	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedges				
– interest rate swaps	25	19	80	
– cross-currency swaps	24	4	7	10
Cash flow hedges				
– interest rate swaps				1
– cross-currency swaps			10	1
– forward foreign currency contracts	20	1	29	8
Net investment hedges				
– cross-currency swaps	53		21	
– forward foreign currency contracts	31	10	3	29
Trading				
– interest rate swaps				1
– cross-currency swaps		43		57
– forward foreign currency contracts	29	13	16	38
– others	18	23	7	17
	200	113	173	162
Current	124	84	86	143
Non-current	76	29	87	19
	200	113	173	162
Current assets and liabilities include:				
– net interest receivable	35	(5)	30	(8)
– trading derivatives that mature beyond one year		37		59
Derivatives:				
– in respect of net debt	125	79	133	116
– other	75	34	40	46
	200	113	173	162

Some derivative financial instruments are not designated as hedges and have been classified as trading derivatives.

The fair values of derivatives are determined based on market data (primarily yield curves, implied volatilities and exchange rates) to calculate the present value of all estimated flows associated with each derivative at the Balance Sheet date. In the absence of sufficient market data, fair values have been based on the quoted market price of similar derivatives.

For cash flow hedges, the timing of expected cash flows is as follows:

	2006		2005	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	11	1	31	10
Between one and two years	2		7	
Between two and three years	7		1	
	20	1	39	10

The maturity dates of all derivative financial instruments are as follows:

	2006		2005	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	89	52	56	92
Between one and two years	5	30	7	11
Between two and three years	67	1	1	41
Between three and four years			61	
Between four and five years	4			
Beyond five years	35	30	48	18
	200	113	173	162

In summary by type, the fair value of derivative financial instruments is as follows:

	2006		2005	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Interest rate swaps	25	19	80	2
Cross-currency swaps	77	47	38	68
Forward foreign currency contracts	80	24	48	75
Others	18	23	7	17
	200	113	173	162

(a) Interest rate swaps

	Maturity date	Principal currency	m	£m	Interest rate %		2006	
					Original	Swapped	Assets £m	Liabilities £m
Fixed to floating	2009	EUR	550	371	4.9	note (a)	10	
	2009	EUR	250	168	4.1	note (a)	4	
	2013	EUR	400	270	5.1	note (a)	7	
	2013	GBP	350	350	5.8	note (a)		19
	2019	GBP	250	250	6.4	note (a)	4	
Floating to fixed	2007	AUD	50	20	note (a)	5.5		
							25	19

	Maturity date	Principal currency	m	£m	Interest rate %		2005	
					Original	Swapped	Assets £m	Liabilities £m
Fixed to floating	2009	EUR	550	378	4.9	note (a)	23	
	2009	EUR	250	172	4.1	note (a)	10	
	2013	EUR	400	275	5.1	note (a)	23	
	2013	GBP	350	350	5.8	note (a)		
	2019	GBP	250	250	6.4	note (a)	24	
Floating to fixed	2006	CHF	50	22	note (a)	4.8		1
	2006	CAD	350	175	note (a)	4.6		1
	2006	AUD	175	75	note (a)	5.7		
	2007	AUD	50	21	note (a)	5.5		
							80	2

Note (a): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between nil and 137 basis points.

The fixed to floating swaps have been used to manage the interest rate profile of external borrowings and are reflected in the repricing table on page 116 in note 21. The floating to fixed swaps have been used to manage the interest rate profile of both internal and external financing arrangements, and those relating to external borrowings are also reflected in the repricing table on page 116 in note 21.

(b) Cross-currency swaps

	Maturity date	Original currency	Interest rate %	Principal original		Swapped currency	Interest rate %	Principal swapped currency m	2006	
				m	£m				Assets £m	Liabilities £m
Fixed to fixed	2007	USD	5.8	70	36	KRW	7.5	85,876	47	13
	2009	EUR	4.9	500	337	USD	6.5	564	288	53
Fixed to floating	2008	GBP	6.5	217	217	AUD	note (b)	607	244	30
	2009	EUR	4.9	150	101	GBP	note (b)	104	104	1
	2012	EUR	3.6	750	505	USD	note (b)	907	463	22
	2016	GBP	5.5	325	325	EUR	note (b)	473	319	3
	2019	EUR	4.6	20	13	USD	note (b)	22	11	2
									77	47

	Maturity date	Original currency	Interest rate %	Principal original		Swapped currency	Interest rate %	Principal swapped currency m	2005	
				m	£m				Assets £m	Liabilities £m
Fixed to fixed	2006	DEM	5.4	250	88	USD	6.7	137	80	8
	2006	USD	4.4	45	26	KRW	6.5	52,785	30	5
	2007	USD	5.8	70	41	KRW	7.5	85,876	49	11
	2009	EUR	4.9	500	344	USD	6.5	564	329	23
Fixed to floating	2006	EUR	5.1	500	344	CAD	note (b)	699	349	2
	2008	GBP	6.5	217	217	AUD	note (b)	607	259	41
	2009	EUR	4.9	150	103	GBP	note (b)	104	104	5
	2012	EUR	3.6	750	515	USD	note (b)	907	528	9
	2019	EUR	4.6	20	14	USD	note (b)	22	13	2
									38	68

Note (b): The floating rate interest rates are based on LIBOR plus a margin ranging between 66 and 127 basis points.

The US dollar/South Korean won swaps have been used to manage internal financing arrangements. The remaining swaps have been used to manage the currency profile of external borrowings and are reflected in the currency table on page 116 in note 21. The fixed to floating swaps are also reflected in the repricing table on page 116 in note 21.

(c) Forward foreign currency contracts

Forward foreign currency contracts are denominated in the following currencies:

Fair values of assets:

	2006							2005				
	Currencies purchased forward							Currencies purchased forward				
	EUR £m	GBP £m	USD £m	CHF £m	CAD £m	AUD £m	Total £m	EUR £m	GBP £m	USD £m	ZAR £m	Total £m
Currencies sold forward												
AUD		1					1					
CAD		15					15					
CHF		5					5		1	1		2
CYP		1					1					
EUR		19					19		1	5		6
GBP								8		3	1	12
JPY			20				20			27		27
USD		18					18		1			1
ZAR		1					1					
		60	20				80	8	3	36	1	48

Fair values of liabilities:

	2006							2005				
	Currencies purchased forward							Currencies purchased forward				
	EUR £m	GBP £m	USD £m	CHF £m	CAD £m	AUD £m	Total £m	EUR £m	GBP £m	USD £m	ZAR £m	Total £m
Currencies sold forward												
AUD		3	1				4		7			7
CAD									7	1		8
CHF									1			1
EUR		1	2				3		4			4
GBP				2	6		8					
HKD									7			7
HUF									2			2
KRW										1		1
NZD						2	2		1			1
SGD									1			1
USD		1					1	13	21			34
RUR			1				1					
ZAR	1	4					5		9			9
	1	9	4	2	6	2	24	13	60	2		75

Forward foreign currency contracts have been used to hedge both internal and external forecast transactions as well as the hedging of internal and external assets and liabilities. Certain contracts were used to manage the currency profile of external borrowings and are reflected in the currency table on page 116 in note 21 and their nominal values are as follows:

	2006		2005	
	£m	£m	£m	£m
Forward contracts to purchase GBP, sell CHF	(74)	73	(78)	77
Forward contracts to purchase GBP, sell CAD	(308)	307		
Forward contracts to purchase GBP, sell AUD	(525)	529		

(d) Others

	2006		2005	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Others: Bund forwards <i>note i</i>	15	16	7	8
Interest derivative <i>note ii</i>		7		9
Sinking fund policy <i>note iii</i>	3			
	18	23	7	17

Notes:

- (i) Forward contracts to purchase and sell German government securities with a nominal value of €1.86 billion (2005: €1.87 billion) taken out to manage internal financing arrangements and maturing within one year.
- (ii) Remaining impact of an interest derivative with a nominal value of €1 billion maturing in 2013.
- (iii) Investment in sinking fund policy with a nominal value of ZAR 51 million.

17 Inventories

	2006 £m	2005 £m
Raw materials and consumables	1,182	1,280
Finished goods and work in progress	721	836
Goods purchased for resale	153	158
	2,056	2,274

Inventories pledged as security for liabilities amount to £11 million (2005: £4 million). Write-offs taken to other operating expenses in the Income Statement comprised £26 million (2005: £35 million), including amounts relating to restructuring costs.

18 Income tax receivable and payable

Income tax balances shown on the Group Balance Sheet as current assets and current liabilities are expected to be received or paid within 12 months of the Balance Sheet date for both 2006 and 2005.

19 Cash and cash equivalents

	2006 £m	2005 £m
Cash and bank balances	484	518
Cash equivalents	972	1,272
	1,456	1,790

Cash equivalents mainly comprise short term deposits with an original maturity of three months or less. The carrying value of cash and cash equivalents approximates their fair value.

Cash and cash equivalents are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	2006 £m	2005 £m
Functional currency	896	1,090
US dollar	352	584
UK sterling	7	4
Euro	179	108
Other currencies	22	4
	1,456	1,790

Cash and bank balances are non-interest bearing. Effective interest rates applicable to cash equivalents are as follows:

	2006 values £m	2005 values £m	2006 rates %	2005 rates %
US dollar	290	527	4.9	3.8
UK sterling	142	206	5.1	4.5
Euro	146	112	3.6	2.3
Canadian dollar	17	20	4.2	3.3
Other currencies	377	407	7.5	8.4
	972	1,272		

In the Group Cash Flow Statement, net cash and cash equivalents are shown after deducting bank overdrafts, as follows:

	2006 £m	2005 £m
Cash and cash equivalents <i>as above</i>	1,456	1,790
<i>Less</i>		
– accrued interest	(1)	
– overdrafts	(179)	(126)
Net cash and cash equivalents	1,276	1,664

Cash and cash equivalents include restricted amounts of £65 million (2005: £77 million).

20 Capital and reserves – reconciliation of movement in total equity

	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Share- holders' funds £m	Minority interests £m	Total equity £m
1 January 2006 <i>as restated</i>	524	3,874	981	1,251	6,630	247	6,877
Differences on exchange			(665)		(665)	(20)	(685)
Cash flow hedges							
– net fair value gains			13		13		13
– reclassified and reported in net profit			(15)		(15)		(15)
Available-for-sale investments							
– net fair value losses			(2)		(2)		(2)
Net investment hedges							
– net fair value gains			117		117		117
Tax on items recognised directly in equity <i>page 92 note 6(c)</i>			(10)		(10)	(2)	(12)
Profit for the year				1,896	1,896	152	2,048
Employee share options							
– value of employee services				41	41		41
– proceeds from shares issued		5		23	28		28
Dividends and other appropriations							
– ordinary shares				(1,008)	(1,008)		(1,008)
– to minority interests						(137)	(137)
Purchase of own shares							
– held in employee share ownership trusts				(77)	(77)		(77)
– share buy-back programme	(7)	7		(500)	(500)		(500)
Acquisition of minority interests						(13)	(13)
Other movements				13	13		13
31 December 2006	517	3,886	419	1,639	6,461	227	6,688

	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Share- holders' funds £m	Minority interests £m	Total equity £m
1 January 2005	535	3,857	625	902	5,919	198	6,117
Change in accounting policy <i>page 89 note 4</i>			(7)	7			
Change in accounting policy <i>page 120 note 24</i>			1	(44)	(43)	1	(42)
	535	3,857	619	865	5,876	199	6,075
Differences on exchange			394		394	31	425
Cash flow hedges							
– net fair value gains			18		18	(1)	17
– reclassified and reported in net profit			37		37	1	38
– reclassified as basis adjustments			3		3		3
Available-for-sale investments							
– net fair value losses			(1)		(1)		(1)
– reclassified and reported in net profit			1		1		1
Net investment hedges							
– net fair value losses			(52)		(52)		(52)
Tax on items recognised directly in equity <i>page 92 note 6(c)</i>			(39)		(39)	(2)	(41)
Profit for the year				1,767	1,767	127	1,894
Employee share options							
– value of employee services				42	42		42
– proceeds from shares issued		6		24	30		30
Dividends and other appropriations							
– ordinary shares				(910)	(910)		(910)
– to minority interests						(112)	(112)
Purchase of own shares							
– held in employee share ownership trusts				(48)	(48)		(48)
– share buy-back programme	(11)	11		(501)	(501)		(501)
Other movements			1	12	13	4	17
31 December 2005	524	3,874	981	1,251	6,630	247	6,877

As described on page 89 in note 4, differences on exchange in 2005 have been restated by £4 million with a corresponding change in net finance costs and consequently profit for the year. The change in accounting policy had a £nil impact on the reported net finance costs and differences on exchange in 2006. The change to the translation reserve and retained earnings as at 1 January 2005 was £7 million as shown above with a consequent change of £3 million as at 31 December 2005.

Details relating to the authorised and allotted share capital, and movements therein, are included on page 146 in note 3.

Share premium account, capital redemption reserves and merger reserves comprise:

	Share premium account £m	Capital redemption reserves £m	Merger reserves £m	Total £m
1 January 2005	37	72	3,748	3,857
31 December 2005	43	83	3,748	3,874
31 December 2006	48	90	3,748	3,886

The share premium account includes the difference between the value of shares issued and their nominal value. The increase of £5 million (2005: £6 million) relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration Report on pages 53 to 66.

On the purchase of own shares as part of the buy-back programme, a transfer is made from retained earnings to the capital redemption reserve equivalent to the nominal value of shares purchased. As described on page 146 in note 3, a technical infringement of the Companies Act 1985 occurred in relation to £100 million of the £500 million shares purchased under the buy-back programme in the table on page 112, which therefore remain in the share capital shown above and are excluded from the transfer to the capital redemption reserve.

In 1999, shares were issued for the acquisition of the Rothmans International B.V. Group, and the difference between the fair value of shares issued and their nominal value was credited to merger reserves.

Movements in other reserves and retained earnings (which is after deducting treasury shares) shown above comprise:

	Translation reserve £m	Hedging reserve £m	Available- for-sale reserve £m	Other reserves £m	Total other reserves £m	Retained earnings Treasury shares £m	Other £m
1 January 2006 as restated	383	10	15	573	981	(182)	1,433
Differences on exchange	(665)				(665)		
Cash flow hedges							
– net fair value gains		13			13		
– reclassified and reported in net profit		(15)			(15)		
Available-for-sale investments							
– net fair value losses			(2)		(2)		
Net investment hedges							
– net fair value gains	117				117		
Tax on items recognised directly in equity page 92 note 6(c)	(12)	2			(10)		
Profit for the year							1,896
Employee share options							
– value of employee services							41
– proceeds from shares issued						23	
Dividends and other appropriations							
– ordinary shares							(1,008)
Purchase of own shares							
– held in employee share ownership trusts						(77)	
– share buy-back programme							(500)
Other movements						39	(26)
31 December 2006	(177)	10	13	573	419	(197)	1,836

	Translation reserve £m	Hedging reserve £m	Available- for-sale reserve £m	Other reserves £m	Total other reserves £m	Retained earnings	
						Treasury shares £m	Other £m
1 January 2005	52			573	625	(190)	1,092
Change in accounting policy <i>page 89 note 4</i>	(7)				(7)		7
Change in accounting policy <i>page 120 note 24</i>	12	(26)	15		1		(44)
	57	(26)	15	573	619	(190)	1,055
Differences on exchange	394				394		
Cash flow hedges							
– net fair value gains		18			18		
– reclassified and reported in net profit		37			37		
– reclassified as basis adjustments		3			3		
Available-for-sale investments							
– net fair value losses			(1)		(1)		
– reclassified and reported in net profit			1		1		
Net investment hedges							
– net fair value losses	(52)				(52)		
Tax on items recognised directly in equity <i>page 92 note 6(c)</i>	(17)	(22)			(39)		
Profit for the year							1,767
Employee share options							
– value of employee services							42
– proceeds from shares issued						24	
Dividends and other appropriations							
– ordinary shares							(910)
Purchase of own shares							
– held in employee share ownership trusts						(48)	
– share buy-back programme							(501)
Other movements	1				1	32	(20)
31 December 2005	383	10	15	573	981	(182)	1,433

The translation reserve is as explained in the accounting policy on foreign currencies on page 79.

The hedging reserve and the available-for-sale reserve are as explained in the accounting policy on financial instruments on page 81.

Other reserves comprise:

- £483 million which arose in 1998 from merger accounting in a Scheme of Arrangement and Reconstruction whereby British American Tobacco p.l.c. acquired the entire share capital of B.A.T Industries p.l.c. and the share capital of that company's principal financial services subsidiaries were distributed, so effectively demerging them; and
- in the Rothmans transaction noted on page 114, convertible redeemable preference shares were issued as part of the consideration. The discount on these shares was amortised by crediting other reserves and charging retained earnings. The £90 million balance in other reserves comprises the accumulated balance in respect of the preference shares converted during 2004.

21 Borrowings

	Currency	Maturity dates	Interest rates	2006 £m	2005 restated £m
Eurobonds	Euro	2006 to 2019	3.6% to 5.4%	3,465	3,881
	UK sterling	2008 to 2019	5.5% to 6.5%	1,364	1,087
Floating rate notes	Euro	2006 to 2010	floating rate	355	692
Other notes	Japanese yen	2006	1.4%		75
	Malaysian ringgit	2007 to 2009	4.6% to 7.9%	103	109
	US dollar	2008	6.9%	176	200
	Other currencies			93	196
Syndicated bank loans	US dollar	2006 to 2007	floating rate	358	404
Bank loans				460	418
Other loans				11	8
Finance leases				62	64
Overdrafts				179	126
				6,626	7,260

The floating rate interest rates are based on EURIBOR or US LIBOR plus a margin ranging between 36 and 200 basis points.

	2006 £m	2005 restated £m
Current	1,058	2,202
Non-current	5,568	5,058
	6,626	7,260

As described on page 96 in note 10, borrowings in respect of finance leases for 2005 have been restated by a £4 million increase to comply with IFRIC Interpretation 4. At the end of 2006, finance lease obligations of £8 million were included within borrowings on a similar basis.

Current borrowings include interest payable of £133 million at 31 December 2006 (2005: £128 million). In addition, the carrying value of non-current borrowings which are subject to fair value hedges has been decreased by £52 million at 31 December 2006 (2005: increased by £57 million). The carrying value of current borrowings which are subject to fair value hedges has been adjusted by £nil at 31 December 2006 (2005: increased by £2 million).

The fair value of borrowings is estimated to be £6,772 million (2005: £7,498 million) and has been determined using quoted market prices, market prices of comparable instruments at the Balance Sheet date or discounted cash flow analysis.

	2006 £m	2005 restated £m
Amounts secured on Group assets	88	68

Amounts secured include finance leases of £62 million (2005: £64 million) and the remaining amounts are secured on certain property and inventory of the Group (page 96 note 10 and page 111 note 17).

Borrowings are repayable as follows:

	2006	2005
	£m	restated £m
Within one year	1,058	2,202
Between one and two years	419	514
Between two and three years	1,240	445
Between three and four years	361	1,230
Between four and five years	828	3
Beyond five years	2,720	2,866
	6,626	7,260

Borrowings are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	Functional currency £m	US dollar £m	UK sterling £m	Euro £m	Canadian dollar £m	Australian dollar £m	Other currencies £m	Total £m
31 December 2006								
Total borrowings	3,128	809	327	2,362				6,626
Effect of derivative financial instruments								
– cross-currency swaps	(113)	762	(325)	(637)		244		(69)
– forward foreign currency contracts	(907)				307	529	73	2
	2,108	1,571	2	1,725	307	773	73	6,559
31 December 2005								
Total borrowings (restated)	3,319	889	218	2,833			1	7,260
Effect of derivative financial instruments								
– cross-currency swaps	104	950	(217)	(1,408)	349	259		37
– forward foreign currency contracts	(78)						77	(1)
	3,345	1,839	1	1,425	349	259	78	7,296

Details of the derivative financial instruments included in these tables are given on page 107 in note 16.

The exposure to interest rate changes when borrowings are repriced is as follows:

	Within 1 year £m	Between 1-2 years £m	Between 2-3 years £m	Between 3-4 years £m	Between 4-5 years £m	Beyond 5 years £m	Total £m
31 December 2006							
Total borrowings	1,505	419	1,240	8	735	2,719	6,626
Effect of derivative financial instruments							
– interest rate swaps	1,409		(539)			(870)	
– cross-currency swaps	1,141	(217)	(101)			(843)	(20)
	4,055	202	600	8	735	1,006	6,606

31 December 2005							
Total borrowings (restated)	2,564	166	431	1,230	3	2,866	7,260
Effect of derivative financial instruments							
– interest rate swaps	1,404	21		(550)		(875)	
– cross-currency swaps	904		(217)	(103)		(529)	55
	4,872	187	214	577	3	1,462	7,315

Details of the derivative financial instruments included in these tables are given on page 107 in note 16.

Effective interest rates are as follows:

	2006 £m	2005 restated £m	2006 %	2005 %
US dollar	866	936	6.6	6.0
UK sterling	1,382	1,090	5.4	6.2
Euro	3,814	4,595	4.5	4.2
Canadian dollar	13	13	5.8	5.0
Australian dollar	7	86	6.5	6.5
Other currencies	544	540	6.8	7.0
	6,626	7,260		

The values and rates shown above do not reflect the effect of the interest rate and cross-currency swaps detailed on page 107 in note 16.

Finance lease liabilities are payable as follows:

	2006			2005		
	Principal £m	Interest £m	Total £m	Principal restated £m	Interest restated £m	Total restated £m
Within one year	18	3	21	19	4	23
Between one and two years	17	2	19	15	3	18
Between two and three years	13	1	14	13	1	14
Between three and four years	8	1	9	10		10
Between four and five years	3		3	3		3
Beyond five years	3	1	4	4	1	5
	62	8	70	64	9	73

Borrowings facilities

	2006 £m	2005 £m
Undrawn committed facilities expiring		
– within one year	85	116
– between one and two years	57	
– between four and five years	1,750	1,750
	1,892	1,866

The facilities include undrawn amounts in respect of the Group's central banking facility of £1.75 billion (2005: £1.75 billion).

22 Other provisions for liabilities and charges

	Restructuring of existing businesses £m	Employee Acquired businesses £m	related benefits £m	Other provisions £m	Total £m
1 January 2006	222	76	25	172	495
Differences on exchange	(15)	(4)	(2)	(13)	(34)
Provided in respect of the year	99	(12)	1	38	126
Utilised during the year	(111)	(19)	(4)	(31)	(165)
Other movements	(4)		(6)	2	(8)
31 December 2006	191	41	14	168	414
Analysed on the Balance Sheet as					
– current	120	24	5	104	253
– non-current	71	17	9	64	161
	191	41	14	168	414
1 January 2005	156	105	28	152	441
Differences on exchange	3	1	2	9	15
Provided in respect of the year	157		4	84	245
Utilised during the year	(94)	(30)	(9)	(66)	(199)
Other movements				(7)	(7)
31 December 2005	222	76	25	172	495
Analysed on the Balance Sheet as					
– current	103	19	6	106	234
– non-current	119	57	19	66	261
	222	76	25	172	495

The restructuring provisions relate to the restructuring costs incurred and reported as exceptional items in the Income Statement. The principal restructurings provided in 2006 and 2005 are as described on page 88 in note 3(e). While some elements of the non-current provisions of £71 million will unwind over several years, as termination payments are made over extended periods in some countries, it is estimated that approximately 67 per cent will unwind in 2008 and approximately 90 per cent within five years.

Provisions in respect of acquired businesses mostly relate to those which were part of the integration of the Rothmans businesses in 1999, the transition of Imperial Tobacco Canada Ltd. to a subsidiary in 2000 and the reorganisation of the Italian business acquired in 2003. While some elements of the non-current provisions of £17 million will unwind over several years, it is estimated that approximately 75 per cent will unwind within five years.

