

Results at a glance

Group results 2008

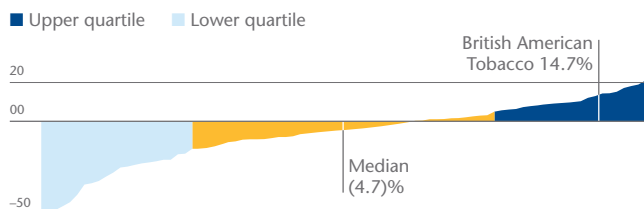
	£m		pence
Gross turnover (including duty, excise and other taxes)	33,921 +25%	Basic earnings per share	123.28 +17%
Revenue	12,122 +21%	Adjusted diluted earnings per share	128.78 +19%
Profit from operations	3,572 +23%	Dividends per share	83.70 +26%
Profit from operations, excluding adjusting items	3,717 +24%		
	bns		bns
Group cigarette volumes, excluding associates	715 +4%	Group cigarette volumes, including associates	919 +1%

Total shareholder return (annual %) 2008 results

Total shareholder return (annual %)

FTSE 100 – 1 January 2006 to 31 December 2008

The FTSE 100 comparison is based on 3 months' average values.



British American Tobacco continued its strong growth and had another very successful year. Group revenue was 21 per cent higher (11 per cent at constant rates of exchange). Group profit from operations was 23 per cent up, 24 per cent if adjusting items are excluded (14 per cent at constant rates).

Group volume from subsidiaries, at 715 billion, increased by 4 per cent.

Adjusted diluted earnings per share were 19 per cent higher, while dividends for the year increased by 26 per cent.

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

Our vision

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

Quantitatively, we seek volume leadership among our international competitors. Qualitatively, we aim to lead our industry as the preferred partner of key stakeholders and in demonstrating responsibility.

See our online Quick read

 go to www.bat.com/annualreport2008 to see our online Quick read presentation



Our strategy

- Growth Page 08
- Productivity Page 14
- Responsibility Page 18
- Winning organisation Page 24



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

We use a range of indicators to assess our performance against our strategy. They include our Key Performance Indicators, described on pages 6 and 7, together with some of our other business measures, described on pages 10 to 29.

A number of other business measures, financial and non-financial, are monitored and assessed frequently to ensure that the Group's strategy is delivered. Although these are not included in management's incentives, we believe that these business measures contribute to the success of the Group, particularly over the long term.

We have therefore included the performance of some of these business measures relating to the 4 elements of our strategy.

Our Global Drive Brands



Dunhill, the 'perfectionist in tobacco', sells in more than 120 countries. It offers a diverse range of premium and super premium cigarettes and cigars at the top end of the tobacco market. 37 billion Dunhill cigarettes were sold in 2008, up 7 per cent on 2007. Key markets include South Korea, Malaysia, Taiwan, Saudi Arabia, South Africa and Australia.

Kent is our largest premium brand, selling more than 63 billion cigarettes in 2008, up 18 per cent on 2007. Sold in more than 70 countries, Kent is consistently perceived as delivering 'the modern way to smoke'. Key markets include Russia, Japan, Eastern Europe and Chile.

Lucky Strike was launched in 1871 and remains 1 of the world's most iconic trademarks. It is among our leading premium brands and offers consumers a 'rich tobacco experience'. Its volumes rose 9 per cent to 25 billion cigarettes. Sold in more than 60 countries, key markets include Germany, Spain, Japan, France, Argentina and Indonesia.

Pall Mall is our leading global value-for-money brand, positioned to exceed consumer expectations. Introduced in 1899, it now sells in more than 80 countries, offering a range of cigarette and make-your-own products. Volumes were up 22 per cent on 2007 to 62 billion cigarettes. Key markets include Germany, Italy, Russia and Uzbekistan.