Employee related benefits mainly relate to long term employee benefits other than post-retirement benefits. As the principal components of these provisions are long service awards and 'jubilee' payments due after a certain service period, they will unwind over several years. It is estimated that approximately 60 per cent of the non-current provisions of £9 million will unwind within five years.

Other provisions comprise balances set up in the ordinary course of general business that cannot be classified within the other categories, such as sales returns, onerous contracts and the age verification scheme in Japan, together with amounts in respect of supplier, excise and other disputes. The nature of the amounts provided in respect of disputes is such that the extent and timing of cash flows is difficult to estimate and the ultimate liability may vary from the amounts provided.

Amounts provided in respect of 2006 above are shown net of reversals of unused provisions which include £15 million for restructuring of existing businesses, £12 million for acquired businesses, £2 million for employee related benefits and £12 million for other provisions.

23 Trade and other payables

	2006	2005
	£m	£m
Trade payables	611	550
Duty, excise and other taxes	1,467	1,581
Accrued charges and deferred income	553	620
Social security and other taxation	9	2
Sundry payables	272	310
	2,912	3,063
Analysed on the Balance Sheet as		
– current	2,766	2,883
– non-current	146	180
	2,912	3,063

Accrued charges and deferred income include £12 million (2005: £17 million) in respect of interest payable.

There is no material difference between the above amounts for trade and other payables and their fair value, due to the short term duration of the majority of trade and other payables.

Trade and other payables are predominantly denominated in the functional currencies of subsidiary undertakings with less than 6 per cent in other currencies.

24 Financial instruments

The accounting policy change in 2005 reflected the application of IAS32 and IAS39 on financial instruments from 1 January 2005. The £42 million reduction in equity at that date reflected:

- the measurement of available-for-sale investments at fair value: £16 million gain;
- the recognition of derivative financial instruments and derecognition of deferred losses on derivatives: £65 million loss; and
- deferred tax asset of £10 million and deferred tax liability of £3 million in respect of the above adjustments.

Management of financial risks

One of the principal responsibilities of Treasury is to manage the financial risks arising from the Group's underlying operations. Specifically, Treasury manages, within an overall policy framework, the Group's exposure to funding and liquidity, interest rate, foreign exchange and counterparty risks. Derivative contracts are only entered into to facilitate the management of these risks.

The Group's management of specific risks is dealt with as follows:

Liquidity risk

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. Furthermore, it is the policy that short term sources of funds (including drawings under US dollar and euro commercial paper programmes) are backed by undrawn committed lines of credit and cash.

During 2006, the Group's central banking facility at £1.75 billion was extended on existing terms under a one year extension option to a term of five years (plus a further one year extension option).

The Group continues to target investment-grade credit ratings; as at end 2006, the ratings from Moody's and S&P were Baa1/BBB+ (end 2005: Baa1/BBB+). The strength of the ratings has underpinned the success of the debt issuance during 2005 and 2006 and the Group continues to enjoy full access to the debt capital markets.

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

Currency risk

The Group is subject to exposure on the translation of the net assets of foreign currency subsidiaries and associates into its reporting currency, sterling. The Group's primary balance sheet translation exposures are to the US dollar, Canadian dollar, euro and South African rand. These exposures are kept under continuous review and the Group's policy is to minimise all balance sheet translation exposure where it is practicable and cost effective to do so. The exposures are managed by matching currency assets with currency borrowings. At 31 December 2006, the currency profile of the Group's gross debt, after taking into account derivative contracts, was 25 (2005: 26) per cent US dollar, 48 (2005: 44) per cent euro, 5 (2005: 5) per cent Canadian dollar, 1 (2005: 12) per cent sterling, 12 (2005: 5) per cent Australian dollar and 9 (2005: 8) per cent other currencies.

The Group faces currency exposures arising from the translation of profits earned in foreign currency subsidiaries and associates; these exposures are not normally hedged. Exposures also arise from:

- (i) foreign currency denominated trading transactions undertaken by subsidiaries. These exposures comprise committed and highly probable forecast sales and purchases, which are offset wherever possible. The remaining exposures are hedged within the Treasury policies and procedures with forward foreign exchange contracts and options, which are designated as hedges of the foreign exchange risk of the identified future transactions; and
- (ii) forecast dividend flows from subsidiaries to the centre. To ensure cash flow certainty, the Group hedges such flows using forward foreign exchange contracts designated as net investment hedges of the foreign exchange risk arising from the investments in these subsidiaries.

Interest rate risk

The objectives of the Group's interest rate risk management policy are to lessen the impact of adverse interest rate movements on the earnings, cash flow and economic value of the Group, and to safeguard against any possible breach of its financial covenants. Additional objectives are to minimise the cost of hedging and the associated counterparty risk.

In order to manage its interest rate risk, the Group maintains both floating rate and fixed rate debt. The desired ratio of fixed to variable rate debt is determined as a result of regular reviews of market conditions and strategy by Treasury and the board of the main central finance company. At 31 December 2006, the ratio of floating to fixed rate borrowings was 58:42 (2005: 55:45). Underlying borrowings are arranged on both a fixed rate and a floating rate basis and, where appropriate, the Group uses derivatives, primarily interest rate swaps, to vary the fixed and floating mix. The interest rate profile of liquid assets is taken into account in determining the net interest rate exposure.

Credit risk

The Group has no significant concentrations of customer credit risk. Subsidiaries have policies in place requiring appropriate credit checks on potential customers before sales commence.

Cash deposits and other financial instruments give rise to credit risk on the amounts due from bank counterparties. Credit risk is managed on a global basis by limiting the aggregate amount and duration of exposure to any one counterparty, taking into account its credit rating. The credit ratings of counterparties are reviewed regularly.

Price risk

The Group is exposed to equity price risk on equity investments held by the Group. These are classified on the consolidated balance sheet as available-for-sale investments. The Group is not exposed to commodity price risk.

Hedge accounting

In order to qualify for hedge accounting, the Group is required to document prospectively the relationship between the item being hedged and the hedging instrument. The Group is also required to demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an on-going basis. This effectiveness testing is reperformed periodically to ensure that the hedge has remained, and is expected to remain highly effective.

Fair value estimation

Derivative financial instruments

The fair values of derivatives are determined based on market data (primarily yield curves, implied volatilities and exchange rates) to calculate the present value of all estimated flows associated with each derivative at the balance sheet date. In the absence of sufficient market data, fair values have been based on the quoted market price of similar derivatives.

Other financial instruments

The fair values of financial assets and liabilities with maturities of less than one year are assumed to approximate to their book values. For financial assets and liabilities with maturities of more than one year, fair values are based on quoted market prices, market prices of comparable instruments at the balance sheet date or discounted cash flow analysis.

25 Cash flow

Cash generated from operations

	2006	2005
	£m	restated £m
Profit before taxation	2,764	2,584
<i>Adjustments for</i>		
– share of post-tax results of associates and joint ventures	(431)	(392)
– net finance costs	289	228
– gains on disposal of brands and joint venture	(60)	(72)
– depreciation and impairment of property, plant and equipment	367	348
– amortisation of intangible assets	34	35
– decrease/(increase) in inventories	21	(28)
– increase in trade and other receivables	(105)	(178)
– increase in trade and other payables	57	326
– decrease in net retirement benefit liabilities	(69)	(52)
– (decrease)/increase in provisions for liabilities and charges	(68)	61
– other	17	33
Cash generated from operations	2,816	2,893

Profit before taxation includes charges in respect of Group restructuring costs referred to on page 88 in note 3(e). These are also reflected in the movements in depreciation, inventories, receivables, payables and provisions above, and in the proceeds on disposal of property, plant and equipment shown on page 77. The cash outflow in respect of the Group restructuring costs was £177 million (2005: £143 million), of which £220 million (2005: £143 million) is included in cash generated from operations above.

Cash flows from investing activities

(a) Proceeds on disposals of intangibles

The cash inflows in 2006 and 2005 principally reflect the sale of brands (page 88 note 3(f)).

- (b) Purchases and disposals of investments
Purchases and disposals of investments (which comprise available-for-sale investments and loans and receivables) include an outflow in respect of current investments of £41 million for the year to 31 December 2006 (2005: £7 million decrease) and £4 million sales proceeds from non-current investments for the year to 31 December 2006 (2005: £15 million).
- (c) Purchases of subsidiaries and minority interests
In 2006, the cash outflow principally reflects the cost of acquiring minority interests in the Group's Chilean subsidiary. In 2005, the cash outflow principally reflected the purchase of Restomat AG in Switzerland, net of £6 million cash and cash equivalents in the acquired company (see note 26 below).
- (d) Proceeds on disposal of subsidiaries
In 2006, the proceeds principally reflect the sale of Toscano in Italy (see note 26 below).
- (e) Purchases of associates
The outflow in 2005 reflects the increase in the shareholding in Skandinavisk Tobakskompagni AS (page 97 note 11).

Cash flows from financing activities

- (a) In 2006, reductions in borrowing principally reflect repayment of €1 billion floating rate notes, a deutschmark 1 billion Eurobond and a €500 million Eurobond, whilst new borrowings principally reflected €600 million Eurobonds with a 2014 maturity, £325 million Eurobonds with a 2016 maturity and €525 million floating rate notes with a 2010 maturity.

In 2005, reductions in borrowings principally reflect repayment of a US\$400 million Eurobond, €300 million floating rate notes and a deutschmark 500 million Eurobond, whilst new borrowings principally reflect a €750 million Eurobond with a 2012 maturity.
- (b) The movement relating to derivative financial instruments is in respect of derivatives taken out to hedge cash and cash equivalents and external borrowings, derivatives taken out to hedge inter company loans and derivatives treated as net investment hedges. Derivatives taken out as cash flow hedges in respect of financing activities are also included in the movement relating to derivative financial instruments, while other such derivatives in respect of operating and investing activities are reflected along with the underlying transactions.

26 Business combinations and disposals

- (a) The Group ceased to be the controlling company of British American Racing (Holdings) Ltd. (BAR) on 8 December 2004 when BAR went into administration. The Group consequently ceased to consolidate BAR from that date. On 7 January 2005, BARH Ltd., a newly formed joint venture between British American Tobacco and Honda Motor Co. Ltd. acquired the BAR business. On 4 October 2005, the Group announced that it had agreed the sale of its 55 per cent shareholding in BARH to Honda, and the sale was completed on 20 December 2005. For the period from 7 January 2005 to 20 December 2005, BARH was equity accounted, reflecting shared control with Honda.

These transactions resulted in a net gain of £5 million in 2005, included in other operating income in profit from operations (page 88 note 3(f)).

- (b) On 25 November 2005, the Group acquired Restomat AG, the largest operator of cigarette vending machines in Switzerland, for a cash consideration of £25 million. The net assets acquired were £10 million of non-current assets and £15 million of current assets (including £6 million of cash and cash equivalents) less £2 million of non-current liabilities and £5 million of current liabilities. The acquisition resulted in goodwill of £7 million. In the period from 1 January 2005 to 25 November 2005, the profit from operations and the profit for the period was £2 million.
- (c) As described on page 88 in note 3(f), the Group's Italian subsidiary sold its cigar business on 19 July 2006.
- (d) In August 2006, the Group purchased minority interests in its subsidiary in Chile for a cost of £91 million, raising the Group shareholding from 70.4 per cent to 96.4 per cent. The goodwill arising on this transaction was £80 million and the minority interests in Group equity were reduced by £11 million.

27 Share-based payments

During the period ended 31 December 2006, the following material share-based payment arrangements existed, which are described below:

Type of arrangement	Long Term Incentive Plan	Deferred Share Bonus Scheme	Sharesave Scheme	Share Option Scheme	Share Reward Scheme
Timing of grant	Annually in March (2005 – May)	Annually in March	Annually in November	See note (a)	Annually in April
Number of options/shares granted in 2006	2,712,841	1,835,223	3 year – 126,844 5 year – 154,664	n/a	334,738
Number of options/shares granted in 2005	3,472,111	2,275,558	3 year – 224,885 5 year – 190,160	n/a	305,888
Fair value per share for 2006 grant	£10.10	£13.00	3 year – £3.65 5 year – £3.91	n/a	£13.85
Fair value per share for 2005 grant	£7.29	£8.12	3 year – £3.12 5 year – £3.33	n/a	£9.31
Method of settlement	Both equity and cash-settled grants	Both equity and cash-settled grants	Equity	Both equity and cash-settled grants	Equity
Contractual life	10 years	3 years	3.5 or 5.5 years	10 years	3 years
Vesting conditions	See note (b)	See note (c)	See note (d)	See note (e)	See note (f)

Notes:

- The granting of options under this scheme ceased with the last grant made in March 2004. Eligible individuals are entitled to participate in the Long Term Incentive Plan and Deferred Share Bonus Scheme.
- Nil-cost options exercisable three years from date of grant, with payout subject to performance conditions based on earnings per share relative to inflation (50 per cent of grant) and total shareholder return, combining the share price and dividend performance of the Company by reference to two comparator groups (50 per cent of grant). Participants are not entitled to dividends prior to the exercise of the options. For grants made in 2005 and thereafter, a cash equivalent dividend will accrue through the vesting period and will be paid on vesting.
- Free shares released three years from date of grant and may be subject to forfeit if participant leaves employment before the end of the three year holding period. Participants receive a separate payment equivalent to a proportion of the dividend during the holding period.
- Options granted by invitation at a 20 per cent discount to the market price. Options are exercisable at the end of a three year or five year savings contract. Participants are not entitled to dividends prior to the exercise of the options.
- Options exercisable three years from date of grant and subject to earnings per share performance condition relative to inflation. Participants are not entitled to receive dividends in the period prior to the exercise of the options.
- Free shares granted (maximum £3,000 in any year) subject to a three year holding period and may be subject to forfeit if the employee leaves within this period. Participants are entitled to receive dividends during the holding period which are reinvested to buy further shares.

During the period, the Company operated a Partnership Share Scheme, which was open to all eligible employees, where employees can allocate part of their pre-tax salary to purchase shares in British American Tobacco p.l.c. The maximum amount that can be allocated in this way to any individual is £1,500 in any tax year. The shares purchased are held in a UK-based trust and are normally capable of transfer to participants tax free after a five-year holding period.

Further details on the operation of share-based payment arrangements can be found in the Remuneration Report.

Share option schemes

Details of the movements for equity-settled share option schemes during the years ended 31 December 2006 and 31 December 2005 covering the Share Option and Sharesave Schemes were as follows. The last of the former B.A.T Industries Employee Share 'E' Option Scheme options were exercised in 2005.

	2006		2005	
	Number of options	Weighted average exercise price per share £	Number of options	Weighted average exercise price per share £
Outstanding at start of year	12,648,695	6.39	17,352,182	5.97
Granted during the period	281,508	11.52	415,045	9.77
Exercised during the period	(4,234,650)	5.75	(4,864,295)	5.20
Forfeited during the period	(245,872)	7.01	(254,237)	5.89
Outstanding at end of year	8,449,681	6.86	12,648,695	6.39
Exercisable at end of year	3,626,882	5.55	3,267,697	5.19

In addition to the above options, the movement in nil-cost equity-settled options from the Long Term Incentive Plan was as follows:

	2006 Number of options	2005 Number of options
Outstanding at start of year	9,403,252	9,851,735
Granted during the period	2,224,313	3,099,082
Exercised during the period	(2,478,316)	(2,078,722)
Forfeited during the period	(1,040,994)	(1,468,843)
Outstanding at end of year	8,108,255	9,403,252
Exercisable at end of year	922,014	744,082

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the period was £13.94 (2005: £10.05). A detailed breakdown of the range of exercise prices for options outstanding for the years ended 31 December 2006 and 31 December 2005 is shown in the table below:

Range of exercise prices	2006			2005		
	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £
Nil-cost	8,108,255	7.8	n/a	9,403,252	8.0	n/a
£2.53 to £4.99	389,805	2.0	3.19	966,689	1.8	3.46
£5.00 to £6.99	3,908,880	4.1	5.74	7,330,469	5.5	5.81
£7.00 to £8.99	3,488,622	6.4	7.83	3,936,492	7.4	7.83
£9.00 to £12.50	662,374	3.9	10.51	415,045	4.4	9.77
	16,557,936	6.4	3.50	22,051,947	6.7	3.66

The weighted average fair value of equity-settled Share Option Schemes' shares granted during 2006 was £9.39 (2005: £6.81).

Assumptions used in the Black-Scholes models to determine the fair value of share options at grant date were as follows:

	2006		2005	
	Long Term Incentive Plan	Sharesave Schemes*	Long Term Incentive Plan	Sharesave Schemes*
Share price at date of grant (£)	14.34	14.40	10.37	12.21
Exercise price (£)	nil-cost	11.52	nil-cost	9.77
Volatility (%)	23	21	27	24
Average expected term to exercise (years)	3.5	3.2/5.2	3.5	3.2/5.2
Risk free rate (%)	4.4	4.9/4.8	4.3	4.2/4.2
Expected dividend yield (%)	3.3	3.4	4.0	3.5

* Where two figures have been quoted for the Sharesave Schemes, the first number represents the assumptions for the three year savings contract and the second number for the five year savings contract.

Market condition features were incorporated into the Monte-Carlo models for the total shareholder return elements of the Long Term Incentive Plan, in determining fair value at grant date. Assumptions used in these models were as follows:

	2006 %	2005 %
Average share price volatility FTSE 100 comparator group	31	34
Average share price volatility FMCG comparator group	23	26
Average correlation FTSE 100 comparator group	26	24
Average correlation FMCG comparator group	18	16

The expected British American Tobacco p.l.c. share price volatility was determined taking account of the daily share price movements over a five year period. The respective FMCG and FTSE 100 share price volatility and correlations were also determined over the same periods. The average expected term to exercise used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural conditions, forfeiture and historical experience.

The risk free rate has been determined from market yield curves for government gilts with outstanding terms equal to the average expected term to exercise for each relevant grant. The expected dividend yield was determined by calculating the yield from the last two declared dividends divided by the grant share price.

For grants containing earnings per share performance conditions, the payout calculation is based on the average of expectations published in analysts' forecasts.

Other equity share-based payment arrangements (other than share options)

Details of the movements of other equity share-based payment arrangements during the years ended 31 December 2006 and 31 December 2005, covering the Deferred Share Bonus and Share Reward Schemes, were as follows:

	2006 Number of shares	2005 Number of shares
Outstanding at start of year	7,001,271	7,284,592
Granted during the period	1,959,868	2,310,273
Exercised during the period	(3,037,981)	(2,461,386)
Forfeited during the period	(89,287)	(132,208)
Outstanding at end of year	5,833,871	7,001,271
Exercisable at end of year	383,294	643,825

The shares outstanding for the year ended 31 December 2006 had a weighted average contractual life of 1.1 years (2005: 1.1 years).

The fair value for other equity share-based payment arrangements granted during the period was determined using the Black-Scholes model with the following input assumptions at their grant date:

	2006		2005	
	Deferred Share Bonus Scheme	Share Reward Scheme	Deferred Share Bonus Scheme	Share Reward Scheme
Grant price (£)	14.34	13.85	9.29	9.31
Expected volatility (%)	23	23	30	30
Average expected term to exercise (years)	3.0	5.0	3.0	5.0
Risk free rate (%)	4.4	4.5	4.8	4.7
Expected dividend yield (%)	3.3	3.4	4.5	4.5

The weighted average fair value of other equity share-based payment arrangements granted during 2006 was £13.14 (2005: £8.27).

Cash-settled share-based payment arrangements

The Group issues to certain employees cash-settled share-based payments that require the Group to pay the intrinsic value of these share-based payments to the employee at the date of exercise. The Group has recorded liabilities at the end of 2006 of £14,294,315 (2005: £13,359,675) of which £3,456,071 (2005: £2,698,902) was in respect of vested grants. Fair value was determined from the Black-Scholes and Monte-Carlo models, using assumptions revised at the balance sheet date for cash-settled share-based payment arrangements. The Group recorded total expenses of £9,306,250 in 2006 (2005: £11,581,489).

Details of movements for cash-settled arrangements in respect of the Share Option Scheme during the years ended 31 December 2006 and 31 December 2005, were as follows:

	2006		2005	
	Number of options	Weighted average exercise price per share £	Number of options	Weighted average exercise price per share £
Outstanding at start of year	1,057,496	6.40	1,859,995	6.35
Granted during the period	n/a	n/a	n/a	n/a
Exercised during the period	(605,634)	6.19	(774,940)	6.28
Forfeited during the period	(20,582)	6.69	(27,559)	6.21
Outstanding at end of year	431,280	6.69	1,057,496	6.40
Exercisable at end of year	313,101	6.17	375,833	6.38

In addition to the above, the movement in other nil-cost cash-settled arrangements during the years ended 31 December 2006 and 31 December 2005, covering the Long Term Incentive Plan and Deferred Share Bonus Scheme, were as follows:

	2006 Number of shares	2005 Number of shares
Outstanding at start of year	1,215,861	1,030,400
Granted during the period	698,621	644,202
Exercised during the period	(239,513)	(408,380)
Forfeited during the period	(60,263)	(50,361)
Outstanding at end of year	1,614,706	1,215,861
Exercisable at end of year	63,934	16,190

Assumptions used to determine the fair value of cash-settled share-based payment arrangements at date of grant, can be found in the sections relating to share option schemes and other equity share-based payment arrangements.

The weighted average British American Tobacco p.l.c. share price at the date of exercise for cash-settled share-based arrangements exercised during the period was £14.05 (2005: £10.05). A detailed breakdown of the range of exercise prices for cash-settled share-based payment arrangements outstanding for the years ended 31 December 2006 and 31 December 2005 are shown in the table below:

Range of exercise prices	2006			2005		
	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £
Nil-cost	1,614,706	6.1	n/a	1,215,861	5.6	n/a
£5.60 to £5.98	163,481	6.1	5.97	546,929	7.1	5.98
£6.39 to £8.09	267,799	6.0	7.14	510,567	6.7	6.86
	2,045,986	6.1	1.41	2,273,357	6.2	2.98

Share-based payment expense

The amounts recognised in the Income Statement in respect of share-based payments were as follows:

	2006 £m	2005 £m
Equity-settled share-based payments	41	42
Cash-settled share-based payments	9	12
Total amount recognised in the Income Statement <i>page 87 note 3(a)</i>	50	54

28 Group employees

The average number of persons employed by the Group and its associates during the year, including Directors, was 97,431 (2005: 96,952).

	2006 Number	2005 Number
Europe	18,953	19,479
Asia-Pacific	10,128	10,407
Latin America	14,941	13,969
Africa and Middle East	8,993	9,247
America-Pacific	2,130	2,262
Subsidiary undertakings	55,145	55,364
Associates	42,286	41,588
	97,431	96,952

Details of Directors' remuneration, share options and retirement benefits are given in the Remuneration Report on pages 53 to 66.

Included within the employee numbers for Europe are certain employees in the UK in respect of central functions. Some of the costs of these employees are allocated or charged to the various regions and markets in the Group.

29 Related party disclosures

The Group has a number of transactions and relationships with related parties, as defined in IAS24 on related party disclosures, all of which are undertaken in the normal course of trading. Details of these are set out below.

Transactions and balances with associates relate mainly to the sale and purchase of cigarettes and tobacco leaf. Amounts receivable from associates in respect of dividends included in the table below were £48 million (2005: £45 million). The Group's share of dividends from associates included in other net income in the table below, was £267 million (2005: £202 million). Legal fees recovered from Reynolds American Inc. included in other net income amounted to £2 million (2005: £10 million).

	2006 £m	2005 £m
Transactions		
– revenue	35	43
– purchases	(292)	(304)
– other net income	272	184
Amounts receivable at 31 December	58	64
Amounts payable at 31 December	(24)	(33)

As described on page 123 in note 26, between 7 January 2005 and 20 December 2005 the Group had an interest in BARH Ltd., a joint venture between British American Tobacco and Honda Motor Co. Ltd. As part of this relationship, the Group had a funding obligation to BARH through to the end of 2006. Payments of US\$67.5 million relating to Lucky Strike sponsorship for 2005 and 2006, were made during 2005 and these are included in the table above under other net income.

The key management personnel of British American Tobacco consist of the members of the Board of Directors of British American Tobacco p.l.c. and the members of the Management Board. No such person had any material interest during the year in a contract of significance (other than a service contract) with the Company or any subsidiary company. The term key management personnel in this context includes the respective members of their households.

	2006 £m	2005 £m
The total compensation for key management personnel, including Directors, was:		
– salaries and other short-term employee benefits	14	11
– post-employment benefits	3	2
– share-based payments	6	5
	23	18

There were no termination benefits paid or other long-term benefits applicable in respect of key personnel.

Other than in their capacity as shareholders, there have been no material transactions with Compagnie Financière Richemont SA and Remgro Limited, who together indirectly own 29.2 per cent (2005: 28.6 per cent) of the fully diluted ordinary share capital of British American Tobacco p.l.c. at 31 December 2006.

30 Contingent liabilities and financial commitments

There are contingent liabilities in respect of litigation, overseas taxes and guarantees in various countries.

Product liability litigation

Group companies, notably Brown & Williamson Holdings, Inc. (formerly Brown & Williamson Tobacco Corporation) (B&W), as well as other leading cigarette manufacturers, are defendants, principally in the US, in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

Indemnity

On 30 July 2004, B&W completed transactions combining its US tobacco business assets, liabilities and operations with R.J. Reynolds Tobacco Company. A new company called R.J. Reynolds Tobacco Company

(RJRT) was created as a result of the combination transactions. These transactions (the Business Combination) were accomplished through a publicly traded holding company Reynolds American Inc. (RAI), which is the indirect parent corporation of RJRT. As a result of the Business Combination: (a) B&W discontinued the active conduct of any tobacco business in the US; (b) B&W contributed to RJRT all of its assets other than the capital stock of certain subsidiaries engaged in non-US businesses and other limited categories of assets; (c) RJRT assumed all liabilities of B&W (except liabilities to the extent relating to businesses and assets not contributed by B&W to RJRT and other limited categories of liabilities) and contributed subsidiaries or otherwise to the extent related to B&W's tobacco business as conducted in the US on or prior to 30 July 2004; and (d) RJRT agreed to indemnify B&W and each of its affiliates (other than RAI and its subsidiaries) against, among other matters, all losses, liabilities, damages, expenses, judgments, attorneys' fees, etc, to the extent relating to or arising from such assumed liabilities or the assets contributed by B&W to RJRT (the RJRT Indemnification). The scope of the RJRT Indemnification includes all expenses and contingent liabilities in connection with litigation to the extent relating to or arising from B&W's US tobacco business as conducted on or prior to 30 July 2004, including smoking and health tobacco litigation, whether the litigation is commenced before or after 30 July 2004 (the tobacco litigation).

Pursuant to the terms of the RJRT Indemnification, RJRT is liable for any possible judgments, the posting of appeal bonds or security, and all other expenses of and responsibility for managing the defence of the tobacco litigation. RJRT has assumed control of the defence of the tobacco litigation involving B&W and RJRT is also a party in most (but not all) of the same cases. Accordingly, RJRT uses or plans to use the same law firm or firms to represent both B&W and RJRT in any single or similar case (except in certain limited circumstances) as RJRT's interests are typically aligned with B&W's interests, and RJRT has substantial experience in managing recognised external legal counsel in defending tobacco litigation, and external counsel have independent professional responsibilities to represent the interests of B&W. In addition, in accordance with the terms of the RJRT Indemnification, affiliates of B&W have retained control of the defence in certain tobacco litigation cases with respect to which such affiliates are entitled to indemnification.

US litigation

The total number of US product liability cases pending at 31 December 2006 involving B&W and other Group companies was approximately 3,492 (2005: 3,810). At 31 December 2006, UK-based Group companies have been named as co-defendants in some seven of those cases (2005: 965). The reduction in this figure is primarily in consequence of the dismissal of B.A.T Industries p.l.c. as a defendant in the West Virginia consolidated smoking and health cases (see below under UK-based Group companies). Only one case against B&W was tried in 2006 (VanDenBurg), which resulted in a defence verdict. No US cases involving the UK-based Group companies were tried in 2006. Only perhaps five cases are likely to come to trial in 2007, some involving amounts ranging possibly into the hundreds of millions and even billions of dollars. Since many of these pending cases seek unspecified damages, it is not possible to quantify the total amounts being claimed, but the aggregate amounts involved in such litigation are significant. The cases fall into four broad categories:

(a) Medical reimbursement cases

These civil actions seek to recover amounts spent by government entities and other third party providers on healthcare and welfare costs claimed to result from illnesses associated with smoking. Although B&W continues to be a defendant in healthcare cost recovery cases involving plaintiffs such as hospitals, Native American tribes, and foreign governments, the vast majority of such cases have been dismissed on legal grounds.

At 31 December 2006, one reimbursement suit was pending against B&W by an Indian tribe, and no suits were pending against B&W by county or other political subdivisions of the states. The Master Settlement Agreement (MSA) with the 46 states includes a credit for any amounts paid in suits brought by the states' political subdivisions; nevertheless, RJRT intends to defend and is defending these cases vigorously. Based on somewhat different theories of claim are two non-governmental medical reimbursement cases and health insurers' claims. One third party reimbursement case (City of St. Louis), consists of more than 60 public and non-profit hospitals in Missouri seeking reimbursement of past and future alleged smoking related healthcare costs. No trial date is currently set for this case.

At 31 December 2006, B&W was named as a defendant in two (2005: two) cases brought by foreign government entities in a single US court (Republic of Panama and State of São Paulo) seeking reimbursement of medical costs which they incurred for treatment for persons in their own countries who

are alleged to have smoked imported cigarettes, including those manufactured by B&W. These two cases, originally filed in state court in Louisiana, were consolidated and then dismissed by the trial court on the basis that Louisiana was the inappropriate forum. These plaintiffs filed new cases in the Superior Court for the State of Delaware on 19 July 2005. On 13 July 2006, the Delaware Superior Court granted defendants' motion to dismiss. Plaintiffs filed notices of appeal to the Supreme Court of Delaware on 19 July 2006. Oral argument on plaintiffs' appeal was heard on 6 December 2006 by the Supreme Court of Delaware, which reserved decision.

(b) Class actions

At 31 December 2006, B&W was named as a defendant in some 15 (2005: 15) separate actions attempting to assert claims on behalf of classes of persons allegedly injured or financially impacted through smoking or where classes of tobacco claimants have been certified. Even if the classes remain certified and the possibility of class-based liability is eventually established, it is likely that individual trials will still be necessary to resolve any actual claims. Class-action suits have been filed in a number of states against individual cigarette manufacturers and their parent corporations, alleging that the use of the terms 'lights' and 'ultralights' constitutes unfair and deceptive trade practices. A class action complaint (Schwab) was filed in the US District Court for the Eastern District of New York on 11 May 2004 against B&W and certain UK-based Group companies. The complaint challenges the practices of defendants with respect to the marketing, advertising, promotion and sale of 'light' cigarettes. The court granted plaintiffs' motion for class certification on 25 September 2006. By order dated 17 November 2006, the Second Circuit Court of Appeals granted defendants' motion to stay the district court proceedings in this case, and further granted defendants' petition for leave to appeal the district court's class certification order. Other types of class-action suits assert claims on behalf of classes of individuals who claim to be addicted, injured, or at greater risk of injury by the use of tobacco or exposure to environmental tobacco smoke, or the legal survivors of such persons.

In Engle (Florida), one jury awarded a total of US\$12.7 million to three class representatives, and in a later stage of this three phase trial process, a jury assessed US\$17.6 billion in punitive damages against B&W. In November 2000, B&W posted a surety bond in the amount of US\$100 million (the amount required by Florida law) to stay execution of this punitive damages award. On 21 May 2003, the intermediate appellate court reversed the trial court's judgment and remanded the case to the trial court with instructions to decertify the class. On 16 July 2003, plaintiffs filed a motion for rehearing which was denied on 22 September 2003. On 12 May 2004, the Florida Supreme Court agreed to review this case and, on 6 July 2006, it upheld the intermediate appellate court's decision to decertify the class, and vacated the jury's punitive damages award. Further, the Florida Supreme Court permitted the judgments entered for two of the three Engle class representatives to stand, but dismissed the judgment entered in favour of the third Engle class representative. Finally, the Court has permitted putative Engle class members to file individual lawsuits against the Engle defendants within one year of the Court's decision. The Court's order precludes defendants from litigating certain issues of liability against the putative Engle class members in these individual actions. On 7 August 2006, defendants filed a motion for rehearing before the Florida Supreme Court, which was granted in part, and denied in part, on 21 December 2006. The Florida Supreme Court's 21 December 2006 ruling did not amend any of the earlier decision's major holdings, which included decertifying the class, vacating the punitive damages judgment, and permitting individual members of the former class to file separate suits. Instead, the ruling addressed the claims on which the Engle jury's phase one verdict will be applicable to the individual lawsuits that were permitted to stand.

In the first 'phase three' trial of an individual Engle class member (Lukacs), the jury awarded the plaintiff US\$37.5 million in compensatory damages (B&W's share: US\$8.4 million). On 1 April 2003, the jury award was reduced to US\$25.125 million (B&W's share: US\$5.65 million) but no final judgment will be entered until the Engle appeal is fully resolved. Therefore the time to appeal this case has not yet begun to run.

In a Louisiana medical monitoring case brought on behalf of Louisiana smokers (Scott), on 28 July 2003, the jury returned a verdict in favour of defendants on the medical monitoring claim but made findings against defendants with respect to claims relating to fraud, conspiracy, marketing to minors and smoking cessation. On 21 May 2004, the jury returned a verdict in the amount of US\$591 million on the class's claim for a smoking cessation programme. On 1 July 2004, the court upheld the jury's verdict and entered final judgment. On 29 September 2004, defendants posted a US\$50 million bond (legislation in Louisiana limits the amount of a bond to prevent execution upon such a judgment to US\$50 million collectively for signatories to the MSA). RJRT posted US\$25 million (i.e. the portions for RJRT and B&W) towards the bond. On 12 April 2006, the Louisiana Fourth Circuit Court of Appeal heard argument on defendants' appeal.

The appellate court issued a decision on 7 February 2007 that affirmed class certification and upheld the smoking cessation programme for certain smokers who began smoking before 1988, but reduced the US\$591 million jury award by US\$312 million and rejected any award of prejudgment interest. Defendants are in the process of seeking further review of this decision.

A federal judge in New York certified a nation-wide punitive-damages-only class (Simon II) in September 2002. Defendants sought reconsideration of the certification ruling, which was denied on 25 October 2002. On 14 February 2003, the US Court of Appeals for the Second Circuit granted defendants' petition to review the class certification decision. Oral argument was heard on 20 November 2003. On 6 May 2005, the Second Circuit Court of Appeals vacated the district court's class certification order. The district court permitted plaintiffs to voluntarily dismiss this action on 8 December 2005. The district court entered its final judgment dismissing this case on 20 March 2006.

(c) Individual cases

Approximately 3,471 cases were pending against B&W at 31 December 2006 (2005: 3,767) filed by or on behalf of individuals in which it is contended that diseases or deaths have been caused by cigarette smoking or by exposure to environmental tobacco smoke (ETS). Of these cases: (a) approximately 75 per cent are ETS cases brought by flight attendants who were members of a class action (Broin) that was settled on terms that allow compensatory but not punitive damages claims by class members; (b) approximately 20 per cent of the individual cases against B&W are cases brought in consolidated proceedings in West Virginia and (c) only about 5 per cent are cases filed by other individuals.

Of the individual cases that went to trial or were decided or remained on appeal during 2006, several resulted in verdicts against B&W:

In November 2003, a Missouri jury (Thompson) awarded US\$210,000 damages against B&W. A notice of appeal was filed on 8 March 2004. Oral argument before the Missouri Court of Appeals was heard on 3 November 2005. The Missouri Court of Appeals affirmed the judgment on all points on 22 August 2006. B&W moved before the Missouri Court of Appeals to transfer this appeal to the Missouri Supreme Court on 6 September 2006. B&W's motion was denied by the Missouri Court of Appeals on 26 September 2006. On 10 October 2006, B&W filed an application with the Missouri Supreme Court for transfer of this action to the Missouri Supreme Court. The Missouri Supreme Court denied B&W's application on 19 December 2006.

In December 2003, a New York jury (Frankson) awarded US\$350,000 compensatory damages against B&W and two industry organisations. In January 2004, the same jury awarded US\$20 million punitive damages. On 22 June 2004, the trial judge granted a new trial unless the parties agreed to an increase in compensatory damages to US\$500,000 and a decrease in punitive damages to US\$5 million, of which US\$4 million would be assigned to B&W. Plaintiffs agreed to a decrease in punitive damages, but B&W has not agreed to an increase in compensatory damages. On 25 January 2005, B&W appealed to an intermediate New York State appellate court. Oral argument was heard on 8 May 2006. The appellate court affirmed the judgment on 5 July 2006. B&W filed a motion for leave to reargue, or in the alternative, for leave to appeal to the New York Court of Appeals, on 3 August 2006. The intermediate appellate court denied this motion on 5 October 2006. On 8 December 2006, the trial judge granted plaintiff's application for entry of judgment, and granted plaintiff's motion to vacate that part of the 2004 order granting a new trial unless the parties agreed to an increase in compensatory damages to US\$500,000. B&W intends to seek further appellate review of the trial court's judgment.

On 1 February 2005, a Missouri jury (Smith) awarded US\$500,000 in compensatory damages against B&W and then, on 2 February 2005, awarded US\$20 million in punitive damages, also against B&W. On 1 June 2005, B&W filed its notice of appeal. B&W filed its opening appellate brief on 28 April 2006. Oral argument was heard on 31 August 2006 and a decision is awaited.

On 18 March 2005, a New York jury (Rose) awarded US\$1.7 million in compensatory damages against B&W. On 18 August 2005, B&W filed its notice of appeal. RJRT posted a bond in the approximate amount of US\$2.058 million on 7 February 2006. Oral argument on this appeal was heard on 12 December 2006 by an intermediate New York appellate court, which reserved decision.

(d) Other claims

The Flintkote Company (Flintkote), a US asbestos production and sales company, was included in the acquisition of Genstar Corporation by Imasco in 1986 and became a Group subsidiary following the restructuring of Imasco Limited (now Imperial Tobacco Canada Limited (Imperial)) in 2000. Soon after this acquisition, and as part of the acquisition plan, Genstar began to sell most of its assets, including the non-asbestos related operations and

subsidiaries of Flintkote. The liquidation of Flintkote assets produced cash proceeds and, having obtained advice that sufficient assets would remain to satisfy liabilities, Flintkote and Imasco authorised the payment of two dividends. In 2003, Imperial divested Flintkote and then, in 2004, Flintkote filed for bankruptcy in the United States Bankruptcy Court for the District of Delaware. In 2006, Flintkote, certain representatives of both the present and future asbestos claimants as well as certain individual asbestos claimants were permitted by the bankruptcy court to file a complaint against Imperial and numerous other defendants for the recovery of the dividends and other compensation under various legal theories. The parties are presently engaged in case management discussions to establish the scope and manner of discovery in this case. This litigation is expected to take several years to proceed to trial.

At 31 December 2006, no cases (2005: 1) were pending against B&W on behalf of asbestos companies. In these cases, certain asbestos companies sought reimbursement for costs and judgments paid in litigation brought by third parties against them. These companies claimed that, but for the smoking of the claimants, their damages would have been less. The final asbestos contribution claim (Fibreboard) was voluntarily dismissed by plaintiffs on 28 July 2006.

In Wisconsin, the authorities have identified potentially responsible parties to fund the clean up of the Fox River, Wisconsin. The pollution was caused by discharges of toxic material from paper mills operating close to the river. The cost of the clean up work is currently estimated to be in the order of US\$600 million. Among the potentially responsible parties are NCR Corporation and Appleton Papers Inc. who may be liable for a proportion of the clean up costs. B.A.T Industries p.l.c. purchased what was then NCR's Appleton Papers Division from NCR Corporation and spun off this business in 1990, obtaining full indemnities from Appleton Papers Inc. for past and future environmental claims. Disputes between NCR Corporation and B.A.T Industries p.l.c. as to the indemnities given and received under the purchase agreement in 1978 have been the subject of arbitration in 1998 and 2006. Under the terms of the arbitration awards, B.A.T Industries p.l.c. has an obligation to share the costs of environmental claims with NCR Corporation, but has never been required to pay any sums in this regard because Appleton Papers Inc. has paid any sums demanded. It is believed that all future environmental liabilities will continue

to be met directly by Appleton Papers Inc. by self-funding or insurance cover and no demand will be made upon B.A.T Industries p.l.c. by NCR Corporation.

Settlement of state health care reimbursement cases

During 2003, agreement was reached on certain disputed MSA payments relating to MSA calculations based on 1999 and 2000 sales. This agreement resulted in a benefit of £27 million which is excluded from the 2003 costs shown in the consolidated audited annual accounts of the Company for the financial year ended 31 December 2004. In other developments, after an Independent Auditor found that the terms of the MSA were a 'significant factor' in market share losses experienced by signatories to the MSA in 2003, several US tobacco companies, including B&W, asserted their rights under the NPM (or Non-Participating Manufacturer) Adjustment provision of the MSA to recover a payment credit or offset – against their April 2006 payment obligations – for MSA payments made in April 2004 in respect of cigarettes shipped or sold in the US in 2003. The amount at stake exceeds US\$1 billion. The settling states oppose these MSA payment reduction claims and, in late April 2006, began filing motions in MSA courts across the country seeking enforcement of certain MSA provisions and a declaration of the parties' rights under the NPM Adjustment provision of the MSA. Defendants have opposed these motions, arguing that their NPM Adjustment claims must go instead to arbitration. To date, the overwhelming majority of MSA courts to decide these motions have ruled in defendants' favour.

UK-based Group companies

At 31 December 2006, B.A.T Industries p.l.c. was a defendant in the US in one class action, the Schwab case mentioned previously. In that case, B.A.T Industries p.l.c. was substituted for British American Tobacco p.l.c. as a defendant. In the West Virginia consolidated smoking and health cases, the court so-ordered the parties' stipulation and order dismissing B.A.T Industries p.l.c. from the action, with prejudice, on 12 December 2006. This is a significant decision as B.A.T Industries p.l.c. was previously a defendant in around 1,000 consolidated individual cases in West Virginia. British American Tobacco (Investments) Limited has been dismissed from those West Virginia consolidated smoking and health cases in which it was a defendant. British American Tobacco (Investments) Limited had been served in one reimbursement case (City of St. Louis), the Department of Justice case (see below), two class actions (Cleary and Schwab) and three individual actions.

Conduct based claims

On 22 September 1999, the US Department of Justice brought an action in the US District Court for the District of Columbia against various industry members, including RJRT, B&W, B.A.T Industries p.l.c., and British American Tobacco (Investments) Limited. B.A.T Industries p.l.c. was dismissed for lack of personal jurisdiction on 28 September 2000. The Government sought to recover federal funds expended in providing healthcare to smokers who have developed diseases and injuries alleged to be smoking-related, and, in addition, sought, pursuant to the federal Racketeer Influenced and Corrupt Organisations Act (RICO), disgorgement of profits the Government contends were earned as a consequence of a RICO 'enterprise'. On 28 September 2000, the portion of the claim which sought recovery of federal funds expended in providing healthcare to smokers who have developed diseases and injuries alleged to be smoking-related was dismissed. The bench (non-jury) trial of the RICO portion of the claim began on 21 September 2004, and ended on 9 June 2005. On 17 November 2004, the Washington DC Circuit Court of Appeals heard an appeal by defendants against an earlier District Court decision that disgorgement of profits is an appropriate remedy to the RICO violations alleged by the Government. On 4 February 2005, the Court of Appeals allowed the appeal, ruling that the Government could not claim disgorgement of profits. On 17 October 2005, the US Supreme Court declined to hear the appeal by the US Government in respect of the claim for disgorgement of US\$280 billion of past profits from the US tobacco industry. The disgorgement claim was a centrepiece of the Government's claim.

On 17 August 2006, the district court issued its final judgment, consisting of some 1,600 pages of factual findings and legal conclusions. The court found in favour of the Government, and against certain defendants, including B&W and British American Tobacco (Investments) Limited. The court also ordered a wide array of injunctive relief, including a ban on the use of 'lights' and other similar descriptors with effect from 1 January 2007. Compliance with the court-ordered remedies may cost RJRT and British American Tobacco (Investments) Limited millions of dollars. In addition, the Government is seeking the recovery of roughly US\$1.9 million in litigation costs. Defendants filed a motion to stay enforcement of the judgment shortly after the judgment was issued. The court denied defendants' stay motion on 28 September 2006. Defendants, including B&W and British American Tobacco (Investments) Limited, filed their notices of appeal to the Washington DC Circuit Court of Appeals on 11 September 2006, and filed an emergency motion to stay the judgment before the same court on 29 September 2006. On 31 October 2006, the Court of Appeals granted defendants' motion to stay enforcement of the judgment pending the outcome of the appeal.

Various departments of the Republic of Colombia brought actions against various tobacco companies including B&W and other UK-based Group companies alleging that defendants engaged in cigarette smuggling and money laundering in their territories. Each of these actions sought compensatory, punitive and treble damages. Defendants' motion to dismiss the complaint was granted in 2002 and plaintiffs appealed. The US Court of Appeals for the Second Circuit affirmed the dismissals, and on 9 January 2006, the US Supreme Court denied plaintiffs' petition for a writ of certiorari.

In the Daric Smith case, purchasers of cigarettes in the State of Kansas brought a class action in the Kansas State Court against B&W, British American Tobacco (Investments) Limited and certain other tobacco companies seeking injunctive relief, treble damages, interest and costs. The allegations are that the defendants participated in a conspiracy to fix or maintain the price of cigarettes sold in the US, including the State of Kansas, in violation of the Kansas Restraint of Trade Act. The matter will be defended vigorously.

Product liability outside the US

At 31 December 2006, active claims against Group companies existed in 18 (2005: 19) countries outside the US but the only countries with more than five active claims were Argentina, Brazil, Canada, Chile, Italy and the Republic of Ireland.

At 31 December 2006, there were some 1,142 (2005: 1,097) pending individual cases in Italy. Some 1,113 (2005: 1,077) of these cases are pending before Justice of the Peace courts, the majority of which relate to claims of alleged fraud in connection with 'light' cigarettes. Because of the type of court involved, the most that any individual plaintiff can recover is €1,033. 678 of these cases have been suspended or decisions given in favour of British American Tobacco Italia S.p.A. There are around 27 smoking and health cases pending before Italian Civil Courts, filed by or on behalf of individuals, in which it is contended that diseases or deaths have been caused by cigarette smoking. There are also two labour cases for alleged occupational exposure pending in Italy.

In Canada, the government of the Province of British Columbia brought a claim pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2000 against domestic and foreign 'manufacturers' seeking to recover the plaintiff's costs of health care benefits. The constitutionality of the 2000 Act was challenged by certain defendants and, on 5 June 2003, the British Columbia Supreme Court found the Act to be beyond the competence of the British Columbia legislature and, accordingly, dismissed the government's claim. The government appealed that decision to the British Columbia Court of Appeal which, on 20 May 2004, overturned the lower court's decision and declared the Act to be constitutionally valid. Defendants appealed to the Supreme Court of Canada in June and that court gave its judgment in September 2005, dismissing the appeals and declaring the Act to be constitutionally valid.

Non-Canadian defendants challenged the personal jurisdiction of the British Columbia Court and those motions were heard in the Supreme Court of British Columbia. On 23 June 2006, the court dismissed all defendants' motions, finding that there is a 'real and substantial connection' between British Columbia and the foreign defendants. Subsequently, defendants were granted leave to appeal. The appeal was dismissed on 15 September 2006. Defendants filed leave to appeal to the Supreme Court on 10 November 2006. Similar legislation has been enacted, but not yet brought into force, in some other Canadian provinces, and is also being considered by other Canadian provinces.