Our regions

	Volume (bns)	Revenue (£m)	Profit (£m)*
Europe	254 +4%	4,745 +30%	1,213 +44%
Asia-Pacific	153 +5%	2,151 +15%	804 +20%
Latin America	147 -2%	2,246 +13%	759 +11%
Africa and Middle East	120 +19%	1,797 +24%	536 +15%
America-Pacific	41 -4%	1,183 +12%	515 +15%

*Profit from operations, excluding adjusting items.



The last 10 years as British American Tobacco p.l.c.

We have been in business for more than 100 years across Europe, the Americas, Africa and Asia. We have been a quoted company on the London Stock Exchange in our current form since 1998.

1998

B.A.T Industries divests its financial services businesses and British American Tobacco p.l.c. becomes a separately quoted company, solely focused on tobacco.

1999

Global merger announced with Rothmans International.

2002

We celebrate our centenary. We also become the first tobacco company to publish a social report.

2003

We acquire Italy's former state tobacco monopoly, ETI.

2004

Brown & Williamson, the Group's US subsidiary, combines with RJ Reynolds Tobacco Company to form Reynolds American, in which we hold a 42 per cent share.

2005

We trial Swedish-style snus in a number of markets, giving smokers the chance to enjoy a less harmful form of tobacco, without lighting up.

2008

We complete our secondary listing on the JSE Limited. We also acquire the cigarette business assets of Tekel, the Turkish state tobacco company, and the cigarette and snus businesses of Skandinavisk Tobakskompagni.

Business review

Chairman's overview

02 Chairman's statement

Performance and strategy

04 Chief Executive's review

06 Measuring our performance

08 Our strategy

08 Growth

14 Productivity

18 Responsibility

24 Winning organisation

Risk factors

30 Key Group risk factors

Regional and financial review

36 Regional review

38 Europe

40 Asia-Pacific

41 Latin America

42 Africa and Middle East

43 America-Pacific

44 Associates

45 Financial review

45 Profit from operations

46 Adjusting items

46 Net finance costs

46 Interest cover

46 Associates

47 Profit before tax

47 Effective tax rate

47 Earnings per share

47 Dividends

47 Total equity

48 Cash flow

48 Treasury operations

49 Net debt/financing

50 Liquidity

50 Retirement benefit schemes

50 Going concern

50 Changes in the Group

50 Share buy-back programme

50 Regional structure from 2009

51 Non-GAAP measures

51 Accounting developments

51 Franked Investment Income

Group Litigation Order

51 Foreign currencies

Directors' report

54 Board of Directors

55 Management Board

56 Directors' report

66 Remuneration report

82 Corporate governance statement

91 Responsibility of Directors

Group financial statements

92 Report of the independent auditors

94 Group income statement

95 Group statement of recognised income and expense

96 Group balance sheet

98 Group cash flow statement

99 Notes on the accounts

176 5 year summary

177 Quarterly analyses of profit

178 Principal subsidiary undertakings

180 Principal associate undertakings

Parent Company financial statements

181 Report of the independent auditors

182 Balance sheet

183 Notes on the accounts

Shareholder information

186 Shareholder and contact information

Chairman's statement



Value creation

Over the past 10 years, British American Tobacco has achieved compound growth of 11 per cent in earnings per share and 13 per cent in dividends per share. Our total shareholder return has been 486 per cent, compared to 3 per cent for the FTSE 100 as a whole.

“We made good progress with all 4 elements of our strategy: growth, productivity, responsibility and building a winning organisation. It should continue to build sustainable shareholder value in the years ahead.”

Jan du Plessis Chairman

Excellent results

2008 was an extraordinary year, with financial markets in unprecedented turmoil, economies slowing and confidence badly shaken. Despite these conditions, British American Tobacco continued to deliver excellent results and completed 2 important acquisitions.

Revenue rose by 11 per cent at constant rates of exchange and by 21 per cent to £12,122 million at current rates. Profit from operations, excluding adjusting items, increased by 14 per cent at constant rates of exchange and by 24 per cent to £3,717 million at current rates. The benefit from the translation of our results into sterling was £295 million.