In addition, there are five class actions and four individual cases in Canada. In the Knight class action, the Supreme Court of British Columbia certified a class of all consumers of cigarettes bearing 'light' or 'mild' descriptors since 1974 manufactured in British Columbia by Imperial, the Group's operating company in Canada. Imperial filed an appeal against the certification which was heard in February 2006. The Appeal Court confirmed the certification of the class but has limited any financial liability, if proved, to the period from 1997. This is a 'lights' class action in which the plaintiff alleges that the marketing of light and mild cigarettes is deceptive because it conveys a false and misleading message that those cigarettes are less harmful than regular cigarettes. Although the claim arises from health concerns, it does not seek compensation for personal injury. Instead it seeks compensation for amounts spent on 'light and mild' products and a disgorgement of profits from Imperial. The motion of the Federal Government to strike out the third party notice issued against them by Imperial was heard in February 2006 and a decision is awaited. A similar 'lights' and 'mild' class action claim has been filed in Newfoundland. Imperial has filed a third party notice against the Federal Government. No hearing date has been set.

There are currently two class actions in Quebec. On 21 February 2005, the Quebec Superior Court granted certification. The court certified two classes, which include residents of Quebec who suffered from lung, throat and laryngeal cancer or emphysema, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. There is no right of appeal. Plaintiffs have served a Statement of Claim. This litigation is expected to take several years to proceed to trial. The other class action is an attempt to establish a class claiming for personal injury or damage to property from fires caused by cigarettes that did not automatically extinguish on being dropped or left unattended. Certification of such a class was denied in October 2005. Plaintiffs have appealed. No hearing date has been set for the appeal.

Other litigation outside the US

In November 2004, the Royal Canadian Mounted Police (RCMP) obtained a warrant to search and seize business records and documents at the head office of Imperial Tobacco Canada Ltd. in Montreal. The affidavit filed by the RCMP to obtain the search warrant made allegations in relation to the smuggling of cigarettes in Canada between 1989 and 1994, naming Imperial, British American Tobacco p.l.c., B.A.T. Industries p.l.c., and certain former directors and employees. No charges have yet been laid. Imperial believes that it has conducted itself appropriately at all times, but cannot predict the outcome of any such investigation, or whether additional investigations will occur.

Two actions have been started in Russia by a minority shareholder in OJSC Company British American Tobacco-Yava (BAT-Yava), a Russian incorporated subsidiary of British American Tobacco Holdings (Russia) B.V. The minority shareholder, Branston Holdings, issued a claim in Moscow seeking to have a contract between BAT-Yava and its sister company invalidated, and issued another claim in the Stavropol region alleging that certain of the directors of BAT-Yava, and other parties, took various unlawful steps. The Moscow Court has dismissed the claim and the Stavropol Court has ordered the transfer of the case filed there to Moscow. An appeal of the dismissed Moscow case has been sent to the Moscow Appellate Court. Branston has also threatened actions in the Netherlands and England but has not yet commenced these. The Company considers these actions to be without merit and will defend the claims strenuously.

Conclusion

While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, the Company believes that the defences of the Group companies to all these various claims are meritorious both on the law and the facts, and a vigorous defence is being made everywhere. If an adverse judgment is entered against any of the Group companies in any case, an appeal will be made. Such appeals could require the appellants to post appeal bonds or substitute security in amounts which could in some cases equal or exceed the amount of the judgment. In any event, with regard to US litigation, the Group has the benefit of the RJRT Indemnification. At least in the aggregate, and despite the quality of defences available to the Group, it is not impossible that the results of operations or cash flows of the Group, in particular quarterly or annual periods, could be materially affected by this and by the final outcome of any particular litigation.

Having regard to all these matters, the Directors (i) do not consider it appropriate to make any provision in respect of any pending litigation and (ii) do not believe that the ultimate outcome of this litigation will significantly impair the financial condition of the Group.

Guarantees

Performance guarantees given to third parties in respect of Group companies were £157 million (2005: £167 million).

Operating leases

Total future minimum lease payments under non-cancellable operating leases comprise leases where payments fall due:

	2006 £m	2005 £m
Property		
Within one year	50	49
Between one and five years	112	99
Beyond five years	167	231
	329	379
Plant and equipment		
Within one year	17	15
Between one and five years	19	12
Beyond five years		1
	36	28

BAT'S SUBSIDIARIES AND ASSOCIATES

The following tables contain a list of the principal subsidiary and associated undertakings of BAT as at 8 October 2008 (being the last practicable date prior to the publication of this Pre-listing statement).

1. SUBSIDIARIES

Name of subsidiary	Country of incorporation	Percentage shareholding and voting rights (within Group)
Europe		
<i>Great Britain</i>		
B.A.T Industries p.l.c.	Great Britain	100
B.A.T (U.K. and Export) Ltd.	Great Britain	100
B.A.T. International Finance p.l.c.	Great Britain	100~
BATMark Ltd.	Great Britain	100~
British-American Tobacco (Holdings) Ltd.	Great Britain	100
British American Tobacco International (Holdings) B.V. (UK resident company)	The Netherlands	100
British American Tobacco (1998) Ltd.	Great Britain	100~
British American Tobacco (Brands) Ltd.	Great Britain	100
British American Tobacco (Investments) Ltd.	Great Britain	100
British American Tobacco UK Ltd.	Great Britain	100
Tobacco Insurance Company Ltd.	Great Britain	100
Weston Investment Company Ltd.	Great Britain	100
<i>Belgium</i>		
British American Tobacco Belgium S.A.	Belgium	100
<i>Cyprus</i>		
B.A.T (Cyprus) Ltd.	Cyprus	100
<i>Czech Republic</i>		
British American Tobacco (Czech Republic), s.r.o.	Czech Republic	100
<i>Denmark</i>		
House of Prince A/S	Denmark	100
<i>Finland</i>		
British American Tobacco Nordic Oy	Finland	100
<i>France</i>		
British American Tobacco France SAS	France	100
<i>Germany</i>		
British-American Tobacco (Germany) GmbH	Germany	100
British American Tobacco (Industrie) GmbH	Germany	100
<i>Greece</i>		
British American Tobacco Hellas S.A.	Greece	100

Name of subsidiary	Country of incorporation	Percentage shareholding and voting rights (within Group)
<i>Hungary</i>		
BAT Pécsi Dohánygyár Kft.	Hungary	100
<i>Italy</i>		
British American Tobacco Italia S.p.A.	Italy	100
<i>Netherlands</i>		
British American Tobacco The Netherlands B.V.	Netherlands	100
British American Tobacco Holdings (The Netherlands) B.V.	Netherlands	100
<i>Norway</i>		
Tiedemanns Tobakk AS	Norway	100
<i>Poland</i>		
British-American Tobacco Polska S.A.	Poland	96
Scandinavian Tobacco S.A.	Poland	100
<i>Republic of Ireland</i>		
P.J. Carroll & Company Ltd.	Republic of Ireland	100
<i>Romania</i>		
British-American Tobacco (Romania) Trading SRL	Romania	100
<i>Russia</i>		
OJSC British American Tobacco - STF	Russia	99
OJSC British American Tobacco - Yava	Russia	99*
CJSC British American Tobacco - SPb	Russia	100*
CJSC 'International Tobacco Marketing Services'	Russia	100
<i>Serbia</i>		
Duvanska Industrija 'Vranje' A.D.	Serbia	88
<i>Spain</i>		
British American Tobacco España, S.A.	Spain	100
<i>Sweden</i>		
House of Prince AB	Sweden	100
Fiedler & Lundgren AB	Sweden	100
<i>Switzerland</i>		
British American Tobacco International Ltd.	Switzerland	100
British American Tobacco Switzerland S.A.	Switzerland	100
<i>Ukraine</i>		
A/T B.A.T. – Prilucky Tobacco Company	Ukraine	99
<i>Uzbekistan</i>		
UZBAT A.O.	Uzbekistan	97
America-Pacific		
<i>Canada</i>		
Imperial Tobacco Canada Ltd.	Canada	100
<i>Japan</i>		
British American Tobacco Japan, Ltd.	Japan	100

Name of subsidiary	Country of incorporation	Percentage shareholding and voting rights (within Group)
<i>United States of America</i>		
B.A.T Capital Corporation	United States of America	100~
BATUS Japan, Inc	United States of America	100
Brown & Williamson Holdings, Inc.	United States of America	100
British American Tobacco (Brands) Inc.	United States of America	100
Asia-Pacific		
<i>Australia</i>		
British American Tobacco Australia Ltd.	Australia	100
<i>Bangladesh</i>		
British American Tobacco Bangladesh Company Ltd.	Bangladesh	65
<i>Cambodia</i>		
British American Tobacco (Cambodia) Ltd.	Cambodia	71
<i>China</i>		
B.A.T. China Ltd. (branch registered in China)	Great Britain	100
British-American Tobacco Company (Hong Kong) Ltd.	Hong Kong	100
<i>Indonesia</i>		
PT BAT Indonesia Tbk	Indonesia	78
<i>Malaysia</i>		
British American Tobacco (Malaysia) Berhad	Malaysia	50
<i>New Zealand</i>		
British American Tobacco (New Zealand) Ltd.	New Zealand	100
<i>Pakistan</i>		
Pakistan Tobacco Company Ltd.	Pakistan	94
<i>Papua New Guinea</i>		
British American Tobacco (PNG) Ltd.	Papua New Guinea	100
<i>Singapore</i>		
British-American Tobacco (Singapore) Pte Ltd.	Singapore	100
British-American Tobacco Marketing (Singapore) Pte Ltd.	Singapore	100
<i>South Korea</i>		
British American Tobacco Korea Ltd.	South Korea	100
British American Tobacco Korea Manufacturing Ltd.	South Korea	100
<i>Sri Lanka</i>		
Ceylon Tobacco Company Ltd.	Sri Lanka	84
<i>Vietnam</i>		
B.A.T Vietnam Ltd. (branch registered in Vietnam)	Great Britain	100
British American Tobacco-Vinata (JV) Ltd.	Vietnam	70

Name of subsidiary	Country of incorporation	Percentage shareholding and voting rights (within Group)
Latin America		
<i>Argentina</i>		
Nobleza-Piccardo S.A.I.C.y F.	Argentina	96
<i>Brazil</i>		
Souza Cruz S.A.	Brazil	75
<i>Chile</i>		
Compania Chilena de Tabacos S.A.	Chile	96
<i>Guyana</i>		
Demerara Tobacco Company Ltd.	Guyana	70
<i>Honduras</i>		
Tabacalera Hondureña S.A.	Honduras	80
<i>Jamaica</i>		
Carreras Group Ltd.	Jamaica	50
<i>Mexico</i>		
British American Tobacco Mexico, S.A. de C.V	Mexico	100
<i>Panama</i>		
British American Tobacco Central America S.A.	Panama	78
Tabacalera Istmeña S.A.	Panama	100
<i>Peru</i>		
Tabacalera Nacional S.A.A.	Peru	96^
<i>Trinidad & Tobago</i>		
The West Indian Tobacco Company Ltd.	Trinidad & Tobago	50
<i>St Lucia</i>		
CARISMA Marketing Services Ltd.	St Lucia	100
<i>Venezuela</i>		
C.A. Cigarrera Bigott Sucs.	Venezuela	100
Africa and Middle East		
<i>Cameroon</i>		
British American Tobacco Cameroun S.A.	Cameroon	99
<i>Congo</i>		
British American Tobacco Congo SARL	Congo	100
<i>Egypt</i>		
British American Tobacco Egypt LLC	Egypt	100
<i>Ghana</i>		
British American Tobacco Ghana Ltd.	Ghana	97
<i>Kenya</i>		
British American Tobacco Kenya Ltd.	Kenya	60
<i>La Reunion</i>		
B.A.T. La Reunion SAS	La Reunion	100

Name of subsidiary	Country of incorporation	Percentage shareholding and voting rights (within Group)
<i>Malawi</i>		
British American Tobacco (Malawi) Ltd.	Malawi	100
<i>Mauritius</i>		
British-American Tobacco (Mauritius) p.l.c. (branch registered in Mauritius)	Great Britain	100
<i>Mozambique</i>		
Sociedade Agricola de Tabacos Lda.	Mozambique	95
<i>Nigeria</i>		
British American Tobacco (Nigeria) Ltd.	Nigeria	100
<i>South Africa</i>		
British American Tobacco Holdings South Africa (Proprietary) Limited	South Africa	100
British American Tobacco South Africa (Proprietary) Limited	South Africa	100
<i>Turkey</i>		
British American Tobacco Sigara ve Tütüncülük Sanayi ve Ticaret A.S.	Turkey	100
British American Tobacco Tütün Mamulleri Sanayi ve Ticaret A.S.	Turkey	100
<i>Uganda</i>		
British American Tobacco Uganda Ltd.	Uganda	90
<i>Zambia</i>		
British American Tobacco (Zambia) p.l.c.	Zambia	78

All subsidiary undertakings held directly by British American Tobacco p.l.c. are indicated by ~, all others are held by sub-holding companies.

All companies' shares are ordinary shares or common stock except those indicated by *, which include preference shares, and those indicated by ^ which include investment stock (non-voting).

2. Associates

Name of Associate	Country of incorporation	Percentage shareholding and voting rights (within the Group)
Reynolds American Inc.	United States	42
ITC Limited	India	32

Note:

Prior to 2 July 2008, ST was an associate of the Group. ST therefore was included as an associate in financial information provided by the Group prior to the acquisition, on 2 July 2008, of 100% of the cigarette business of ST and certain snus and roll-your-own tobacco interests (see paragraph 6 of this Pre-listing statement for more detail).

OTHER DIRECTORSHIPS OR PARTNERSHIPS HELD BY THE DIRECTORS AND SENIOR MANAGERS

1. DIRECTORS

The table below sets out all the companies and partnerships of which the Directors (other than companies in Group and companies which are subsidiaries of companies of which the Directors are also directors) have been a director or partner at any time during the five years prior to the date of this Pre-listing statement:

Name of Director	Current directorships and partnerships	Previous directorships and partnerships
J P du Plessis	Adena Holdings Limited Lloyds TSB Group plc Rio Tinto plc Rio Tinto Limited	Compagnie Financière Richemont S.A. DWRH Holdings Limited Ehrbar Nominees Limited Keoni Holdings Limited Laureus World Sports Awards Limited RHM plc (now RHM Limited) Rona Holdings Limited
P N Adams	None	Allied Domecq plc (now Allied Domecq Limited)
J B Stevens	None	Ciberion Limited ITC Limited The Confederation of European Community Cigarette Manufacturers Limited Trifast plc
N Durante	None	None
K M A de Segundo	Ahold NV (Supervisory Board Member) Blackrock New Energy Investment Trust PLC E.ON AG Ensus Holdings Limited Lonmin Plc Pöyry Oyj (Non-Executive Director)	Shell Forestry Limited Shell International Renewables Limited
R E Lerwill	Aegis Group plc (Chief Executive) Synergy Health PLC	Multigraphics Limited The Anthony Nolan Trust
A M Llopis	ABN AMRO Bank (Supervisory Board Member) J F Llopis Foundation (Executive Deputy Chairman) Polyphonic Human Media Interface, S.L.	Reckitt Benckiser plc
C J M Morin-Postel	Royal Dutch Shell PLC 3i Group plc	Alcan Inc Pilkington plc

Name of Director	Current directorships and partnerships	Previous directorships and partnerships
A Ruys	ABN AMRO Bank (Supervisory Board Member) Janivo Holding BV Lottomatica S.p.A. Schiphol Airport N.V. (Supervisory Board Member) Rijksmuseum (Supervisory Board)	GTech Holdings Inc Heineken N.V. ROBECO Group Sara Lee International B.V. (Supervisory Board Member)
N Scheele	Caparo plc Grupo Proeza Key Safety Systems, Inc (Chairman) Pegasus Holdings Group The Cambridge – MIT Institute Limited (Chairman)	Ford Motor Company
M H Visser	Distell Group Limited (Non-Executive Director) Kagiso Trust Investments (Pty) Limited Medi-Clinic Corporation Limited Nampak Limited PG Group (Pty) Limited PGSI Limited Rainbow Chicken Limited (Chairman) Remgro Limited (Chief Executive Officer) R & R Holdings S.A. Unilever South Africa Foods (Pty) Limited V & R Management Services AG	M & I Management Services (Proprietary) Limited Unilever Bestfoods Robertsons (Holdings) LLC

2. SENIOR MANAGERS

The table below sets out all the companies and partnerships of which the Senior Managers (other than companies in Group and companies which are subsidiaries of companies of which the Senior Managers are directors) have been a director or partner at any time during the five years prior to the date of this Pre-listing statement:

Name of Senior Manager	Current directorships and partnerships	Previous directorships and partnerships
M H Cobben	None	None
J P Daly	ITC Limited	None
D S Fell	None	None
A M Gray	None	None
R Kindts	None	None
J-M Levy	None	None
M C T Prideaux	None	None
J Rembiszewski	None	None
P H Taylor	None	None
N R Withington	Reynolds American Inc.	BARH Limited

SUMMARIES OF EXTRACTS OF BAT'S ARTICLES OF ASSOCIATION

The Articles contain (among others) provisions to the following effect. For convenience, the summary below includes certain explanations and elaborations on English law which are not included in the Articles:

1. DIRECTORS

The Articles provide for a board of directors, consisting (unless otherwise determined by ordinary resolution of the shareholders) of not fewer than five directors, but not subject to any maximum, who shall manage the business of BAT.

The directors may, subject to the provisions of the UK Companies Acts, the Memorandum and the Articles and to any directions given by special resolution, exercise all the powers of BAT.

The directors may appoint one or more of their number to the office of executive chairman, executive vice-chairman, executive deputy chairman, chief executive, managing director or to any other executive office or employment under BAT and, subject to the provisions of the UK Companies Acts, any such appointment may be made for such term, at such remuneration and on such other conditions as the directors think fit.

The directors may appoint any person, whether a director or not, to be president of BAT upon such terms as to remuneration and otherwise as the directors shall from time to time determine.

The directors may delegate any of their powers to any managing director or any director holding any other executive office, to a committee consisting of one or more directors and (if thought fit) one or more other persons, and to any local board, management board or agency for managing the affairs of BAT in the United Kingdom or elsewhere.

The quorum for meetings of directors may be fixed by the directors and, unless so fixed, shall be two. The quorum at a meeting of a committee may be decided upon by the directors at the meeting.

Questions arising at a meeting shall be decided by a majority of votes. In case of an equality of votes, the chairman shall have a second or casting vote.

The Articles place a general prohibition on a director voting at a meeting of the directors on any resolution concerning a matter in which he has an interest other than by virtue of his interest in shares in BAT. However a director is entitled to vote and to be counted in a quorum for the purpose of any vote relating to a resolution concerning the following matters:

- the giving to him of a guarantee, security or indemnity in respect of money lent to, or an obligation incurred by him for the benefit of, BAT or any of its subsidiaries;
- the giving to a third party of a guarantee, security or indemnity in respect of an obligation of BAT or any of its subsidiaries for which the director has assumed responsibility (in whole or part and whether alone or jointly with others) under a guarantee or indemnity or by the giving of security;
- any proposal concerning his being, or intending to become, a participant in the underwriting or sub-underwriting of an offer of any such shares, debentures or other securities for subscription, purchase or exchange;
- any arrangement for the benefit of the employees and directors and/or former employees and directors of BAT or any of its subsidiary undertakings, and/or the members of their families (including a spouse or civil partner and a former spouse and a former civil partner) or any person who is or was dependent on such persons including but without being limited to a retirement benefits scheme and an employees' share scheme, which does not accord to any director any privilege or advantage not generally accorded to the employees and/or former employees to whom the arrangement relates;
- any transaction or arrangement with any other company, being a company in which the director is interested only as an officer, creditor or shareholder, provided that he is not the holder of or beneficially interested in one per cent or more of the equity share capital of that company (or of any other company through which his interest is derived) and not entitled to exercise one per cent or more of the voting rights available to members of the relevant company (disregarding, for the purposes of this

proviso (i) any shares held by a director as bare or custodian trustee and in which he has no beneficial interest; (ii) any shares comprised in any authorised unit trust scheme in which the director is interested only as a unit holder; and (iii) any shares of that class held as treasury shares); or

- any proposal concerning the purchase of directors' liability insurance.

BAT may by ordinary resolution suspend or relax to any extent, either generally or in respect of any particular matter, any provision of the Articles prohibiting a director from voting at a meeting of the directors or of a committee of the directors.

Any director (other than an alternate director) may appoint any other director, or any other person approved by resolution of the directors and willing to act, to be alternate director and may remove from office an alternate director appointed by him.

2. REMUNERATION

Fees for non-executive directors and the chairman shall be determined by the directors but shall not exceed in aggregate an annual sum of £2,500,000, unless determined otherwise by ordinary resolution of the shareholders. The directors may also be paid all travelling, hotel and other expenses properly incurred by them in connection with their attendance at meetings of the directors or of committees of the directors or general meetings or separate meetings of the holders of any class of shares or otherwise in connection with the discharge of their duties as directors.

Any director who holds the office of manager of BAT or any other executive office or serves on any committee, or who devotes special attention to the business of BAT or who otherwise performs services which, in the opinion of the directors, are outside the scope of the ordinary duties of a director, may be paid such special remuneration by way of salary, commission, participation in profits or otherwise as the directors may determine.

The directors may establish and maintain, or procure the establishment and maintenance of, any pension or superannuation funds for the benefit of, and give or procure the giving of donations, gratuities, pensions, allowances and emoluments to any persons:

- who are or were at any time in the employment or service of BAT, or of any company which is a subsidiary of BAT or is allied to or associated with BAT or any such subsidiary or of any of the predecessors in business of BAT or any such other company as aforesaid; or
- who may be or have been directors or officers of BAT or of any such other company as aforesaid, and who hold or have held executive positions or agreements for service with BAT or any such other company as aforesaid,

and the wives, widows, families and dependants of any such persons, and also establish, subsidise and subscribe to any institutions, associations, societies, clubs or funds calculated to be for the benefit of, or to advance the interests and well-being of, BAT or of any such other company as aforesaid, or of any such person as aforesaid, and make payments for or towards the insurance of any such persons as aforesaid and subscribe or guarantee money for charitable or benevolent objects, or for any exhibition or for any public, general or useful object, and do any of the matters aforesaid either alone or in conjunction with any such other company as aforesaid. Subject to particulars with respect to the proposed payment being disclosed to the shareholders of BAT and to the proposal being approved by BAT by ordinary resolution, if the UK Companies Acts shall so require, any director who holds or has held any such executive position or agreement for services shall be entitled to participate in and retain for his own benefit any such donation, gratuity, pension, allowance or emolument.

Subject to the provisions of the UK Companies Acts, BAT may indemnify any person who is or was a director directly or indirectly (including by funding any expenditure incurred or to be incurred by him) against any loss or liability whether in connection with any proved or alleged negligence, default, breach of duty or breach of trust or otherwise in relation to BAT or any associated company and/or may purchase and maintain for any such person insurance in relation to the same.

3. DIRECTORS' APPOINTMENT AND REMOVAL

The directors and BAT (by ordinary resolution) may appoint a person who is willing to act as a director, either to fill a vacancy or as an additional director. A director appointed by the directors shall retire at the next annual general meeting and may put himself/herself forward to be reappointed by the shareholders.

At each annual general meeting at least one third of the directors who are subject to retirement by rotation or, if their number is not three or a multiple of three, the number constituting at least one-third, shall retire from office. Notwithstanding this, at the annual general meeting every director who was not appointed at either of the two previous annual general meetings and who has served as a director for more than two years since his appointment shall retire. Subject to the provisions of the UK Companies Acts and the Articles, the directors to retire by rotation will be those who have been in office the longest since their appointment or last reappointment. If a director retires at an annual general meeting and is not reappointed he shall retain office until at the meeting someone is appointed in his place. If no one is appointed in his place he shall retain office until the end of the meeting.

Without prejudice to the provisions of the UK Companies Acts or any claim to damages for breach of any contract of service the director may have with BAT or a subsidiary, the shareholders may, by ordinary resolution, remove any director from office before the expiration of his period of office and may, by ordinary resolution, appoint another person in his place. A director so appointed shall be subject to retirement at the same time as if he had become a director on the day on which the director in whose place he is appointed was last appointed.

The office of a director shall be vacated if:

- he ceases to be a director by virtue of any provision of the UK Companies Acts or he becomes prohibited by law from being a director;
- he becomes bankrupt or makes any arrangement or composition with his creditors generally; or
- he is, or may be, suffering from mental disorder and either –
 - he is admitted to hospital in pursuance of an application for listing for treatment under the Mental Health Act 1983 or, in Scotland, an application for listing under the Mental Health (Scotland) Act 1960, or
 - an order is made by a court having jurisdiction (whether in the United Kingdom or elsewhere) in matters concerning mental disorder for his detention or for the appointment of any person to exercise powers with respect to his property or affairs;
- he resigns his office by notice in writing to BAT;
- in the case of a director who holds any executive office with BAT or any subsidiary, his appointment as such is terminated or expires and the directors resolve that his office be vacated;
- he is absent for more than six consecutive months without permission of the directors from meetings of the directors held during that period and the directors resolve that his office be vacated; or
- he is requested in writing by all the other directors to resign.

4. BORROWING POWERS

Without prejudice to their general powers, the directors may exercise all the powers of BAT to borrow money and to mortgage or charge its undertaking, property, assets (present and future) and uncalled capital or any part thereof, and (subject to the provisions of the Memorandum and Articles) to issue debentures, debenture stock and other securities whether outright or as security for any debt, liability or obligation of BAT or of any third party.

5. INTERESTED DIRECTOR TRANSACTIONS

Subject to the provisions of the UK Companies Acts, and provided that he has disclosed to the directors the nature and extent of any material interest of his, notwithstanding his office, a director:

- may be a party to, or otherwise interested in, any transaction or arrangement with BAT or in which BAT is otherwise interested;
- may be a director or other officer of, or employed by or may be a party to, or otherwise interested in, any transaction or arrangement with any body corporate promoted by BAT or in which BAT is otherwise interested; and (i) he shall not, by reason of his office, be accountable to BAT for any benefit which he derives from any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate; (ii) he shall not infringe his duty to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of BAT as a result of any such office or employment or any such transaction or arrangement or any interest in any such body corporate; and (iii) no such transaction or arrangement will be liable to be avoided because of any such interest or benefit.

For the purposes of the Articles, a general notice given to the directors that he is to be regarded as having an interest of the nature and extent specified in the notice in any transaction or arrangement in which a specified person or class of persons is interested is deemed to be a disclosure that the director has an interest in any such transaction of the nature and extent so specified; and an interest of which a director has no knowledge and of which it is unreasonable to expect him to have knowledge is not treated as his interest.

The directors may, subject to such terms and conditions as they think fit, authorise to the fullest extent permitted by law:

- any matter which would otherwise result in a director infringing his duty to avoid a situation in which he has or could have a direct or indirect interest that conflicts or might conflict with the interests of BAT and which might reasonably be regarded as likely to give rise to a conflict of interest; and
- a director to accept and continue in any office, employment or position in addition to his office as director in which a conflict of interest arising out of such office, employment or position may be dealt with, either before or at the time that such a conflict arises,

provided that the authorisation is only effective if:

- any requirement as to the quorum at the meeting at which the matter is considered is met without counting the director in question and any other interested director; and
- the matter was agreed without their voting or would have been agreed to if their votes had not been counted.

If a matter, or office, employment or position, has been authorised by the directors, the director, subject to such terms and conditions as the directors think fit:

- shall not be required to disclose any confidential information relating to his authorised interest;
- may absent himself from discussions and exclude himself from information, which will or may relate to that matter, office, employment or position; and
- shall not, by reason of his office as a director of BAT, be accountable to BAT for any benefit he derives from such matter, office, employment or position.

6. DIVIDEND RIGHTS

Holders of BAT's ordinary shares may, by ordinary resolution, declare dividends but may not declare dividends in excess of the amount recommended by the directors. The directors may also pay interim dividends if it appears that such dividends are justified by the profits available for distribution.

The directors may, with the sanction of an ordinary resolution of the shareholders, offer any holders of ordinary shares the right to elect to receive ordinary shares credited as fully paid instead of cash in respect of the whole or part of all such dividends as may be specified by the resolution. Any general meeting declaring a dividend may, upon the recommendation of the directors, direct payment or satisfaction of such dividend to be wholly or partly by the distribution of specific assets. Where difficulty arises in regard to distribution the directors may ignore fractions or issue fractional certificates, fix the value for distribution of any assets and may determine that cash shall be paid to any shareholder in order to adjust the rights of such shareholders.

No shareholder holding shares representing 0.25% or more in nominal value of the issued shares of any class of capital in BAT (calculated exclusive of treasury shares) shall, if the directors so determine, be entitled to receive payment of any dividend (including shares in lieu of dividend) in respect of any such shares if he or any person appearing to be interested in such shares has been given a notice under section 793 of the UK Companies Act 2006 and has failed to give BAT the information thereby required within 14 days from the date of giving such notice.

Any dividend which has been unclaimed for twelve years from the date when it became due for payment shall, if the directors so resolve, be forfeited and shall cease to be owing by BAT.

BAT can cease sending dividend warrants and cheques by post or otherwise if these have been returned undelivered to, or left uncashed by, the shareholder on at least two consecutive occasions, or, if following one such occasion, reasonable enquiries have failed to establish the shareholder's new address. No dividend shall bear interest against BAT, unless provided by the rights attached to the share.

Subject to the provisions of the Articles and to the rights attaching to any shares any dividend or other amount payable on or in respect of a share may be paid in such currency as the directors may determine, using such exchange rate for currency conversions as the directors may select, and notwithstanding the payment of such dividend or amount in a different currency in respect of other shares.

7. OVERSEAS SHAREHOLDERS

A shareholder whose registered address is not within the United Kingdom shall not be entitled to receive any notice, document or information from BAT unless he gives to BAT an address (not being an electronic address) within the United Kingdom at which notices, documents or information may be sent or supplied to him.

8. OVERSEAS BRANCH REGISTERS

Subject to and to the extent permitted by the Acts and the UK Uncertificated Securities Regulations 2001, BAT, or the directors on behalf of BAT, may cause to be kept in any territory an overseas branch register of members resident in such territory, and the directors may make and vary such provisions as they may think fit respecting the keeping of any such register. Subject to and to the extent permitted by the UK Companies Acts and the Uncertificated Securities Regulations and the rules and/or conditions applicable to the operation of such a system, the directors may determine that any shares or class of shares held on any overseas branch register of members may be held in uncertificated form in accordance with any system outside the United Kingdom which enables title to such shares to be evidenced and transferred without a written instrument and which is a relevant system.

9. VOTING RIGHTS

Voting at any general meeting of shareholders is by a show of hands unless a poll is demanded. On a show of hands, every shareholder who is present in person at a general meeting (and every proxy appointed by a shareholder and present at a general meeting) has one vote regardless of the number of shares held by the shareholder (or represented by the proxy). On a poll, every shareholder who is present in person or by proxy has one vote for every share held by the shareholder. A poll may be demanded by any of the following:

- the chairman of the meeting;
- the directors;
- not less than five shareholders having the right to vote at the meeting;
- a shareholder or shareholders representing not less than one-tenth of the total voting rights of all shareholders having the right to vote at the meeting (excluding any voting rights attached to treasury shares); or
- a shareholder or shareholders holding shares which confer a right to vote on the resolution at the meeting being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all shares conferring that right (excluding any voting rights attached to treasury shares).

The necessary quorum for a meeting of BAT is a minimum of two shareholders present in person or by proxy or by a duly authorised representative of a corporation which is a shareholder and entitled to vote.

In the case of an equality of votes, whether on a show of hands or on a poll, the chairman of the meeting is entitled to a casting vote in addition to any other votes he may have.

10. WINDING-UP

If BAT is wound up, the liquidator may, with the sanction of a special resolution and any other sanction required by law, subject to the provisions of the UK Companies Acts, divide among the shareholders the whole or any part of the assets of BAT, and may, for that purpose, value any assets and determine how the division is to take place as between the shareholders or different classes of shareholders. Alternatively, with the same sanction, the liquidator may vest the whole or any part of the assets in trustees upon trusts for the benefit of the shareholders, but no shareholder will be compelled to accept any asset upon which there is a liability.

11. TRANSFER OF SHARES

Shares in a certificated form may be transferred by an instrument of transfer in any usual form or in any other form which the directors may approve. The instrument of transfer shall be executed by or on behalf of the transferor and, where the share is not fully paid, by or on behalf of the transferee. The directors can, in their absolute discretion, refuse to register the transfer of a share in certificated form which is not fully paid, provided that such a refusal would not prevent dealings in shares in certificated form which are not fully paid from taking place on a proper basis. The directors may also refuse to register a transfer of a share in certificated form unless the instrument of transfer:

- is lodged, duly stamped, at the registered office of BAT or such other place as the directors may appoint and is accompanied by a certificate for the shares to which it relates and such other evidence as the directors may reasonably require to show the right of the transferor to make the transfer;
- is in respect of only one class of shares; and
- is in favour of not more than four transferees.

In the case of uncertificated shares, transfers shall be registered only in accordance with the terms of the UK Uncertificated Securities Regulations 2001 so that directors may refuse to register a transfer which would require shares to be held jointly by more than four persons. If the directors refuse to register a transfer of a share they shall as soon as practicable and in any event within two months after the date on which the transfer was lodged with BAT, or in the case of uncertificated shares the Operator-instruction was received by BAT, send to the transferee notice of the refusal together with reasons for the refusal. The directors shall send to the transferee such further information about the reasons for the refusal as the transferee may reasonably request. No fees may be charged for the registration of a transfer of shares. Subject to the Uncertificated Securities Regulations 2001, the registration of transfers of shares or of any class of shares may be suspended for such periods, not exceeding thirty days in any year, as the directors may determine.

12. PRE-EMPTIVE RIGHTS AND NEW ISSUES OF SHARES

Subject to the provisions of the UK Companies Acts and without prejudice to any rights attached to any existing shares, any share may be issued with such rights or restrictions as BAT may by ordinary resolution determine or, in the absence of such resolution, as the directors may determine. BAT may, in particular, issue preference shares.

Subject to the provisions of the UK Companies Acts, the unissued shares in BAT shall be at the disposal of the directors, who may allot, grant options over or otherwise dispose of them to such persons and on such terms as the directors think fit.

13. ALTERATION OF SHARE CAPITAL

BAT may, from time to time, by ordinary resolution:

- increase its share capital by such amount as the resolution prescribes;
- consolidate and divide all or any of its shares into shares of a larger amount than its existing shares;
- subject to UK Companies Acts, sub-divide any of its shares into shares of smaller amount than is fixed by BAT's Memorandum;
- determine that, as between the shares resulting from such a sub-division, any of them may have any preference or advantage as compared with the others; and
- cancel shares which, at the date of the passing of the resolution, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

BAT may, by special resolution, reduce its share capital, any capital redemption reserve and any share premium account in any way.

14. PURCHASE OF OWN SHARES

Subject to the provisions of the UK Companies Acts, BAT may purchase its own shares, including redeemable shares, and may hold such shares as treasury shares or cancel them.

15. GENERAL MEETINGS AND NOTICES

The directors may call general meetings and, if there are not sufficient directors to form a quorum in order to call a general meeting, any director may call a general meeting and, if there is no director, any shareholder of BAT may call a general meeting. Subject to the UK Companies Acts, all general meetings shall be called by at least such minimum period of notice as is prescribed under the UK Companies Acts. The notice shall specify the place, date and time of the meeting and the nature of the business to be transacted. In the case of an annual general meeting notice shall specify the meeting as such. The accidental omission to give notice to, the non-receipt of notice by, or the failure to give notice due to circumstances beyond BAT's control to, any person entitled to receive such notice shall not invalidate the proceedings at that meeting.

The directors may make arrangements for the simultaneous attendance and participation of shareholders and proxies entitled to attend general meetings at places other than the place specified in the notice convening the meeting. The right of any shareholder or proxy otherwise entitled to attend at the place specified in the notice is subject to any arrangements that the directors may make for facilitating the organisation and administration of any general meeting by requiring such person to attend the meeting at one or more of the other places.

The directors may determine that those persons entitled to receive notice of meetings are those persons entered on the register of members at the close of business on a day not more than twenty-one days before the day that notices are sent and may specify in the notice of the meeting a time, not more than 48 hours before the time fixed for the meeting, by which a person must be entered on the register of members in order to have the right to attend or vote at the meeting.

The directors or the chairman of the meeting may make any arrangements and impose any requirements or restrictions that they or he consider appropriate to ensure the security of the general meeting including requirements for evidence of identity, searching of personal property or restriction of items that may be taken into the meeting. The directors or the chairman of the meeting are entitled in their or his absolute discretion to refuse entry to any person who refuses to comply with such restrictions.

Directors may attend and speak at any general meeting or any separate meeting of holders of any class of shares whether or not they are shareholders. The chairman of the meeting may permit other persons who are not shareholders or otherwise entitled to exercise the rights of shareholders in relation to general meetings to attend and, at the chairman's discretion, speak at a general meeting or any separate class meeting.

A shareholder is entitled to appoint another person, who need not be a shareholder, as his proxy to exercise all or any of his rights to attend and to speak and vote at a meeting of BAT. Delivery of an appointment of proxy shall not preclude a shareholder from attending and voting at the meeting or at any adjournment of it. A shareholder may appoint more than one proxy in relation to a meeting, provided that each proxy is appointed to exercise the rights attached to a different share or shares held by him.

An appointment of proxy will be invalid unless the proxy, together with any authority (or appropriately certified copy of the authority) under which it is given, is received by BAT in relation to the meeting:

- in the case of an appointment of proxy in hard copy form, not less than 48 hours before the time for holding the meeting or adjourned meeting at which the person named in the appointment of proxy proposes to vote;
- in the case of an appointment of proxy in electronic form, not less than 48 hours before the time for holding the meeting or adjourned meeting at which the person named in the appointment of proxy proposes to vote; or
- in the case of a poll taken subsequently to the date of the meeting or adjourned meeting, not less than 24 hours (or such shorter time as the directors may determine) before the time appointed for the taking of the poll.

Subject to the provisions of the UK Companies Acts, any corporation (other than BAT itself) which is a shareholder of BAT may, by resolution of its directors or other governing body, authorise a person or persons to act as its representative or representatives at any meeting of BAT, or at any separate meeting of the holders of any class of shares.

No shareholder shall, if the directors so determine, be entitled in respect of any share held by him to vote (either in person or by representative or proxy) at any general meeting or at any separate meeting of the holders of any class of shares, or to exercise any other right conferred by membership in relation to any

such meeting if he or any other person appearing to be interested in the share has been given a notice under section 793 of the Companies Act 2006 and has failed to give BAT the information thereby required within 28 days from the date of giving that notice.

A vote given or poll demanded by proxy or by the duly authorised representative of a corporation shall be valid notwithstanding the previous termination of the authority of the person voting or demanding a poll, unless notice of the termination was delivered to BAT not later than the last time at which an appointment of proxy should have been received in order for it to be valid for use at the meeting at which the vote was given or the poll demanded or for use on the holding of the poll at which the vote was given.

16. VARIATION OF RIGHTS

Subject to the UK Companies Acts, if the capital of BAT is divided into different classes of shares then the rights attached to any class of shares may only be varied, either in such a manner as provided by those rights or, in the absence of any such provision, with the consent in writing of the holders of three-quarters in nominal value of the issued shares of that class (excluding any shares of that class held as treasury shares) or with the sanction of a special resolution passed at a separate meeting of holders of such shares. At any separate meeting, the necessary quorum is two persons together holding or representing by proxy at least one-third in nominal amount of the issued shares of the class (but at an adjourned meeting shall be any one person holding shares of the class or his proxy).

Unless otherwise expressly provided by the rights attached to any shares, those rights shall be deemed to be varied by the reduction of the capital paid up on those shares and by the creation or issue of further shares ranking in priority for payment of a dividend or in respect of capital or which confer on the holders voting rights more favourable than those conferred by the first-mentioned shares, but shall not otherwise be deemed to be varied by the creation or issue of further shares ranking *pari passu* with them or subsequent to them.

DETAILS OF BORROWINGS AND CONTRACTUAL COMMITMENTS

The following table sets out the Group's long- and short-term borrowings as at the dates indicated:

	Currency	Maturity dates	Interest rates	Year ended 31 December (in £ million)		
				2007	2006	2005 (unaudited)
Eurobonds	Euro	2009 to 2019	3.6% to 5.4%	3,920	3,465	3,881
	UK Sterling	2008 to 2019	5.5% to 6.5%	1,376	1,364	1,087
Floating rate notes	Euro	2010	Floating rate ⁽¹⁾	388	355	692
Other notes	Malaysian ringgit	2007 to 2012	3.7% to 7.9%	115	103	109
	US Dollar	2008	6.9%	173	176	200
	Other currencies			97	93	196
Syndicated bank loans	US Dollar	2012	Floating rate ⁽¹⁾	346	358	404
Bank loans				352	460	418
Other loans				13	11	8
Finance leases				65	62	64
Overdrafts				78	179	126
				6,923	6,626	7,260

Note:

(1) The floating rate interest rates are based on EURIBOR or US LIBOR plus a margin ranging between 36 and 200 basis points.

1. FACILITIES AGREEMENTS AND DEBT PROGRAMMES

The following are the Group's material facility agreements and debt programmes. These facility agreements and debt programmes are all unsecured.

1.1 Syndicated £1.75 billion Committed Revolving Credit Facility

On 8 March 2005, BAT, B.A.T. International Finance p.l.c. ("**BATIF**"), B.A.T. Capital Corporation ("**BAT Capital**") and British American Tobacco Holdings (The Netherlands) B.V. ("**BATHTN**") (as borrowers and, in the case of BAT, as a borrower and guarantor) entered into a revolving credit facility agreement with HSBC Bank p.l.c. (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrowers a revolving credit and swingline facility of £1.75 billion for a term of five years (with two additional one-year extension options), which is available for general corporate purposes. In 2006 and 2007, respectively, each of the two one-year extension options was exercised and the facility was extended on existing terms with final maturity dates between 2011 and 2012. At 8 October 2008, the amount available for drawdown under the facility was £1.75 billion.

Interest on revolving advances is payable at LIBOR or EURIBOR (as the case may be) plus a margin of between 0.25% and 0.40% depending on the credit rating of BAT plus any applicable reserve asset costs. Interest on US Dollar swingline advances is payable at the higher of HSBC Bank U.S.A.'s prime commercial lending rate and Federal Funds Rate plus 1%. Interest on Euro swingline advances is payable at the Euro Overnight Index Average plus the then current margin for revolving advances.

The facility contains representations, undertakings and events of default that are customary for facilities of this type. Where there is a change of control in respect of BAT, the lenders can require all amounts outstanding under the facility to be repaid.

1.2 Syndicated \$690 million Term Credit Facility

On 7 August 2007, British American Tobacco Mexico, S.A. de C.V. (as borrower) entered into a term credit facility arrangement with Barclays Capital (as mandated lead arranger), HSBC Bank p.l.c. (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrower \$690 million to refinance existing facilities and for general corporate purposes. The facility is guaranteed by BAT, BATIF and BAT Capital. The final maturity date is 10 October 2012. At 8 October 2008, the facility was fully drawn.

Interest is payable at US Dollar LIBOR plus a margin of 1.75% and any reserve asset costs. On payment of the interest the lenders pay BAT a guarantee fee of between 1.35% and 1.50% depending on the credit rating of BAT.

The facility contains representations, undertakings and events of default that are customary for facilities of this type. Where there is a change of control in respect of BAT, the lenders can require all amounts outstanding under the facility to be repaid.

1.3 Syndicated €420 million Term Credit Facility

On 13 February 2008, BATIF and BATIF Dollar Limited (as borrower) and BAT and BATIF (as guarantor) entered into a term credit facility agreement with Barclays Capital and J.P. Morgan plc (as mandated lead arrangers), Barclays Bank plc (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrowers \$2 billion to finance the Tekel acquisition and other associated costs (the facility). On 1 May 2008, the facility was amended by the parties thereto and the facility amount was decreased to €420 million. This €420 million term credit facility, along with the syndicated €860 million term credit facility discussed below, funded the \$1,720 million (€1,112 million) acquisition of Tekel. The final maturity date is 31 October 2009. The availability period for this facility has expired and no further drawings may be made thereunder. At 8 October 2008, €395 million had been drawn under the facility.

Interest is payable at LIBOR or EURIBOR (as the case may be) plus a margin of between 0.500% and 0.725% depending on the credit rating of BAT plus reserve asset costs.

The facility contains representations, undertakings and events of default that are customary for facilities of this type. Where there is a change of control in respect of BAT, the lenders can require all amounts outstanding under the facility to be repaid.

1.4 Syndicated €860 million Term Credit Facility

On 1 May 2008, British American Tobacco Tütün Mamulleri Sanayi Ve Ticaret Anonim fiirketi (as borrower) and BAT and BATIF (as guarantor) entered into a term credit facility agreement with Barclays Capital and J.P. Morgan plc (as mandated lead arrangers), Barclays Bank plc (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrower €860 million to finance the Tekel acquisition and other associated costs (the facility). This €860 million term credit facility, along with the syndicated €420 million term credit facility discussed above, funded the \$1,720 million (€1,112 million) acquisition of Tekel. The final maturity date is 31 October 2009. The availability period for this facility has expired and no further drawings may be made thereunder. At 8 October 2008, €759 million had been drawn under the facility.

Interest is payable at LIBOR or EURIBOR (as the case may be) plus a margin of 3.5% plus reserve asset costs. On payment of the interest the lenders pay BAT a guarantee fee of between 2.775% and 3.000% depending on the credit rating of BAT.

The facility contains representations, undertakings and events of default that are customary for facilities of this type. Where there is a change of control in respect of BAT, the lenders can require all amounts outstanding under the facility to be repaid.

1.5 Euro Medium Term Note Programme

BATIF, BAT Capital and BATHTN (each an issuer and together the issuers) operate a euro medium term note programme for the issue of euro medium term notes, pursuant to a trust deed dated 6 July 1998 (as modified and/or supplemented and/or restated from time to time (the “**EMTN Programme**”). Notes issued pursuant to the trust deed are guaranteed by BAT and each of the issuers (except where it is the relevant issuer) (each a guarantor and together the guarantors). The

Law Debenture Trust Corporation p.l.c. is a party to the trust deed as trustee. The maximum aggregate amount of notes which may be outstanding (determined based on the date of issue) under the EMTN Programme is \$16 billion. The form of the notes, the aggregate nominal amount of the notes, interest payable (if any), the issue price and other terms and conditions with respect to an issue are set out in the base prospectus and the relevant final terms document.

Under the terms of the trust deed, the guarantors have unconditionally, jointly and severally guaranteed the payment of principal and interest on the notes. The obligations of an issuer or guarantor are direct, unconditional and unsecured, subject to a negative pledge. The negative pledge restricts an issuer or guarantor from granting securities over its assets or undertaking, as security for payment (whether as principal or as guarantor) with respect to certain quoted or listed notes and debentures.

Each note will be redeemed by the issuer at its final redemption amount on the maturity date.

Under the EMTN Programme, notes were issued during 2008, 2007, 2006, and 2005, the proceeds of which were used in part to refinance maturing note issues.