Adjusted diluted earnings per share grew by 19 per cent to 128.8p and the Board has recommended a final dividend of 61.6p, an increase of 29 per cent. This brings our total dividend for the year to 83.7p, an increase of 26 per cent. For us, 2008 was an outstanding year.

It rounds off a decade of value creation for shareholders. It is just over 10 years since we demerged our financial services businesses and announced the merger with Rothmans. Over the past 10 years, British American Tobacco has achieved compound growth of 11 per cent in earnings per share and 13 per cent in dividends per share. Our total shareholder return has been 486 per cent, compared to 3 per cent for the FTSE 100 as a whole.

Growth

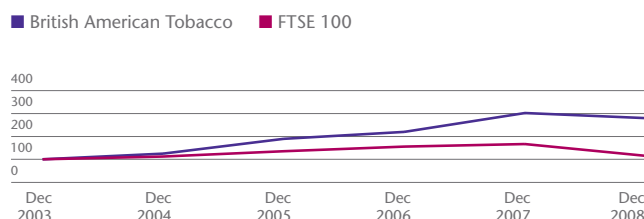
Our continued focus on our 4 Global Drive Brands (GDBs) has played a major role in these achievements. Last year, our 4 GDBs grew by 16 per cent, with about a quarter of the increase attributable to successful brand migrations. Kent rose by 18 per cent and Pall Mall by 22 per cent and they each achieved sales of over 60 billion cigarettes for the first time. Kent, which is premium priced, is now the Group's biggest brand. Completing a very strong all round performance, Lucky Strike increased by 9 per cent and Dunhill by 7 per cent.

GDB volume now represents over 26 per cent of our total volume, providing us with a significant opportunity to add scale to our key competitive innovations. Moreover, as the GDBs are predominantly premium, our premium volume grew by 5 per cent organically, compared to the 1 per cent level of overall organic growth. Total volumes were up 4 per cent as a result of the combination of this organic growth and the benefit from the acquisitions of Tekel and Skandinavisk Tobakskompagni (ST) in the middle of the year.

As a result of these acquisitions, we now have much stronger market positions in Turkey, Denmark, Sweden, Norway and Poland and both acquisitions are performing in line with expectations, each contributing positively to earnings in 2008.

Historical total shareholder return performance

Growth in the value of a hypothetical £100 holding over 5 years
FTSE 100 comparison based on 30 trading day average values.



Productivity

We have also made further progress with our productivity savings and we are very much on track towards our target of reducing our costs by £800 million by 2012, in addition to the £1 billion saved between 2003 and 2007. The principal areas of focus continue to be the supply chain, through initiatives such as our Global Leaf Pool, overheads and indirect costs.

Responsibility

In 2008, for the seventh year running, we were included in the Dow Jones Sustainability Indexes and we published our first Sustainability Report.

Winning organisation

We conducted our biennial employee opinion survey, Your Voice, in 2008 and we are, once again, encouraged by the results. Employee opinion at British American Tobacco compared favourably with other FMCG companies in the comparator group.

Earnings, dividends and share buy-back

Adjusted diluted earnings per share grew by 19 per cent to 128.8p. The substantial improvement in profit from operations, the significant uplift from foreign exchange and the benefit from the share buy-back programme were partially offset by higher net finance costs, a higher tax rate and an increase in minority interests.

The Board has recommended a final dividend of 61.6p per share, which will be paid on 6 May 2009 to shareholders on the register at 13 March 2009. This

takes the total dividend for the year to 83.7p, an increase of 26 per cent, as we reach our previously stated target of paying out 65 per cent of sustainable earnings in dividends.

In addition, some 22 million shares were bought back at a cost of £400 million and at an average price of 1812p per share. In order to preserve the Group's financial flexibility during a period of economic uncertainty, the Board has decided to suspend the share buy-back programme for the time being. However, we continue to appreciate the merit of having the share buy-back programme in place, together with the financial flexibility it provides, and we will therefore be seeking the necessary authority to resume the buy-back at the Annual General Meeting (AGM) on 30 April.