The following table sets out the outstanding series of notes issued by BATIF and BATHTN under the EMTN Programme as of 8 October 2008:

Issuer	Original Issue Date	Currency	Amount	Interest Rate	Maturity Date
BATIF	25 Feb. 1999	EUR	900,000,000	4.875%	25 Feb. 2009
BATIF	22 Mar. 1999	EUR	20,000,000	Fixed/Floating	22 Mar. 2019
BATIF	13 Nov. 2001	GBP	217,000,000 ⁽¹⁾	6.500%	13 Nov. 2008
BATIF	9 Jul. 2003	EUR	1,000,000,000	5.125%	9 Jul. 2013
BATIF	9 Jul. 2003	GBP	350,000,000	5.750%	9 Dec. 2013
BATIF	12 Dec. 2003	GBP	500,000,000	6.375%	12 Dec. 2019
BATHTN	7 Apr. 2004	EUR	1,000,000,000	4.375%	15 Jun. 2011
BATIF	29 Jun. 2005	EUR	750,000,000	3.625%	29 Jun. 2012
BATHTN	15 Mar. 2006	EUR	600,000,000	4.375%	15 Sep. 2014
BATHTN	15 Mar. 2006	GBP	325,000,000	5.500%	15 Sep. 2016
BATHTN	16 May 2006	EUR	525,000,000	3m Euribor +36bp	17 May 2010
BATIF	29 Jun. 2007	EUR	1,250,000,000	5.375%	29 Jun. 2017
BATIF	12 Mar. 2008	EUR	1,250,000,000	5.875%	12 Mar. 2015
BATIF	12 Mar. 2008	GBP	500,000,000	7.250%	12 Mar. 2024

Note:

(1) Issue on 13 November 2001 is a standalone issue and not an issue made pursuant to the EMTN Programme. These notes are issued pursuant to a trust deed dated 13 November 2001 (as amended) and are guaranteed by BAT. The Law Debenture Trust Corporation p.l.c. is a party to the trust deed as trustee.

Repayment of the notes may be accelerated upon the occurrence of customary events of default, including where an issuer defaults on payment of principal or interest, where an issuer or guarantor fails to perform or observe other obligations under the trust deed or notes, and where an issuer or guarantor is subject to certain insolvency events.

2. OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL COMMITMENTS

The Group has no significant off-balance sheet arrangements. In the normal course of business, the Group enters into contractual arrangements where the Group commits to future purchases of services from unaffiliated and related parties.

The following table sets forth the Group's total future minimum payments under non-cancellable operating leases which comprises leases where payments fall due:

	2007	2006	2005
	£m	£m	£m
Property			
Within one year	55	50	49
Between one and five years	100	112	99
Beyond five years	147	167	231
	302	329	379
Plant and Equipment			
Within one year	21	17	15
Between one and five years	29	19	12
Beyond five years	1		
	50	36	28

TRADING HISTORY OF THE SHARES ON THE LSE

The table below sets the high, low and closing price and the aggregate volumes of the Shares traded on the LSE for the following periods:

	High £	Low £	Close £	Volume (shares)
Quarterly				
2006				
September	15.10	13.48	14.44	442,264,000
December	14.82	14.12	14.29	475,237,000
2007				
March	16.04	14.34	15.89	751,531,000
June	17.18	15.39	16.98	575,808,000
September	17.77	15.57	17.52	588,544,000
Monthly				
2007				
October	18.34	16.81	18.30	281,406,000
November	18.87	17.25	18.87	116,715,000
December	19.96	18.80	19.65	81,903,000
2008				
January	20.49	17.08	17.95	148,508,000
February	19.39	17.94	18.95	103,895,000
March	19.58	17.76	18.91	157,831,000
April	20.23	18.85	18.97	101,522,000
May	20.27	18.88	18.88	90,777,000
June	18.99	16.81	17.39	111,316,000
July	18.66	16.92	18.28	106,790,000
August	19.40	18.04	18.61	89,536,000
Daily				
2008				
September				
1	19.11	18.48	19.02	2,787,000
2	19.35	18.86	19.16	8,608,000
3	19.13	18.60	18.93	4,390,000
4	19.06	18.31	18.37	4,472,000
5	18.43	18.02	18.20	5,724,000
8	18.74	18.28	18.64	2,093,000
9	18.95	18.66	18.91	5,450,000
10	19.16	18.67	18.95	6,085,000
11	18.93	18.47	18.73	5,103,000
12	18.96	18.22	18.65	4,780,000
15	18.70	18.20	18.40	7,520,000
16	18.88	17.55	17.91	10,767,000
17	18.23	17.01	17.12	9,226,000
18	18.40	16.88	18.30	14,074,000
19	19.06	17.90	18.05	16,996,000
22	18.19	17.61	17.68	5,831,000
23	18.08	17.40	17.95	6,068,000

	High £	Low £	Close £	Volume (shares)
Daily (continued)				
24	18.29	17.80	17.97	5,425,000
25	18.59	17.67	18.51	6,942,000
26	18.75	18.18	18.66	3,368,000
29	18.65	18.03	18.03	4,744,000
30	18.50	17.50	18.35	7,828,000
October				
1	18.92	18.01	18.90	7,016,000
2	19.37	18.81	19.01	6,888,000
3	19.41	18.88	19.32	6,498,000
6	19.24	17.71	18.10	8,403,000
7	18.60	17.83	18.03	8,076,000
8	18.10	16.76	16.93	12,243,000

SUMMARY OF PRINCIPAL FEATURES OF SHARE SCHEMES

Set out below is a summary of each of the Share Schemes which has been established by BAT:

1. SHARESAVE SCHEME

The Sharesave Scheme is an HMRC approved scheme.

1.1 Eligibility

All Executive Directors and employees who have worked for BAT or a participating group company for a qualifying period determined by the Directors (but not to exceed five years) and any other employees nominated by the Directors are eligible to participate in the Sharesave Scheme and must be invited to participate when the Directors determine that the scheme is to be operated.

1.2 Invitations

When the Directors decide to operate the Sharesave Scheme, invitations for the grant of options are normally only issued either within 42 days following the announcement of BAT's results for any period or at any time when there are exceptional circumstances which justify the grant of options.

1.3 Savings contract

Employees granted an option under the Sharesave Scheme must enter into a savings contract with a bank or building society under which they make monthly savings for a period of three or five years in respect of that option. The monthly savings must not exceed the limit imposed by the relevant legislation (currently £250 per month). A bonus, currently equivalent to 2.4 months' worth of savings, is payable after three years, seven months' worth after five years, and (if the savings are left with the savings carrier for two further years under a five year savings contract) 12.7 months' worth after seven years. In operating the Sharesave Scheme, the Directors will specify the length of savings contract employees may enter into and whether options granted under a five year savings contract may include the seven year bonus.

1.4 Option price

Options are normally granted at an option price which is not less than 80% of the market value of the Shares on the London Stock Exchange dealing day prior to the day on which invitations are sent out or 80% of the average market value over the three London Stock Exchange dealing days prior to the day on which the invitations are sent out (or some other date agreed with HMRC), and where Shares are to be subscribed, at not less than their nominal value. Market value for this purpose means the middle market quotation as derived from the Daily Official List.

1.5 Exercise of options

Options are normally exercisable for a six-month period following the bonus date under the relevant savings contract. If the option is not exercised within this six-month period, the option will lapse. Options may also be exercisable early in certain circumstances, for example, on the optionholder ceasing to be an employee due to death, injury, disability, redundancy, retirement or following a change of control of the employing company. Exercise is also allowed where the employee leaves for any other reason, except gross misconduct, provided that the option has been held for more than three years. If any option is exercised early, the optionholder may only use the savings made under his/her savings contract (together with any interest) at that time to exercise the option. An option may only be exercised by the person to whom it is granted or his/her personal representative(s) and is not transferable.

1.6 Takeover or reconstruction

An option may be exercised in the event of a takeover, reconstruction or winding-up of BAT. In the event of another company acquiring control of BAT, optionholders may in certain circumstances exchange their options for options over ordinary shares in the acquiring company.

1.7 Issue of Shares

Shares issued on the exercise of options will rank equally with Shares of the same class in issue on the date of allotment except in respect of rights arising by reference to a prior record date.

1.8 Dilution limit

In any ten year period, the aggregate number of newly issued Shares allocated under the Sharesave Scheme, when added to the number of newly issued Shares allocated under all other employees' share schemes operated by BAT must not exceed 10% of the issued ordinary share capital of BAT in issue immediately prior to that day.

1.9 Variation in share capital

Options may be adjusted following a capitalisation, rights issue or sub-division, consolidation or reduction in the capital of BAT or any other variation of ordinary share capital.

1.10 Amendments to the Sharesave Scheme

The rules of the Sharesave Scheme relating to eligibility, scheme limits, the option price and various rights attaching to options may not be amended to the advantage of optionholders without shareholder approval, except minor amendments to benefit the administration of the Sharesave Scheme, to take account of a change in legislation, or to obtain or maintain favourable tax treatment for optionholders or BAT (or other participating Group companies). All amendments to key features of the Sharesave Scheme require approval of HMRC if the Sharesave Scheme is to retain its approved status. Similar schemes for overseas employees based on the Sharesave Scheme may be established but modified to take account of local tax, securities laws and local requirements.

1.11 Termination of the Sharesave Scheme

No options may be granted under the Sharesave Scheme after 26 April 2017.

2. EMPLOYEE SHARE OWNERSHIP PLAN

The ESOP is an HMRC approved share incentive plan.

2.1 Partnership Share Scheme

BAT operates its Partnership Share Scheme as an element of the ESOP. The Partnership Share Scheme is open to all eligible employees, including Executive Directors. Employees can allocate part of their pre-tax salary to purchase Shares. The maximum amount that can be allocated in this way is £1,500 in any tax year, or 10% of salary (if lower). Shares purchased are held in a UK-based trust, normally capable of transfer to participants tax free after a five year holding period. No holding period applies to Partnership Shares, although there are tax benefits where the Shares are held for at least five years from acquisition.

Although not currently operated, should the Directors so determine, it is possible for BAT to award free Shares in proportion to the number of Partnership Shares acquired, such proportion not to exceed two free "Matching Shares" for each Partnership Share acquired.

If dividends are declared, the Directors may allow or require those dividends to be re-invested on behalf of the participant in the acquisition of further Shares up to a maximum of £1,500 in any tax year, which must then be held in the UK-based trust for three years.

2.2 Share Reward Scheme

BAT also operates the Free Shares element of the ESOP, known as the Share Reward Scheme. Under this scheme, eligible employees (including Executive Directors) receive an appropriation of

Shares in April of each year in which the scheme operates in respect of performance in the previous financial year. The Shares are held in a UK-based trust for a minimum period of three years (although the Directors have the ability to set a holding period of up to five years), and employees receive tax benefits where the Shares are held for at least five years from allocation. The maximum individual award under the Share Reward Scheme is £3,000.

If dividends are declared, the Directors may allow or require those dividends to be re-invested on behalf of the participant in the acquisition of further Shares up to a maximum of £1,500 in any tax year, which must then be held in the UK-based trust for three years.

Although not currently operated, Free Shares (and Matching Shares, if operated under the Partnership Share Scheme) may if the Directors so determine be forfeited if the participant ceases to be employed by BAT or an associated company before the expiry of a period of up to three years from allocation, unless the participant leaves employment in circumstances specified in the relevant legislation.

2.3 Acquisition of Shares

The trustees may buy Shares for the Partnership Share Scheme and the Share Reward Scheme by market purchase or by subscription. Purchases by the trustees will be funded by the employee and/or by participating group companies, as appropriate. Any Shares issued will rank equally with Shares of the same class in issue on the date of allotment except in respect of rights arising by reference to a prior record date.

2.4 Dilution limit

In any ten year period, the aggregate number of newly issued Shares allocated under the ESOP, when added to the number of newly issued Shares allocated under all other employees' share schemes operated by BAT, must not exceed 10% of the issued ordinary share capital of BAT in issue immediately prior to that day.

2.5 Voting, dividend and other rights

Whilst Shares are held in trust, the participant will be the beneficial owner and will be entitled to receive dividends (subject to any mandatory reinvestment) and, through the trustees, to vote and to participate in substantially the same way as other shareholders. Shares may be left in trust until the participant ceases to be employed by BAT or an associated company.

2.6 Alterations to the ESOP

The Directors may amend the trust deed and rules of the ESOP as they consider appropriate, provided that no modification may be made which confers any additional advantage on participants relating to eligibility, scheme limits, the basis of individual entitlement, the price payable for the acquisition of Shares and the provisions for the adjustment of awards without prior shareholder approval, except minor amendments to benefit the administration of the ESOP, to take account of a change in legislation, or to obtain or maintain favourable tax, exchange control or regulatory treatment for participants or BAT (or other participating companies). All amendments to key features of the ESOP require HMRC approval.

2.7 Overseas schemes

As permitted by the rules, BAT has established further schemes for the benefit of overseas employees based on the ESOP but modified as necessary or as the Directors determined to be desirable to take account of overseas tax, exchange control or securities laws. In particular, BAT has established the British American Tobacco International Employee Share Ownership Plan for overseas employees who would otherwise qualify for ESOP, but who do not pay UK tax; and has established specific arrangements for employees in Belgium and the Netherlands. Employees in Germany currently continue to participate in similar arrangements to the ESOP.

3. LONG TERM INCENTIVE PLANS

The British American Tobacco Long Term Incentive Plan (the “**1998 LTIP**”) was established in 1998 for a period of ten years. On the recommendation of the Remuneration Committee, BAT obtained shareholders’ approval to establish the British American Tobacco 2007 Long Term Incentive Plan (the “**2007 LTIP**”) to replace the 1998 LTIP. Save as specified below, the terms of the 1998 LTIP and the 2007 LTIP are identical. No new awards may be made under the 1998 LTIP.

The LTIPs provide for awards of free Shares provided certain performance conditions are met. The LTIPs confer no tax advantages on participants, who are normally subject to income tax on the market value of the Shares at the date of release. The LTIPs are operated in conjunction with the group’s employee benefit trust, which is administered by an independent offshore trustee, and by the Remuneration Committee in relation to awards to Executive Directors and members of the Management Board.

3.1 Eligibility

Any employee (including Executive Directors) of BAT or any participating subsidiary is eligible to participate in the LTIPs at the discretion of the Directors with the consent of the Remuneration Committee.

3.2 Grant of Awards

Awards may normally only be granted during the six weeks following an announcement of BAT’s results for any period or at any other time if the Directors consider that there are exceptional circumstances which justify the grant of one or more awards at that time. However, at all times, the grant of awards will be subject to the terms of the Model Code on directors’ dealings in securities. No awards may be granted later than ten years after the adoption of the LTIPs by BAT. Awards take the form of an option to acquire Shares at nil cost. Awards may be granted over newly issued Shares, treasury Shares, Shares purchased in the market or Shares held by an employee benefit trust established by BAT.

3.3 Individual limits

No employee may be granted an award under the 2007 LTIP in any financial year over Shares worth more than 300% of his base salary (the limit specified in the 1998 LTIP was 200% of his base salary).

3.4 Dilution limits

The maximum number of newly issued Shares that may be allocated under the LTIPs must not exceed the following limits:

- (i) in any ten year period, the aggregate number of newly issued Shares allocated under the LTIPs, when added to the number of newly issued Shares allocated under all other employees’ share schemes operated by BAT, must not exceed 10% of the issued ordinary share capital of BAT in issue immediately prior to that day; and
- (ii) in any ten year period, the aggregate number of newly issued Shares allocated under the LTIPs, when added to the number of newly issued Shares allocated under all other discretionary employees’ share schemes operated by BAT must not exceed 5% of the issued ordinary share capital of BAT in issue immediately prior to that day.

While it remains best practice to do so, treasury Shares will be treated as newly issued for the purpose of these limits. For the purpose of these limits, no account shall be taken of any allocation where the right to acquire Shares was released, lapsed or otherwise became incapable of vesting. However, Shares subscribed by the trustees of an employee benefit trust to satisfy rights granted under any employees’ share schemes adopted by BAT would count towards these limits.

3.5 Vesting of awards

Subject to the performance conditions having been satisfied, awards will normally become exercisable on the third anniversary of the date of grant of the award. The period over which performance will be measured shall not be less than three years. Awards can be exercised no later than the tenth anniversary of the date of the award (or such earlier date as determined by the Directors).

3.6 Dividends

The Remuneration Committee may, at its discretion, determine that at vesting of awards participants shall be paid an amount equivalent to the value of dividends that would have accrued on their vested Shares.

3.7 Leaver provisions

Awards granted under the LTIPs will normally lapse on cessation of employment. In the event of death, however, an award will become immediately exercisable for a period of twelve months, subject to the extent to which the performance conditions have been satisfied at that date. If a participant leaves employment as a result of injury, illness, disability, redundancy or for any other reason, at the discretion of the Directors, an award will become immediately exercisable for a period of six months, based on the extent to which the performance conditions have been satisfied. In the case of redundancy or where the Directors exercise their discretion to allow exercise, awards shall also be reduced pro rata for time to the date of cessation of employment, unless the Directors determine this not to be appropriate in the circumstances.

3.8 Change of control

In the event of a change of control of BAT as a result of a takeover, reconstruction or winding up of BAT (not, in respect of the 2007 LTIP, being an internal reorganisation), awards will become exercisable for a limited period based on the period of time which has elapsed since the date of the award and the achievement of the performance conditions at that date, unless the Directors determine this not to be appropriate in the circumstances. As an alternative to early release, participants may, if permitted, exchange their awards for new awards of Shares in the acquiring company on a comparable basis.

3.9 Performance conditions

Awards are subject to the satisfaction of challenging performance conditions which determine the proportion (if any) of the awards which will be exercisable from the end of the performance period. The period over which performance will be measured shall not be less than three years. The performance period will normally start on the first day of the financial year in which the award is made. There is no provision for retesting opportunities for any of the performance conditions. If the performance conditions are not met, the awards will lapse.

3.10 Rights attaching to Shares

Shares allotted or transferred under the LTIPs will rank equally with all other Shares for the time being in issue (except for rights attaching to such Shares by reference to a record date prior to the exercise of the award).

3.11 Variation of capital

In the event of any variation of share capital (which, for the purposes of the 2007 LTIP, includes a demerger or similar corporate event), the Remuneration Committee may make such consequential adjustments as they consider appropriate to the performance conditions and the number of Shares subject to an award in order that a participant's award retains the same economic value.

3.12 Amendments and termination

The LTIPs may be altered by the Directors in any respect. However, any alteration to the advantage of participants, in respect of eligibility, plan limits, the terms on which awards may be exercised or adjustments on a variation in share capital, must be approved in advance by shareholders in general meeting unless the alteration or addition is minor in nature to benefit the administration of the LTIPs, to take account of a change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for existing or potential participants. The LTIPs terminate on the tenth anniversary of their respective approval by shareholders, or such earlier time as the Directors may determine, but the rights of existing participants will not be affected by any termination. In the event of termination, no further awards will be made under the LTIPs.

3.13 US Sub-Plan

The 2007 LTIP includes a US Sub-Plan to take account of the adverse US tax implications of nil cost options for US residents. This ensures that vested options shall be deemed to be exercised by the participant at the vesting date.

4. SHARE OPTION SCHEME

Set out below is a summary of the principal features of the ESOS which was established by BAT. No grants have been made under the ESOS since 2004 and the ESOS expired in April 2008.

The ESOS is divided into two parts: an approved part which has been approved by HMRC and allows for options to subsist over Shares worth up to £30,000 at the original grant price per participant. Shares in excess of this limit may be granted under the unapproved part and gains arising on the exercise of options under the unapproved part will, in the case of UK resident participants at the time of grant, be subject to deduction of income tax under the PAYE system on exercise.

4.1 Eligibility

Employees, including Executive Directors, of participating group companies are eligible to participate in the ESOS, although participation has been restricted to key individuals.

4.2 Grant of options

Options are granted for nil consideration and are normally only granted within 42 days following the announcement of BAT's results for any period or at any time when there are exceptional circumstances which justify the grant of options. It has been the policy of the Remuneration Committee to not normally grant options in any year to individuals who have received an award under one of the LTIPs.

4.3 Option price

Options may be granted by BAT at an option price which is not less than the market value of the Shares on the London Stock Exchange dealing day prior to the date of grant (or, in the case of approved options, some other date agreed with HMRC) or the average market value over the three London Stock Exchange dealing days prior to the date of grant, and, where Shares are to be subscribed, at not less than their nominal value. Market value for this purpose means the middle market quotation as derived from the Daily Official List.

The rules of the ESOS provide for option grants in any ten year period to be limited to no more than four times the participant's annual earnings.

4.4 Performance targets

Where options have been granted, performance targets are imposed as a condition of exercise.

4.5 Exercise of options

All options are currently exercisable.

Options lapse ten years after the date of their original grant.

4.6 Takeover or reconstruction

An option may be exercised in the event of a takeover, reconstruction or winding-up of BAT. In the event of another company acquiring control of BAT, participants may in certain circumstances exchange their options for options over ordinary shares in the acquiring company on a comparable basis.

4.7 Issue of Shares

Shares issued on the exercise of options will rank equally with Shares of the same class in issue on the date of allotment except in respect of rights arising by reference to a prior record date.

4.8 Dilution limits

The maximum number of newly issued Shares that may be allocated under the ESOS must not exceed the following limits:

- (i) In any ten year period, the aggregate number of newly issued Shares allocated under the ESOS, when added to the number of newly issued Shares allocated under all other employees' share schemes operated by BAT, must not exceed 10% of the issued ordinary share capital of BAT in issue immediately prior to that day;
- (ii) In any three year period, the aggregate number of newly issued Shares allocated under the ESOS, when added to the number of newly issued Shares allocated under all other employees' share schemes operated by BAT must not exceed 3% of the issued ordinary share capital of BAT in issue immediately prior to that day;
- (iii) In any five year period, the aggregate number of newly issued Shares allocated under the ESOS, when added to the number of newly issued Shares allocated under all other employees' share schemes operated by BAT must not exceed 5% of the issued ordinary share capital of BAT in issue immediately prior to that day; and
- (iv) In any ten year period, the aggregate number of newly issued Shares allocated under the ESOS, when added to the number of newly issued Shares allocated under all other discretionary employees' share schemes operated by BAT must not exceed 5% of the issued ordinary share capital of BAT in issue immediately prior to that day.

4.9 Variation in ordinary share capital

Options may be adjusted following a capitalisation, rights issue or sub-division, consolidation or reduction in the capital of BAT or any other variation of ordinary share capital.

4.10 Amendments to the ESOS

The rules of the ESOS relating to eligibility, scheme limits, the option price and various rights attaching to options may not be amended to the advantage of participants without shareholder approval, except minor amendments to benefit the administration of the ESOS, to take account of a change in legislation, or to obtain or maintain favourable tax treatment for participants, BAT or participating group companies. All amendments to the approved part of the ESOS require HMRC approval. Similar schemes for overseas employees to the ESOS may be established but modified to take account of local tax, securities laws and other local requirements.

5. DEFERRED ANNUAL SHARE BONUS SCHEME

The DSBS is operated in conjunction with BAT's annual bonus arrangements (known as "**the International Executive Incentive Scheme**") under which, provided certain performance conditions are met, participants receive a cash bonus and DSBS share award.

The DSBS provides for awards of free Shares subject to the participant remaining in employment with BAT until the vesting date. The DSBS is operated in conjunction with the group's employee benefit trust, which is administered by an independent offshore trustee.

5.1 Eligibility

Any employee (including Executive Directors) of BAT or any participating subsidiary is eligible to participate in the DSBS at the discretion of the Directors.

5.2 Grant of Awards

Awards may normally only be granted during the six weeks following an announcement of BAT's results for any period or at any other time if the Directors consider that there are exceptional circumstances which justify the grant of one or more awards at that time. Awards take the form of a conditional right to receive Shares at nil cost. Awards may not be granted over newly issued Shares, and so Shares must be purchased in the market by the employee benefit trust to satisfy awards.

5.3 Vesting of awards

Awards will normally vest on the third anniversary of the date of grant of the award.

5.4 Leaver provisions

Awards will normally lapse on cessation of employment. In the event of death or if a participant leaves employment as a result of injury, disability, redundancy, retirement, change of control of the employing company or business, or for any other reason at the discretion of the Directors, awards will vest following such event.