Liquidity

Arguably the most satisfying feature of our results last year was the high level of cash generation. Free cash flow rose 52 per cent to £2,604 million, exceeding the cost of the share buy-back and the increased level of dividends by more than £800 million.

We continue to maintain investment grade credit ratings. The strength of the ratings has underpinned the debt issued during 2007 and 2008 and, despite the impact of the turbulence in financial markets, we are confident of our ability to access the debt capital markets successfully. The Group's central banking facility of £1.75 billion was undrawn as at 31 December 2008.

Highlights

+52%

Free cash flow rose to £2,604 million

+19%

Adjusted diluted earnings per share grew to 128.78p

Significant shareholding

2008 saw the completion of the demerger of Richemont and Remgro's shareholding in British American Tobacco and the resulting secondary listing of the Group's shares on the JSE. This represents a very satisfactory and orderly disposal of the 30 per cent owned by Richemont and Remgro, giving the Group a more diversified shareholder base and increasing the weighting that index funds need to hold to 100 per cent of the freely tradeable shares.

Board of Directors

Thys Visser, who has been a Non-Executive Director since 2001, will be retiring from the Board following the AGM, at the expiry of his current term of office. With his in-depth knowledge of the tobacco industry and his down to earth, no nonsense style, I should like to thank him very much for his contribution to our business over the years.

Outlook

We remain alert to the possibility of downtrading. However, our well balanced portfolio of brands covers all major price points, while our geographic diversity further mitigates the risks for shareholders. We are very much aware of the potential challenges but the inherent strength of our businesses, our brands and our people should make us more resilient than most.

Chief Executive's review



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



Vision

To achieve leadership of the global tobacco industry.

Growth

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

Productivity

To effectively and efficiently deploy our global resources to increase profits and generate funds to reinvest in our business.

Responsibility

To continue balancing our commercial objectives with the expectations of a broad range of stakeholders, thus ensuring a sustainable business.

Winning Organisation

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

"We are as determined as ever to ensure that our strategy is executed effectively and to meet our shareholders' expectations."

Paul Adams Chief Executive

Strong growth

Group volumes from subsidiaries were 715 billion, up 4 per cent. The slightly softer volumes in Latin America and America-Pacific were more than offset by growth in Asia-Pacific, Africa and Middle East, and Europe.

Organic volume was up 1 per cent, driven by the strong performance of our Global Drive Brands (GDBs) – Dunhill, Kent, Lucky Strike and Pall Mall – and revenue improved due to a beneficial price mix.

Our acquisitions of the cigarette assets of Tekel and the cigarette and snus businesses of Skandinavisk Tobakskompagni (ST) have further strengthened our market positions in Turkey, Scandinavia and Poland. We have now integrated the manufacturing, distribution and sales operations of these businesses and they are meeting our marketing and financial expectations.

Productivity gains

Over £245 million in productivity savings were delivered in 2008. We are well on the way to delivering our cost savings target of £800 million by 2012. Our operating margin has increased to 31 per cent in the year.

Savings in 2008 were largely achieved through primary supply chain efficiencies and further standardisation and complexity reduction. An example of this is our Global Leaf Pool organisation, which has allowed us to reduce leaf stocks, saving £111 million in working capital at 2007 prices.

Progress on responsibility

We published our first Sustainability Report, building on our social reporting over the previous 6 years. You can read the Report at www.bat.com/sustainability. We will publish our 2008 Report by May 2009.

In addition to our existing snus brands, Lucky Strike, Peter Stuyvesant and du Maurier, we have introduced Pall Mall snus in Norway and Sweden. With the acquisition of ST, we now own the Fiedler & Lundgren business and its Granit, Mocca and Metropol brands. These will strengthen our capability for further progress in this product category.

Building a winning organisation

Our recent employee opinion survey, Your Voice, found that 87 per cent of respondents are proud to be associated with our organisation, 82 per cent would recommend the Group as a good place to work and 90 per cent say they understand how their role contributes to the achievement of the Group's strategy. These are all higher than the norm for the comparator group of businesses.

There is more about these topics on pages 26 to 29.

Industry outlook

World consumption

The World Health Organisation (WHO) has estimated that even allowing for an average decline in tobacco consumption of 1 per cent per year, adult population growth could see the number of smokers in the world increase from 1.4 billion to 1.5 billion between 2005 and 2050.

Group numbers 2008

£33,921 million

Gross turnover
(including duty, excise and other taxes)

£3,717 million

Profit from operations, excluding
adjusting items

128.78 pence

Adjusted diluted earnings per share

£12,122 million

Revenue

£105 million

Research and development expenditure

715 billion

Group cigarette volumes, excluding
associates

Volume declines are evident in developed markets. However, some developing markets in eastern Europe and east Asia are recording growth. This trend should be maintained and the profit pool is expected to continue to grow.

Illicit trade

We estimate that global illicit trade volumes are in excess of 300 billion cigarettes per annum, representing around 6 per cent of world cigarette consumption and losing governments internationally about £10 billion in taxes.

As such, illicit trade represents a major global competitor. Addressing this could provide a potential source of growth for the Group, tax revenue for governments and better serve the needs of consumers.

The Parties to the WHO Framework Convention on Tobacco Control (FCTC) are developing a protocol aimed at creating an international regulatory framework for addressing illicit trade. We strongly support the development of a protocol as it should provide measures to help address the problem.

Increasing regulation

In November 2008, the Parties to the FCTC adopted guidelines containing recommendations for governments on tobacco policy-making. These recommendations include bans on tobacco companies publicising their corporate social responsibility activities, bans on the display of tobacco products at the point of sale and the introduction of plain tobacco packaging. These guidelines are not mandatory for

governments and in our view several aspects of them would be unworkable or illegal in various parts of the world.

As governments consider incorporating elements of the FCTC into their own laws, we will continue to offer constructive views and solutions. We believe there is much to be gained by including the responsible tobacco industry in the regulatory process and we remain in dialogue with many governments.

Challenging economic times

The short-term outlook is overshadowed by deteriorating consumer confidence and the prospect of many key economies being in recession.

Although it is prudent to expect some level of adverse consumer response, on the whole we have not experienced a loss of consumer interest in our premium brands, which recorded a 5 per cent rise in organic volumes in 2008.

We are well placed to capture down-trading consumers with our balanced brand portfolio covering all the key consumer price points. Our volume is approximately one-third in each of the premium, mid-price and low-price segments.

Our geographic spread also helps to protect shareholders from volatility in foreign exchange markets.

Competitive landscape

The last 2 years have seen a high level of corporate activity in the industry with Japan Tobacco's acquisition of Gallaher, the spin-off of Philip Morris International

and Imperial Group's Altadis deal, as well as our 2 acquisitions.

In the near term, corporate activity is likely to comprise further disposals of state-owned or privately-owned tobacco businesses rather than large scale, transformational deals. We will continue to monitor acquisition opportunities and participate where it makes financial and strategic sense to do so.

Moving forward

Tobacco has shown itself to be 1 of the more resilient industries in economic downturns. We are confident that our balance across price segments and geographies, our strong brand portfolio and our dedicated and talented people will help us to navigate through this challenging period.

We are as determined as ever to ensure that our strategy is executed effectively and to meet our shareholders' expectations.

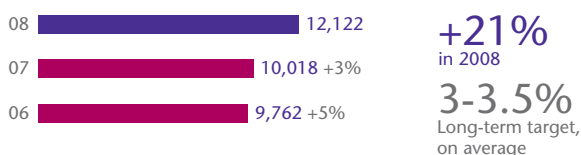
Measuring our performance

We have a wide range of measures and indicators by which the Board assesses performance compared to the Group's strategy. To ensure management's focus is aligned with the interests of our shareholders, the Key Performance Indicators reflect the incentives for the global organisation. From 2009 a further measure on costs will be introduced, as discussed in the Remuneration report.