5.5 Change of control

In the event of a change of control of BAT, an application for the reconstruction of BAT or the passing of a resolution for the winding up of BAT, awards will immediately vest.

5.6 Variation of capital

In the event of any variation of share capital, the Directors may make such consequential adjustments as they consider appropriate to the number of Shares subject to an award.

5.7 Amendments and termination

The DSBS may be altered by the Directors in any respect.

6. EMPLOYEE BENEFIT TRUSTS

In connection with the Share Schemes, BAT operates a number of employee benefit trusts, each of which is administered by an independent trustee (either onshore or offshore). BAT may provide funds to the trustees of the employee benefit trusts to purchase Shares in the Company for the purposes of the Share Schemes, provided that no funds are provided which would result in the trustees holding more than 5% of the ordinary share capital of BAT in issue at that time.

MATERIAL CONTRACTS

STANDSTILL AGREEMENT

In connection with the merger of the Company with Rothmans, the Company entered a Standstill Agreement dated 11 January 1999 entered into between BAT and R&R (then named Rothmans International Holdings S.A.), Richemont (then called Compagnie Financière Richemont AG) and Rembrandt (together, "**the R and R Parties**"). Pursuant to a deed of release and adherence dated 18 January 2002, Rembrandt was released from its obligations under the Standstill Agreement and replaced by Remgro, an investment holding company formed as a result of the restructuring of Rembrandt in 2000. Under the Standstill Agreement, the R and R Parties gave certain undertakings to BAT including the following:

- (i) that the R and R Parties and persons acting in concert with any of them will not exercise at any general meeting of BAT more than 25% of the voting rights attached to shares of a class carrying rights to vote in all circumstances at general meetings of BAT;
- (ii) the interests of the R and R Parties and persons acting in concert with any of them in the issued ordinary share capital of BAT will not exceed 27.8% except in certain specified circumstances. These circumstances include an increase in interests (in percentage terms) of the R and R Parties and persons acting in concert with any of them as a result of BAT having purchased its own Shares or otherwise having reduced its issued ordinary share capital. In any event, if in any of these circumstances the interests of the R and R Parties and persons acting in concert with any of them in the issued ordinary share capital of BAT exceed 29.9%, the R and R Parties would be required to dispose (or procure the disposal) of such part of those interests as would be required to reduce their interests in the issued ordinary share capital of BAT to no more than 29.9%;
- (iii) except in certain specified circumstances each of the R and R Parties and persons acting in concert with any of them will not acquire any Shares in the capital of BAT and any of its subsidiaries, including any acquisition of shares or other securities convertible into, or exchangeable for or giving the right to subscribe for Shares, nor shall any person directly or indirectly make or cause to be made on its behalf any offer, invitation or solicitation for all or any part of the Shares, nor take any step which gives rise to any obligation on it under The City Code on Takeovers and Mergers to make a general offer for all or any part of the Shares. Exemptions from these restrictions include the acquisition of Shares pursuant to capitalisation issues, the take up of rights under a rights issue or other pre-emptive offering and any acquisition that does not result in the interests of the R and R Parties and persons acting in concert with any of them in the issued ordinary share capital of BAT exceeding 25%; and
- (iv) each of the R and R Parties and persons acting in concert with any of them will not dispose of any Shares or Convertible Preference Shares (these are no longer in issue) where the R and R Parties have in the previous six months, disposed of Shares representing in aggregate 5% or more of the issued share capital of BAT, without first giving BAT at least five business days' notice prior to the proposed additional disposal and consulting with BAT.

In the Standstill Agreement, BAT has undertaken to the R and R Parties that it will not (without their consent):

- (i) issue any shares which are not in all respects uniform with existing classes of shares outstanding (except for the date from which such shares rank for dividends or any restrictions on voting rights or any shares issued pursuant to employees' share schemes within the meaning of applicable UK law); or
- (ii) repurchase any Shares or otherwise reduce its issued ordinary share capital in circumstances which would result in the interests of the R and R Parties and persons acting in concert with any of them in the issued ordinary share capital of BAT equalling or exceeding 30%.

The provisions of the Standstill Agreement cease to apply if:

- (i) the number of Shares and Convertible Preference Shares held by the R and R Parties and any person acting in concert with any of them, expressed as a percentage of the total issued ordinary share capital of BAT (treating Convertible Preference Shares and any other shares or other securities convertible into ordinary share capital as ordinary share capital for this purpose), falls below 15%; or

- (ii) general offer made by a person independent of the R and R Parties and any person acting in concert with any of them for the issued ordinary share capital of BAT becomes wholly unconditional or a court scheme, having the effect of giving control of BAT to any such person, become effective; or on the fifth anniversary of completion of the R&R Parties investment in BAT, BAT fails to redeem the Convertible Preference Shares (these are no longer in issue) in full.

Pursuant to a deed of release and adherence dated 7 August 2008:

- (i) immediately upon the cancellation or transfer of Richemont's entire holding of existing ordinary shares in Richemont S.A. ("**RSA**") in accordance with a proposed corporate reorganisation to be effected by Richemont and the members of its group, RSA will agree to be bound by the terms of the Standstill Agreement; and
- (ii) on and from the date when R&R ceases to be interested in the shares of the Company following the corporate reorganisation of the Richemont group as referred to in (i) above and the transfer of the shares of the Company held by R&R to RSA and Remgro, R&R will be released from its obligations under the Standstill Agreement.

DETAILS OF MATERIAL LITIGATION

1. PRODUCT LIABILITY LITIGATION

Group companies, notably B&W as well as other leading cigarette manufacturers, are defendants, principally in the United States, in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

1.1 Indemnity

On 30 July 2004, B&W completed the Business Combination with RJRT, as a result of which:

- B&W discontinued the active conduct of any tobacco business in the United States;
- B&W contributed to RJRT all of its assets other than the capital stock of certain subsidiaries engaged in non-US businesses and other limited categories of assets;
- RJRT assumed all liabilities of B&W (except liabilities to the extent relating to businesses and assets not contributed by B&W to RJRT and other limited categories of liabilities) and contributed subsidiaries or otherwise to the extent related to B&W's tobacco business as conducted in the United States on or prior to 30 July 2004; and
- RJRT agreed to indemnify B&W and each of its associates (other than Reynolds American and its subsidiaries) against, among other matters, all losses, liabilities, damages, expenses, judgments, attorneys' fees, etc., to the extent relating to or arising from such assumed liabilities or the assets contributed by B&W to RJRT (the "**RJRT Indemnification**").

The scope of the RJRT Indemnification includes all expenses and contingent liabilities in connection with litigation to the extent relating to or arising from B&W's US tobacco business as conducted on or prior to 30 July 2004, including smoking and health tobacco litigation, whether the litigation is commenced before or after 30 July 2004 (the "**Tobacco Litigation**").

Pursuant to the terms of the RJRT Indemnification, RJRT is liable for any possible judgments, the posting of appeal bonds or security, and all other expenses of and responsibility for managing the defense of the Tobacco Litigation. RJRT has assumed control of the defense of the Tobacco Litigation involving B&W, to which RJRT is also a party in most (but not all) of the same cases. Accordingly, RJRT uses or plans to use the same law firm or firms to represent both B&W and RJRT in any single or similar case (except in certain limited circumstances) as RJRT's interests are typically aligned with B&W's interests, as RJRT has substantial experience in managing recognised external legal counsel in defending the Tobacco Litigation, and external counsel have independent professional responsibilities to represent the interests of B&W. In addition, in accordance with the terms of the RJRT Indemnification, associates of B&W have retained control of the defense in certain Tobacco Litigation cases with respect to which such associates are entitled to indemnification.

1.2 US litigation

The total number of US product liability cases pending at 31 July 2008, involving B&W and/or other Group companies was approximately 4,830 (compared to 3,323 in 2007). At 31 July 2008, UK-based Group companies have been named as co-defendants in six of those cases (compared to six in 2007). In 2007, only one case was tried against B&W, and it resulted in a defense verdict. That case, *Menchini*, was an individual case brought by a flight attendant who was a member of the Broin class action (see below). No US cases involving the UK-based Group companies were tried in 2007. As of 31 July 2008, only one US product liability case where B&W is a defendant is currently scheduled for trial in 2008. That case, *L Williams*, is an individual smoking and health case filed in the Missouri state court. No product liability case in which a UK-based Group company is a defendant is currently scheduled for trial in 2008. Since many of these pending cases seek unspecified damages, it is not possible to quantify the total amounts being claimed, but the aggregate amounts involved in such litigation are significant, possibly totalling in the billions of dollars. The cases fall into four broad categories:

1.2.1 *Medical reimbursement cases*

These civil actions seek to recover amounts spent by government entities and other third party providers on healthcare and welfare costs claimed to result from illnesses associated with smoking. Although B&W continues to be a defendant in healthcare cost recovery cases involving plaintiffs such as hospitals and Native American tribes, the vast majority of such cases have been dismissed on legal grounds.

At 31 July 2008, one reimbursement suit was pending against B&W by an Indian tribe in Indian tribal court in South Dakota, and no suits were pending against B&W by county or other political subdivisions of the states. The Master Settlement Agreement ("**MSA**") with the 46 states includes a credit for any amounts paid in suits brought by the states' political subdivisions; nevertheless, RJRT intends to defend and is defending these cases vigorously. Based on somewhat different theories of claim are two non-governmental medical reimbursement cases and health insurers' claims. One third party reimbursement case (*City of St. Louis*), in which a UK-based company is also a defendant, consists of more than 60 public and non-profit hospitals in Missouri seeking reimbursement of past and future alleged smoking related healthcare costs. A trial date for this case has been set for 11 January 2010.

1.2.2 *Class actions*

At 31 July 2008, B&W was named as a defendant in some 10 (compared to 12 in 2007) separate actions attempting to assert claims on behalf of classes of persons allegedly injured or financially impacted through smoking or where classes of tobacco claimants have been certified. Even if the classes are or remain certified and the possibility of class-based liability is eventually established, it is likely that individual trials will still be necessary to resolve any actual claims. Class-action suits have been filed in a number of states against individual cigarette manufacturers and their parent corporations, alleging that the use of the terms 'lights' and 'ultralights' constitutes unfair and deceptive trade practices. A class-action complaint (*Schwab*) was filed in the US District Court for the Eastern District of New York on 11 May 2004 against several defendants, including B&W and certain UK-based Group companies. The complaint challenges the defendants' practices with respect to the marketing, advertising, promotion and sale of 'light' cigarettes. The court granted plaintiffs' motion for class certification on 25 September 2006. By an order dated 17 November 2006, the Second Circuit Court of Appeals granted defendants' motion to stay the district court proceedings in this case, and further granted defendants' petition for leave to appeal the district court's class certification order. Briefing on the appeal was completed on 31 January 2007, and oral argument was heard on 10 July 2007. On 3 April 2008, in a unanimous ruling, the *Schwab* class was decertified by the appellate court and the prior order was overturned. The appellate court found that the individual issues of civil Racketeer Influenced and Corrupt Organisations Act ("**RICO**") reliance, injury and causation predominated over any common issue, rendering the case unsuitable for class treatment. The Second Circuit Court of Appeals issued the mandate officially returning the case to the District Court on 29 May 2008. Other types of class-action suits assert claims on behalf of classes of individuals who claim to be addicted, injured, or at greater risk of injury by the use of tobacco or exposure to environmental tobacco smoke, or the legal survivors of such persons.

In *Engle* (Florida), a jury awarded a total of \$12.7 million to three class representatives, and in a later stage of this three phase trial process, a jury assessed \$17.6 billion in punitive damages against B&W. In November 2000, B&W posted a surety bond in the amount of \$100 million (the amount required by Florida law) to stay execution of this punitive damages award. On 21 May 2003, the intermediate appellate court reversed the trial court's judgment and remanded the case to the trial court with instructions to decertify the class. On 16 July 2003, plaintiffs filed a motion for rehearing which was denied on 22 September 2003. On 12 May 2004, the Florida Supreme Court agreed to review this case and, on 6 July 2006, it upheld the intermediate appellate court's decision to decertify the class, and vacated the jury's punitive damages award. By an order dated 17 April 2007, the surety bond for the punitive damages was released and the \$100 million collateral securing that bond was returned to B&W. Further, the Florida Supreme Court permitted the judgments entered for two of the three *Engle* class representatives to stand, but dismissed the judgment entered in favour of the third *Engle* class representative. Finally, the Florida Supreme Court has

permitted putative *Engle* class members to file individual lawsuits against the *Engle* defendants within one year of the Court's decision (subsequently extended to 11 January 2008). The Court's order precludes defendants from litigating certain issues of liability against the putative *Engle* class members in these individual actions. On 7 August 2006, defendants filed a motion for rehearing before the Florida Supreme Court, which was granted in part, and denied in part, on 21 December 2006. The Florida Supreme Court's 21 December 2006 ruling did not amend any of the earlier decisions' major holdings, which included decertifying the class, vacating the punitive damages judgment, and permitting individual members of the former class to file separate suits. Instead, the ruling addressed the claims on which the *Engle* jury's phase one verdict will be applicable to the individual lawsuits that were permitted to stand. On October 1, 2007, the United States Supreme Court denied defendants' request for certiorari review of the Florida Supreme Court's decision.

As of 31 July 2008, RJRT and/or B&W have been served in approximately 2,290 *Engle* progeny cases in both state and federal courts in Florida. These cases include approximately 8,838 plaintiffs. Plaintiffs' counsel is attempting to include multiple plaintiffs in most of the cases filed. The number of cases will likely increase due to delays in processing the cases within the Florida court system.

In the first 'phase three' trial of an individual *Engle* class member (*Lukacs*), the jury awarded the plaintiff \$37.5 million in compensatory damages (B&W's share: \$8.4 million) on 11 June 2002. On 1 April 2003, the jury award was reduced to \$25.125 million (B&W's share: \$5.65 million) but no final judgment was entered into because the trial court postponed the entry of final judgment until the *Engle* appeal was fully resolved. On 2 January 2007, defendants moved to set aside the jury's verdict for the plaintiffs. On 3 January 2007, plaintiff filed a motion for entry of judgment, which the trial court deferred until the completion of appellate review of *Engle*. On 12 October 2007, the plaintiff filed notice of completion of all appellate review to the trial court. Following a hearing on 24 July 2008, the trial court, on 14 August 2008, issued an order entering judgment for the plaintiff that awarded \$24,835,000 to plaintiff (plus interest), for which the defendants would be jointly and severally liable. On 25 August 2008, the defendants filed a motion for reconsideration of, or in the alternative, to alter or amend, the trial court's order that entered judgment for the plaintiff, and subsequently objected to the plaintiff's 27 August 2008 submission of a proposed order to schedule a trial on punitive damages. A hearing on defendants' motion has been scheduled for 21 October 2008.

In a Louisiana medical monitoring case brought on behalf of Louisiana smokers (*Scott*), on 28 July 2003, the jury returned a verdict in defendants' favour on the medical monitoring claim but made findings against defendants with respect to claims relating to fraud, conspiracy, marketing to minors and smoking cessation. On 21 May 2004, the jury returned a verdict in the amount of \$591 million on the class's claim for a smoking cessation programme. On 1 July 2004, the court upheld the jury's verdict and entered final judgment. On 29 September 2004, defendants posted a \$50 million bond (legislation in Louisiana limits the amount of a bond to prevent execution upon such a judgment to \$50 million collectively for signatories to the MSA). RJRT posted \$25 million (i.e. the portions for RJRT and B&W) towards the bond. On 12 April 2006, the Louisiana Fourth Circuit Court of Appeal heard argument on defendants' appeal. The appellate court issued a decision on 7 February 2007 that affirmed class certification and upheld the smoking cessation programme for certain smokers who began smoking before 1988, but reduced the \$591 million jury award by \$312 million and rejected any award of prejudgment interest. The decision also remanded the case to re-determine damages in light of its holding that no class members who started smoking before 1988 were entitled to any monetary damages. All further proceedings in the trial court have been stayed, however, pending further appellate review. Defendants (on 2 April 2007) and plaintiffs (on 13 April 2007) both filed petitions for review by the Louisiana Supreme Court, which the Court denied on 7 January 2008. The defendants' petition for writ of certiorari with the US Supreme Court was denied on 10 June 2008. On 21 July 2008, the trial court entered judgment in the case. The court found that the defendants were jointly and severally liable for funding the cost of a court-supervised smoking cessation programme and ordered the defendants to deposit approximately \$264 million together with interest

from 30 June 2004 into a trust for the funding of the programme. On 20 August 2008, defendants filed a motion for a suspensive appeal from the trial court's 21 July 2008 entry of judgment, which the trial court denied on 27 August 2008. On 28 August 2008, defendants filed a notice of intention to apply for writ of mandamus or supervisory writ seeking review of the trial court's 27 August 2008 decision, and also moved for a stay of the case (including a stay of execution on the judgment) pending the completion of appellate review. On 8 September 2008, the trial court granted defendants' application for permission to file a writ of mandamus or supervisory writ with the Court of Appeal for the Fourth Circuit, but denied the branch of defendants' motion that sought to stay execution of judgment pending further appellate review. On 9 September 2008, defendants filed with the Court of Appeal an emergency application for writ of mandamus or supervisory writ, along with a request for a stay of execution of judgment and for expedited consideration of defendants' application. On 9 September 2008, the Court of Appeal stayed the case pending further orders of the Court. Briefing on defendants' application is now complete, and a decision by the Court of Appeal remains *sub judice*.

1.2.3 Individual cases

Approximately 5,505 cases were pending against B&W at 31 July 2008 (compared to 3,307 in 2007) filed by or on behalf of individuals in which it is contended that diseases or deaths have been caused by cigarette smoking or by exposure to environmental tobacco smoke ("**ETS**"). Of these cases, approximately: (a) 2,621 are ETS cases brought by flight attendants who were members of a class action (Broin) that was settled on terms that allow compensatory but not punitive damages claims by class members; (b) 490 of the individual cases against B&W are cases brought in consolidated proceedings in West Virginia; (c) 2,290 are *Engle* progeny cases that have been filed either directly against B&W or against RJRT, as successor to B&W, and (d) 104 are cases filed by other individuals.

Of the individual cases that were decided or remained on appeal during 2007, three resulted in verdicts against B&W:

In December 2003, a New York jury (*Frankson*) awarded \$350,000 compensatory damages against B&W and two industry organisations. In January 2004, the same jury awarded \$20 million punitive damages. On 22 June 2004, the trial judge granted a new trial unless the parties agreed to an increase in compensatory damages to \$500,000 and a decrease in punitive damages to \$5 million, of which \$4 million would be assigned to B&W. Plaintiffs agreed to a decrease in punitive damages, but B&W has not agreed to an increase in compensatory damages. On 25 January 2005, B&W appealed to an intermediate New York State appellate court. Oral argument was heard on 8 May 2006. The appellate court affirmed the judgment on 5 July 2006. B&W filed a motion for leave to reargue, or in the alternative, for leave to appeal to the New York Court of Appeals, on 3 August 2006. The intermediate appellate court denied this motion on 5 October 2006. On 8 December 2006, the trial judge granted plaintiff's application for entry of judgment, and granted plaintiff's motion to vacate that part of the 2004 order granting a new trial unless the parties agreed to an increase in compensatory damages to \$500,000. RJRT posted a bond in the approximate amount of \$8.018 million on 3 July 2007. B&W appealed from final judgment on 3 July 2007 to an intermediate New York State appellate court. Briefing has been completed, but oral argument has not yet been scheduled by the court.

On 1 February 2005, a Missouri jury (*Smith*) awarded \$500,000 in compensatory damages against B&W and then, on 2 February 2005, awarded \$20 million in punitive damages, also against B&W. On 1 June 2005, B&W filed its notice of appeal. B&W filed its opening appellate brief on 28 April 2006. Oral argument was heard on 31 August 2006. On 31 July 2007, an intermediate Missouri appellate court affirmed the compensatory damages award, but it reversed the punitive damages award, reasoning that plaintiff failed to produce sufficient evidence to justify the verdict. The court remanded the case for a second trial, limited to punitive damages. The court also transferred the case to the Missouri Supreme Court. Oral argument was heard by the Missouri Supreme Court on 13 February 2008. On 31 July 2008, the Missouri Supreme Court transferred the case back the intermediate appellate court for further proceedings.

On 18 March 2005, a New York jury (*Rose*) awarded \$1.7 million in compensatory damages against B&W. On 18 August 2005, B&W filed its notice of appeal. RJRT posted a bond in the approximate amount of \$2.058 million on 7 February 2006. Oral argument on this appeal was heard on 12 December 2006 by an intermediate New York appellate court. On 10 April 2008, the appellate court reversed the judgment in the plaintiff's favour and ordered that the case be dismissed. On 8 May 2008, the plaintiff filed a notice of appeal to New York's Court of Appeals and oral argument is scheduled for 18 November 2008.

1.2.4 Other claims

The Flintkote Company ("**Flintkote**"), a US asbestos production and sales company, was included in the acquisition of Genstar Corporation by Imasco in 1986 and became a Group subsidiary following the restructuring of Imasco Limited (now Imperial Tobacco Canada Limited "**Imperial**") in 2000. Soon after this acquisition, and as part of the acquisition plan, Genstar began to sell most of its assets, including the non-asbestos related operations and subsidiaries of Flintkote. The liquidation of Flintkote assets produced cash proceeds and, having obtained advice from the law firm of Sullivan & Cromwell LLP and other advice that sufficient assets would remain to satisfy liabilities, Flintkote and Imasco authorised the payment of a dividend of \$170.2 million in 1986 and a further dividend of \$355 million in 1987. In 2003, Imperial divested Flintkote and then, in 2004, Flintkote filed for bankruptcy in the United States Bankruptcy Court for the District of Delaware. In 2006, Flintkote, representatives of both the present and future asbestos claimants, and individual asbestos claimants were permitted by the bankruptcy court to file a complaint against Imperial and numerous other defendants including Sullivan & Cromwell LLP, for the recovery of the dividends and other compensation under various legal and equitable theories. Sullivan & Cromwell LLP and Imperial have since filed cross complaints against each other. The parties are presently engaged in case management discussions to establish the scope and manner of discovery in this case. Although the litigation is at a preliminary stage the judge has stated an intention to select discrete issues for resolution either through evidentiary hearings or trial in hopes of simplifying or clarifying the determinative issues in the litigation. The first issue the judge seeks to resolve is expected to be whether Flintkote's claim for malpractice against Sullivan & Cromwell LLP is time barred. The parties are presently engaged in case management discussions regarding discovery and scheduling with respect to this issue.

In Wisconsin, the authorities have identified potentially responsible parties ("**PRPs**") to fund the clean up of the Fox River, Wisconsin. The pollution was caused by the alleged discharges of toxic material from paper mills operating close to the river. The cost of the clean up work has been estimated to be in the order of \$600 million. Among the potentially responsible parties are NCR Corporation ("**NCR**") and Appleton Papers Inc. ("**Appleton**") who may be liable for a proportion of the clean up costs. In 1978, B.A.T Industries p.l.c. ("**Industries**") purchased what was then NCR's Appleton Papers Division from NCR. In 1978, Industries also incorporated a US entity by the name of BATUS, Inc. ("**BATUS**"), which in 1980 became the holding company for all of Industries' US subsidiaries, including Appleton. As the holding company, BATUS obtained insurance policies for itself and its subsidiaries that included coverage for certain environmental liabilities. Industries/BATUS spun off the Appleton business in 1990 to Wiggins Teape Appleton p.l.c. and Wiggins Teape Appleton (Holdings) p.l.c., now known as Arjo Wiggins Appleton Ltd. and Arjo Wiggins US Holdings Ltd. (collectively, the "**AWA Entities**"), obtaining full indemnities from AWA Entities for past and future environmental claims. Disputes between NCR, Appleton, the AWA Entities, and Industries as to the indemnities given and received under the purchase agreement in 1978 have been the subject of arbitrations in 1998 and 2006. Under the terms of the arbitration awards, Industries and Appleton/the AWA Entities have an obligation to share the costs of environmental claims with NCR, but Industries has never been required to pay any sums in this regard because Appleton and the AWA Entities have paid any sums demanded to date, and the authorities have not identified Industries or BATUS as PRPs. It is believed that all future environmental liabilities will continue to be met directly by Appleton and the AWA Entities by self-funding or insurance cover and no demand will be made upon Industries. However, the risk for Industries in respect of the Fox River clean up is that Appleton and the AWA Entities will exhaust insurance policies beyond what Industries believes Appleton and the AWA Entities are entitled to under the demerger agreement, potentially leaving

Industries with no insurance to call on should it be called on to contribute. There is currently a tolling agreement in place with regard to the differing interpretations of the provisions of the demerger agreement in this regard. Given the likelihood that the case will not be resolved for some time, Appleton, the AWA Entities, Industries and BATUS have agreed to extend the tolling agreement until 31 December 2009. If circumstances change, the agreement is terminable on notice.