1. Revenue growth

Revenue

£ million



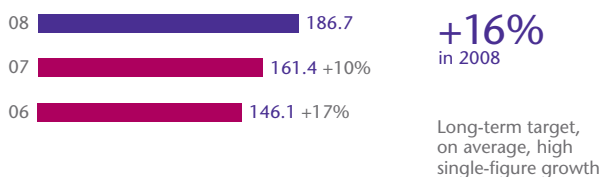
Revenue for 2008 grew by 21 per cent compared to the long-term target of growing revenue, on average over the medium to long term, by 3 to 3.5 per cent per annum.

Excluding the acquisitions made during 2008, the growth in revenue was 17 per cent.

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

2. Global Drive Brand volume

billions



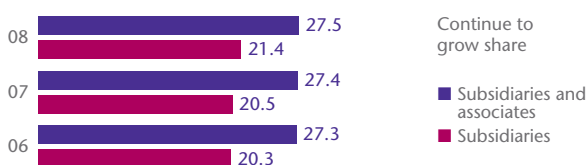
A key strength of the Group is its diversified Global Drive Brands (GDBs) portfolio. The growth of the 4 GDBs – Dunhill, Kent, Lucky Strike and Pall Mall – is therefore a key driver of the Group's strategy. In 2008, GDB overall volume grew by 16 per cent to 187 billion, compared to 10 per cent growth in 2007. Our target is to achieve high single figure growth.

GDB volumes are calculated as the total volumes of the 4 brands sold by our subsidiaries. More information about the GDBs and their individual performances is provided in the section 'Our Strategy – Growth'.

3. Group's market share amongst key players

Share of global volume, excluding China

%

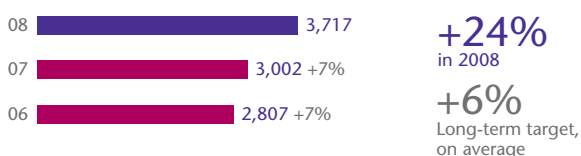


The Group subsidiaries' market share amongst key players of global volumes, excluding China, grew from 20.5 per cent to 21.4 per cent. When the volumes of associate companies are included, the share grew from 27.4 per cent to 27.5 per cent. The target is to continue our growth of the share of global volume as compared to other global players.

Share of global volume is calculated as the volumes sold by all international players, namely Philip Morris International, Japan Tobacco, Imperial Group and previously, Gallaher and Altadis. The information used in this calculation is based on publicly available information and internal company analysis.

4. Profit from operations excluding adjusting items

£ million



The Group's long-term target is to grow, on average, operating profit by 6 per cent per annum. For 2008 it was 24 per cent, compared to 7 per cent growth in 2007.

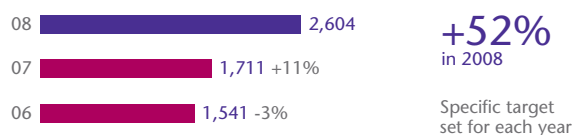
Profit used in this assessment is the profit from operations of the Group's subsidiaries, excluding any adjusting items – the items shown as memorandum information on the Group income statement.

A number of other business measures, financial and non-financial, are monitored and assessed frequently to ensure that the Group's strategy is delivered. Although these are not included in management's incentives, we believe that these business measures contribute to the success of the Group, particularly over the long term. We have therefore included on pages 8 to 29 our performance against some of these business measures relating to the 4 elements of our strategy.

5. Cash flow

Free cash flow

£ million



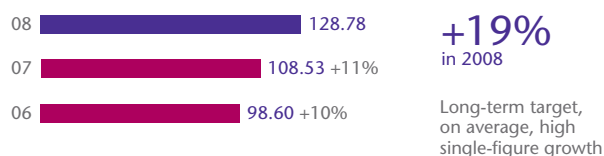
The Group's free cash flow in 2008 was £2,604 million, up £893 million from 2007. The change in free cash flow for the year is described in the Financial review.

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

6. Earnings per share

Adjusted diluted EPS

pence



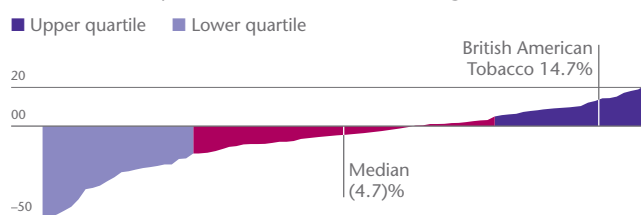
Adjusted diluted earnings per share (adjusted diluted EPS) has grown at an average of 11 per cent per annum since the beginning of 2002. This compares favourably to the target of growing at the rate of high single figures per annum, on average, over the medium to long term. Adjusted diluted EPS grew by 19 per cent in 2008 (2007: 11 per cent).

Adjusted diluted EPS is the best measure to assess the underlying performance of the business as it excludes all significant distortions (exceptional items, trademark amortisation and one-off items) – defined as adjusting items. The detail of the calculation and the adjustments made are explained in note 7 on the accounts.

7. Total shareholder return (annual %)

FTSE 100 – 1 January 2006 to 31 December 2008

The FTSE 100 comparison is based on 3 months' average values.

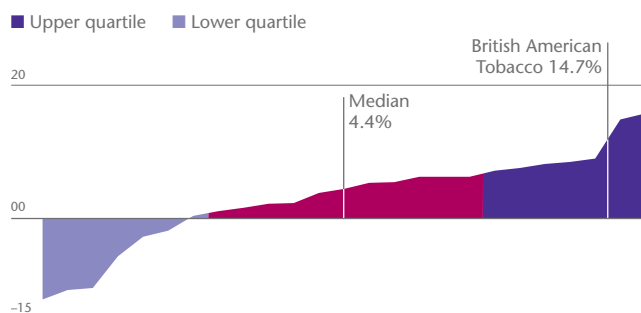


The Group's strategy is focused on increasing shareholder value, which is measured using total shareholder return (TSR) compared to the FTSE 100 Index and also to the Fast Moving Consumer Goods (FMCG) peer group. The target is to show an above average performance in the long term, compared to the 2 comparator groups, based on a 3 year average.

TSR performance combines both the share price and dividend performance of the Company during the performance period, as set against the 2 comparator groups. The FMCG comparator group is reviewed annually to ensure that it remains both relevant and representative.

FMCG group – 1 January 2006 to 31 December 2008

The FMCG group comparison is based on 3 months' average values.



TSR is measured according to the return index calculated by Datastream, on the basis of all companies' dividends being reinvested in their shares. The return is the percentage increase in each company's index over a 3 year period. On the TSR measure, the Company ranked seventh out of the FTSE 100 group of companies while it ranked second in the peer group of international FMCG companies. The Group has achieved a top quartile performance in both of these categories since 1999. See the Remuneration report for more information.

Growth



Our Global Drive Brands grew by 16 per cent in 2008 and we continue to have a strong brand balance across price segments and geographies. Successful acquisitions have also helped us raise our market share in key markets.



Image: A British American Tobacco Turkey trade marketing representative delivers cigarettes to an independent retailer in Istanbul. Direct Store Sales like this give us more control over distribution, help to strengthen our retailer relationships and improve our access to market information.





Growth

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



Organic growth means increasing our market share in existing markets and entering new markets. To achieve organic growth, we focus on key market segments that offer the best long-term prospects, including premium and international brands.