1.3 Settlement of State Health Care Reimbursement Cases

During 2003, agreement was reached on certain disputed MSA payments relating to MSA calculations based on 1999 and 2000 sales. This agreement resulted in a benefit of £27 million which is excluded from the 2003 costs shown in the consolidated audited annual accounts of the Company for the financial year ended 31 December 2004. In other developments, after an Independent Auditor found that the terms of the MSA were a 'significant factor' in market share losses experienced by signatories to the MSA in 2003, several US tobacco companies, including B&W, asserted their rights under the NPM (or Non-Participating Manufacturer) Adjustment provision of the MSA to recover a payment credit or offset - against their April 2006 payment obligations - for MSA payments made in April 2004 in respect of cigarettes shipped or sold in the US in 2003. The amount at stake exceeds \$1 billion. The settling states oppose these MSA payment reduction claims and, in late April 2006, began filing motions in MSA courts across the country seeking enforcement of certain MSA provisions and a declaration of the parties' rights under the NPM Adjustment provision of the MSA. Defendants have opposed these motions, arguing that their NPM Adjustment claims must go instead to arbitration. To date, the overwhelming majority of MSA courts to decide these motions have ruled in defendants' favour. Subsequent proceedings have been initiated with respect to subsequent NPM Adjustments, and remain pending.

1.4 UK-Based Group Companies

At 31 July 2008, Industries was a defendant in the US in one class action, the *Schwab* case mentioned previously. In that case, Industries was substituted for the Company as a defendant. British American Tobacco (*Investments*) Limited had been served in one reimbursement case (*City of St. Louis*), the Department of Justice case (see below), one anti-trust case (*Smith*, see below), two class actions (*Cleary* and *Schwab*) and two individual actions (*Eiser* and *Perry*).

2. Conduct-based claims

On 22 September 1999, the US Department of Justice brought an action in the US District Court for the District of Columbia against various industry members, including RJRT, B&W, Industries and Investments. Industries was dismissed for lack of personal jurisdiction on 28 September 2000. The Government sought to recover federal funds expended in providing healthcare to smokers who have developed diseases and injuries alleged to be smoking-related, and, in addition, sought, pursuant to the federal RICO, disgorgement of profits the Government contends were earned as a consequence of a RICO 'enterprise'. On 28 September 2000, the portion of the claim which sought recovery of federal funds expended in providing healthcare to smokers who have developed diseases and injuries alleged to be smoking-related was dismissed. The bench (non-jury) trial of the RICO portion of the claim began on 21 September 2004, and ended on 9 June 2005. On 17 November 2004, the Washington DC Circuit Court of Appeals heard an appeal by the defendants against an earlier district court decision that disgorgement of profits is an appropriate remedy to the RICO violations alleged by the Government. On 4 February 2005, the Court of Appeals allowed the appeal, ruling that the government could not claim disgorgement of profits. On 17 October 2005, the US Supreme Court declined to hear the appeal by the US Government in respect of the claim for disgorgement of \$280 billion of past profits from the US tobacco industry. The disgorgement claim was a centrepiece of the Government's claim.

On 17 August 2006, the district court issued its final judgment, consisting of some 1,600 pages of factual findings and legal conclusions. The court found in favour of the government, and against certain defendants, including B&W and Investments. The court also ordered a wide array of injunctive relief, including a ban on the use of 'lights' and other similar descriptors beginning 1 January 2007. Compliance with the court-ordered remedies may cost RJRT and Investments millions of dollars. In addition, the Government is seeking the recovery of roughly \$1.9 million in litigation costs. Defendants filed a motion

to stay enforcement of the judgment shortly after the judgment was issued. The court denied defendants' stay motion on 28 September 2006. Defendants, including B&W and Investments, filed their notices of appeal to the Washington DC Circuit Court of Appeals on 11 September 2006, and filed an emergency motion to stay the judgment before the same court on 29 September 2006. On 31 October 2006, the Court of Appeals granted defendants' motion to stay enforcement of the judgment pending the outcome of the appeal. On 10 August 2007, defendants filed their initial appellate briefs to the Court of Appeals. All defendants filed a joint appellate brief, and Investments also filed its own brief which raised the issue of whether Congress intended for RICO to apply to extraterritorial conduct by a foreign defendant. On 19 November 2007, the Government filed its opposition/cross-appeal brief. Appellate briefing was completed in May 2008, and oral argument has been scheduled for 14 October 2008.

In the *Daric Smith* case, purchasers of cigarettes in the State of Kansas brought a class action in the Kansas State Court against B&W, Investments and certain other tobacco companies seeking injunctive relief, treble damages, interest and costs. The allegations are that the defendants participated in a conspiracy to fix or maintain the price of cigarettes sold in the US, including the State of Kansas, in violation of the Kansas Restraint of Trade Act. The court is expected to issue a new case management order soon. That order will likely set a trial date for June 2009 or beyond. Discovery is continuing.

3. PRODUCT LIABILITY OUTSIDE THE UNITED STATES

At 31 July 2008, active claims against the Group's companies existed in 16 markets outside the US but the only markets with more than five active claims were Argentina, Brazil, Canada, Chile, Italy, and the Republic of Ireland. Recoupment actions are being brought in Canada, Argentina, Brazil, Israel, Nigeria, Spain and Saudi Arabia. There are also three class actions being brought in Brazil and a "lights" class action has been recently brought in Israel against a number of parties including British American Tobacco's distributor. In March 2008, a claim was filed in the Sofia City Court of Bulgaria against 21 tobacco companies. The plaintiff purports to bring a collective claim for damages and regulatory relief on behalf of all affected smokers in Bulgaria under the new civil procedure laws enacted on 1 March 2008. On 26 September 2008, the claim was dismissed on procedural grounds, and the plaintiff has seven days from receipt of the court's decision to appeal the ruling.

In September 2008, a "lights" action was filed by the Ministry of Health and Social Development in Russia against BAT Yava and related company ITMS. The claim seeks a declaration from the court that the use of the words "light, superlight, and 1mg light" on cigarette packets are misleading and unlawful and further seeks the removal of these descriptors. Should it be successful the Ministry may request the court to order advertising by BAT of the court's decision.

At 31 July 2008, there were some 1,425 (compared to 3,478 in 2007) individual 'lights' cases in Italy pending against British American Tobacco Italia S.p.A. In 2007, 2,230 cases were filed by a single plaintiffs' counsel in one jurisdiction (Pescopagano). The court has now confirmed the withdrawal of all of these claims. Almost all of the individual 'lights' cases filed in Italy are pending before Justices of the Peace courts. Because of the type of court involved, the most that any individual plaintiff can recover in damages is €1,033. To date, 983 (compared to 950 in 2007) cases (not including Pescopagano cases) have been suspended or resulted in decisions given in favour of British American Tobacco Italia S.p.A. There are 35 (compared to 33 in 2007) smoking and health cases pending before Italian Civil Courts, filed by or on behalf of individuals in which it is contended that diseases or deaths have been caused by cigarette smoking. There are three (compared to two in 2007) labour cases for alleged occupational exposure pending in Italy.

In Canada, the government of the Province of British Columbia brought a claim pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2000 (the "**Recovery Act**") against domestic and foreign 'manufacturers' seeking to recover the plaintiff's costs of health care benefits. Investments, Industries and other former Rothmans Group companies are named as defendants. The constitutionality of the Recovery Act was challenged by certain defendants and, on 5 June 2003, the British Columbia Supreme Court found the Recovery Act to be beyond the competence of the British Columbia legislature and, accordingly, dismissed the government's claim. The government appealed the decision to the British Columbia Court of Appeal which, on 20 May 2004, overturned the lower court's decision and declared the Recovery Act to be constitutionally valid. Defendants appealed to the Supreme Court of Canada in June and that court gave its judgment in September 2005 dismissing the appeals and declaring the Act to be constitutionally valid. The action is now set down for trial in September 2011. The federal Government was enjoined by a Third Party Notice, and presented a Motion to Strike the claim.

The hearing took place during the week of 3 March 2008 and the Court found in favour of the federal Government. Notice of appeal against the ruling on the third party notice has been filed. It is not expected that the appeal will be heard before early 2009. The appeal is likely to be consolidated with that for *Knight* so that the hearings are scheduled over consecutive days.

Non-Canadian defendants challenged the personal jurisdiction of the British Columbia Court and those motions were heard in the Supreme Court of British Columbia. On 23 June 2006, the court dismissed all defendants' motions, finding that there is a 'real and substantial connection' between British Columbia and the foreign defendants. Subsequently, defendants were granted leave to appeal that ruling to the Court of Appeal of British Columbia. The appeal was dismissed on 15 September 2006. Defendants filed leave to appeal to the Supreme Court on 10 November 2006, and that application was denied on 5 April 2007.

In another Canadian recoupment case, the government of the Province of New Brunswick has brought a health care recoupment claim against domestic and foreign tobacco "manufacturers", pursuant to the provisions of the Recovery Act passed in that Province in June 2006. The Company, Investments, Industries and Carreras Rothmans Limited have all been named as defendants. The government filed a statement of claim on 13 March 2008. The Group Defendants were served with the Notice of Action and Statement of Claim on 2 June 2008.

Similar legislation has been enacted, but not yet brought into force, in some other Canadian provinces, and is also being considered by other Canadian provinces.

In addition, there are five class actions and four individual cases in Canada. In the *Knight* class action, the Supreme Court of British Columbia certified a class of all consumers of cigarettes bearing 'light' or 'mild' descriptors since 1974 manufactured in British Columbia by Imperial, the Group's operating company in Canada. Imperial filed an appeal against the certification which was heard in February 2006. The Appeal Court confirmed the certification of the class but has limited any financial liability, if proved, to the period from 1997. This is a 'lights' class action in which plaintiff alleges that the marketing of light and mild cigarettes is deceptive because it conveys a false and misleading message that those cigarettes are less harmful than regular cigarettes. Although the claim arises from health concerns, it does not seek compensation for personal injury. Instead it seeks compensation for amounts spent on 'light and mild' products and a disgorgement of profits from Imperial. The motion of the Federal Government to strike out the third party notice issued against them by Imperial was heard in February 2006 and was granted but is currently under appeal by Imperial. A similar 'lights' and 'mild' class action claim has been filed in Newfoundland. Imperial has filed a third party notice against the Federal Government. The certification hearing took place in September 2007 and is now under advisement.

There are currently two class actions in Quebec. On 21 February 2005, the Quebec Superior Court granted certification. The court certified two classes, which include residents of Quebec who suffered from lung, throat and laryngeal cancer or emphysema, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. In Quebec, there is no right of appeal for a defendant upon certification. Plaintiffs have served a Statement of Claim. This litigation is expected to take several years to proceed to trial. On 12 May 2008, the Ontario Court of Appeal dismissed the plaintiffs' appeal in the *Ragoonanan* class action. The proposed class action sought to certify as a class "*all persons who suffered bodily damage or property damage as a result of fires commenced by cigarettes that did not automatically extinguish upon being dropped or left unattended*". Certification was denied in first instance and leave to appeal was denied in the 12 May decision. In summary, the court decided that there was no rational relationship between the class definition and the proposed common issues and that a class action was not a preferable procedure. The court also noted that the plaintiffs failed to produce a workable litigation plan and that the individual issues far outweighed any potential common issues.

In 2007, four Nigerian states (Lagos, Kano, Gombe, and Oyo) and the federal government of Nigeria filed separate health care recoupment actions, each seeking the equivalent of billions of US Dollars for costs allegedly incurred by the state and federal governments in treating smoking-related illnesses. British American Tobacco (Nigeria) Limited, the Company and Investments have all been named as defendants, and have filed preliminary objections in each of the pending cases.

On 21 February 2008, the Lagos action was voluntarily discontinued by the plaintiffs. On 13 March 2008, the Lagos Attorney General filed a substantially similar action which was marked as "qualified" under Lagos State's "Fast-Track" system. The "Fast-Track" system provides for resolution of the dispute within

an eight-month time-period after filing. British American Tobacco (Nigeria) Limited, the Company and Investments have all been served in the new action, and have filed preliminary objections. At a hearing on 16 September, because service is yet to be completed on all defendants, the Court directed that the case no longer qualified to be heard on the "Fast Track". The case has been adjourned until 9 December 2008 for a further report on service.

On 8 July 2008, the High Court of Gombe State issued a ruling on the preliminary objections filed by the Company, Investments and other defendants in the case, setting aside the service on all defendants and striking out the Gombe suit. In its decision, the court held that the writs served on the defendants were invalid, the plaintiff had failed to pay the requisite filing fees, and that based on these filing defects, the court was not competent to assume jurisdiction. In its decision, the court stated, however, the plaintiff, through its statement of claim and affidavit evidence filed in support of its *ex parte* motion for leave to serve outside the jurisdiction, had satisfied the requirements for service outside the jurisdiction. The plaintiff may still appeal the court's decision, or file a new action.

In Kano, the case stands adjourned until 7 November 2008 and it is not expected that the parties will adopt the written submissions previously filed with respect to the preliminary objections to jurisdiction by the Company and Investments until late 2008 or early 2009.

At a hearing on 3 July 2008 in the Oyo case, the court heard argument whether the plaintiffs' Written Addresses, opposing the objections to jurisdiction filed by the Company and Investments, were timely filed and served. On 1 August 2008 the court ruled that the plaintiffs were out of time in filing their Written Address but granted their oral application that they be granted a retrospective extension of time. Their Written Address already filed was therefore deemed timely filed and served. The Court is expected to set a date for the parties to adopt their Written Addresses as to the jurisdictional objections by the Company and Investments.

The Federal claim has been adjourned to 29 October 2008 for a further report on service.

In Saudi Arabia, there are reports that the Ministry of Health is pursuing a health-care recoupment action in the Riyadh General Court against Saudi tobacco distributors, seeking damages of billions of Saudi Riyals. The identity of the defendants is unclear at this time. At 31 July 2008, no Group company had yet been served with process. In addition, a separate recoupment action has reportedly been filed by the King Faisal Specialist Hospital in the Riyadh General Court, naming 'BAT Company Limited' as a defendant. At 31 July 2008, no Group company had been served with process in the action.

British American Tobacco (South America) Limited was served on 18 July 2008 in a public interest action that has a recoupment component. The case was brought by two Colombian citizens alleging that the defendant violated numerous "collective" interests and rights of the Colombian population. In addition to equitable and injunctive relief being sought, plaintiffs are seeking 25% of smoking-related health-care costs since the time that British American Tobacco has been operating in Colombia.

4. Other Litigation outside the US

In November 2004, the Royal Canadian Mounted Police (the "RCMP") obtained a warrant to search and seize business records and documents at the head office of Imperial in Montreal. The affidavit filed by the RCMP to obtain the search warrant made allegations in relation to the smuggling of cigarettes in Canada between 1989 and 1994, naming Imperial, the Company, Industries, Philip Morris, and certain former directors and employees of these companies. In July 2008, Imperial entered into a plea of guilty to a violation of a single count of section 240(1)(a) of the Canadian Excise Act and paid a fine of Cdn\$200 million. Imperial thereafter obtained full immunity from further prosecution and civil proceedings from the federal and all 10 provincial governments in Canada. Imperial also entered into a 15-year civil agreement with the federal and provincial governments of Canada, under which Imperial, the federal government, the provinces and others will work together on initiatives to fight the growth of illegal tobacco products. The agreement further requires a payment of Cdn\$50 million in 2008 and a percentage of Imperial's annual net sales revenue going forward for fifteen years up to a maximum of Cdn\$350 million.

5. TAX LITIGATION

BAT is the principal test claimant in a widely publicised action in the United Kingdom against HM Revenue and Customs in the Franked Investment Income Group Litigation Order (“**FII GLO**”). There are over 20 companies in the FII GLO. The case relates to whether the UK corporate tax law relating to the taxation of dividends from overseas and the system of Advance Corporation Tax was in breach of the UK government’s European Community obligations. The claim was filed in 2003 and the case was heard in the European Court of Justice in 2005 and a decision of the ECJ received in December 2006. In July 2008, the case reverted to a trial in the UK High Court for the UK Court to determine how the principles of the ECJ decision should be applied in a UK context. A decision of the UK Court is expected in October 2008. No monetary claim has yet been filed against HM Revenue and Customs. Given the complex nature of the proceedings, it is too early to assess the range of possible outcomes in this matter or to quantify the amount of any possible monetary claim that may be made. Furthermore, BAT expects that any decision of the UK High Court is likely to be subject to further appeal by the parties involved.

6. CONCLUSION

While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, the Group believes that the defences of the Group’s companies to all these various claims are meritorious on both the law and the facts, and a vigorous defense is being made everywhere. If an adverse judgment is entered against any of the Group’s companies in any case, an appeal will be made. Such appeals could require the appellants to post appeal bonds or substitute security in amounts which could in some cases equal or exceed the amount of the judgment. In any event, with regard to US litigation, the Group has the benefit of the RJRT Indemnification. At least in the aggregate, and despite the quality of defences available to the Group, it is not impossible that the Group’s results of operations or cash flows in particular quarterly or annual periods could be materially affected by this and by the final outcome of any particular litigation.

Having regard to all these matters, the Group (i) does not consider it appropriate to make any provision in respect of any pending litigation and (ii) does not believe that the ultimate outcome of this litigation will significantly impair the Group’s financial condition.

TRADING UPDATE

The following wording is extracted without modification from the trading update released by BAT on 9 October 2008.

“In terms of current trading, the trends outlined in the Interim Report to 30 June 2008, as announced on 31 July 2008, continued for the period to 30 September 2008.

The acquisitions of the cigarette assets of Tekel and the cigarette and snus businesses of Skandinavisk Tobakskompagni were completed on 24 June and 2 July 2008 respectively and the integration of the assets and businesses into the British American Tobacco Group is progressing according to plan.

The Group will publish its Quarterly Report for the nine months to 30 September 2008 on Thursday, 30 October 2008.”

DETAILS OF DIRECTORS OF MATERIAL SUBSIDIARIES OF BAT

The names, business address and functions of the directors of each of the material subsidiaries of BAT are set out below.

1. BRITISH AMERICAN TOBACCO AUSTRALIA LIMITED

Name	Function
David Crow	Managing Director
Maurice Tsangaris	Finance Director
Marcio Salgado	Marketing Director

The business address of the above directors is Virginia Park, 1 Westfield Drive, Pagewood, NSW, Australia 2036.

2. BRITISH AMERICAN TOBACCO (GERMANY) GMBH

Name	Function
Adrianus Schenk	Managing Director
Nikolaus Mohr	Legal Director
Thorsten Otto-Lehthaus	HR Director
Marc Van Herreweghe	Operations Director
Karsten Weber	Finance Director

The business address of the above directors is Alsterufer 4, 20354 Hamburg, Germany.

3. BRITISH AMERICAN TOBACCO SOUTH AFRICA (PROPRIETARY) LIMITED

Name	Function
John Taylor	Managing Director
Hendrik Dippenaar	HR Director
Brian Finch	Marketing Director
Fayrouz Kajee	Director: Corporate and Regulatory Affairs
Shon Kumar	Director: IT and Corporate Strategy and Planning
Dudley Saayman	Finance Director
Salim Young	Director: Legal/Risk and Security/ Facilities

The business address of the above directors is 34 Alexander Street, Stellenbosch, 7600, South Africa.

4. BROWN & WILLIAMSON HOLDINGS, INC. (DIRECT HOLDING COMPANY OF REYNOLDS AMERICAN INC.)

Name	Function
Timothy Hazlett	Director and President
Robert Casey	Director
Andrew Panaccione	Director and Secretary

The business address of the above directors is 103 Foulk Road, Suite 117, Wilmington, DE 19803, U.S.A.

5. CJSC 'INTERNATIONAL TOBACCO MARKETING SERVICES'

Name	Function
Kingsley Wheaton	General Director

The business address of the above director is Krylatskaya Street, 17, Building 2, Moscow 121614, Russia.

6. IMPERIAL TOBACCO CANADA LIMITED

Name	Function
Benjamin Kemball	President and Chief Executive Officer
Thomas Gillespie	Non-Executive Director and Chairman
Richard Hodgson	Vice-President and Chief Financial Officer
Donald McCarty	Vice-President, General Counsel and Secretary
Alain Benedetti	Non-Executive Director
Timothy Every-Burns	Non-Executive Director
Barbara McDougall	Non-Executive Director

The business address of the above directors is 3711 Saint-Antoine Street West, Montreal, Quebec, H4C 3P6 Canada.

7. SOUZA CRUZ S.A.

Name	Function
Mark Cobben	Chairman
Dante Letti	Chief Executive Officer
Luis Rapparini	Chief Financial Officer
Carlos Geraldo Langoni	Non-Executive Director
Celio De Oliveira Borja	Non-Executive Director
Rudolf Hohn	Non-Executive Director
João Pedro Gouvêa Vieira Filho	Non-Executive Director
Israel Vainboim	Non-Executive Director
Luiz Felipe Palmeira Lampreia	Non-Executive Director

The business address of the above directors Rua Candelária, 66, Centro, city of Rio de Janeiro, state of Rio de Janeiro, Brazil.

DETAILS OF MATERIAL INTER-COMPANY BALANCES

There are a number of material balances between Group companies, which is a result of, amongst other, the strategy to use a limited number of financing companies in the Group to arrange banking facilities and to issue bonds in the market. Some inter-company balances are the result of the set up of Group structures, or changes in Group structures over time and the transfer of companies to different parts of the Group at market value. These balances do not have any impact on the Group consolidated financial statements.

The table below sets out the Group's material inter-company balances as at 30 June 2008.

Lending entity	Borrowing entity	£m
British American Tobacco (1998) Limited	Weston Investment Company Limited	4,335
B.A.T. International Finance p.l.c.	B.A.T Industries p.l.c.	3,617
British American Tobacco Plc	British American Tobacco (1998) Limited	2,432
British American Tobacco International (Holdings) B.V.	B.A.T. International Finance p.l.c.	2,393
Louisville Securities Limited	British American Tobacco (1998) Limited	1,841
B.A.T. International Finance p.l.c.	British American Tobacco (Industrie) GmbH	1,754
British American Tobacco International (Holdings) B.V.	British American Tobacco Plc	1,571
Weston Investment Company Limited	Precis (1814) Limited	1,500
BATIF Dollar Limited	British American Tobacco (1998) Limited	1,491
British American Tobacco (1998) Limited	Louisville Securities Limited	1,466
B.A.T. International Finance p.l.c.	BATIF Dollar Limited	1,369
Carreras Rothmans Limited	B.A.T. International Finance p.l.c.	1,309
BAT (CI) Finance Limited	Carreras Rothmans Limited	1,309
British-American Tobacco (Holdings) Limited	British American Tobacco (1998) Limited	1,298
British American Tobacco Italy Limited	British American Tobacco Southern Europe S.p.A.	1,265
British American Tobacco (Investments) Limited	B.A.T. International Finance p.l.c.	1,180
B.A.T. International Finance p.l.c.	Imperial Tobacco Canada Limited	1,043
British American Tobacco (1998) Limited	British-American Tobacco (Holdings) Limited	1,022
B.A.T. International Finance p.l.c.	British American Tobacco (1998) Limited	1,005