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

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

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

Our approach to marketing

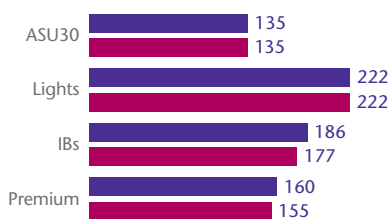
Our International Marketing Standards, revised in 2007, detail our commitment to marketing appropriately and only to adult consumers. The Standards apply to all our companies globally and govern our tobacco marketing across all areas including print, billboards, electronic media, promotional events and sponsorship. Visit www.bat.com/marketing for details.

Our updated Standards were rolled out during a 12 month period and all our companies were expected to confirm their adherence to them by 30 June 2008.

To track implementation, a self-assessment audit of adherence was conducted by all Group companies shortly after this deadline. The assessment reported an overall adherence rate of 97 per cent but it also identified some areas where we were not yet meeting our updated Standards.

Strategic segment volume in 22 key markets

billions

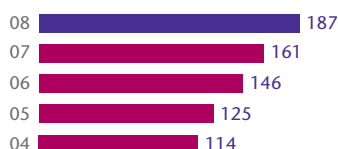


Based on data from the 22 markets, our share in each segment in 2008 was ASU30 (29%), Lights (27%), IBs (22%) and Premium (30%). It excludes Tekel and ST acquisition volumes.

■ 2008
■ 2007

Global Drive Brand volume growth

billions



Since 2004, our 4 GDBs – Dunhill, Kent, Lucky Strike and Pall Mall – have increased combined volume by 64%.

Instances of non-adherence were principally related to inconsistencies in interpretation of the Standards at a local level. The self-assessment highlighted the need for clarification of this interpretation around certain promotional activities and for sanctions that may be applied to retailers who sell to the underage.

We have issued additional guidance to our companies to help address these issues.

Action plans are now in place to help us achieve 100 per cent adherence by the end of 2009. Progress against these plans will be monitored through the Regional Audit and CSR Committees and the Board CSR Committee.

Balanced and innovative brand portfolio

Our Global Drive Brands (GDBs) – Kent, Dunhill, Lucky Strike and Pall Mall – cover the premium and value-for-money (VFM) segments and are at the forefront of our successful innovations, our product refinements and our trade marketing strategy. They account for 26 per cent of our global volume sales and our overall brand mix is broadly balanced among premium, mid-price and low-price.

In geographic terms, our brand contributions are evenly split between developed and developing markets, although some 73 per cent of our volume comes from developing markets.

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

We are confident that the balance of our brand portfolio across price segments and geographies will allow us to navigate through challenging economic times.

Strong performance of Global Drive Brands

187 billion cigarettes sold in 2008
+16% volume growth

Our GDBs grew by 16 per cent or 25 billion cigarettes in 2008, leading our growth in the premium segment. Almost a quarter of the rise was attributed to brand migrations.

Our premium organic volume grew by 5 per cent, while VFM volumes grew by over 4 per cent in the year.

Total Group volumes increased to 715 billion, up 4 per cent, due to a combination of organic volume growth of 1 per cent and the benefits of the Turkish and Scandinavian acquisitions.

Dunhill

37 billion cigarettes sold in 2008
+7% volume growth

2008 was another good year for Dunhill. Continuing its growth in volume, share and value terms, it delivered accelerated margin growth due to an improved product mix.

Innovation and modernisation continues to build consumer preference for Dunhill as the 'perfectionist in tobacco'. A new packaging variant was launched in Taiwan, the exclusive Reloc® resealable pack, to positive consumer response. The new Dunhill Fine Cut variant continues to see good performance.

Overall, the Dunhill cigar business grew by 48 per cent. This was achieved by delivering an exceptional quality product and by expansion into new markets. The Dunhill tobacco expertise was also reaffirmed in 2008 when the Dunhill Signed Range cigar won excellent ratings in various prestigious cigar publications.

Growth

DUNHILL

37 billion

Cigarettes sold in 2008
+7% volume growth

KENT

63 billion

Cigarettes sold in 2008
+18% volume growth



25 billion

Cigarettes sold in 2008
+9% volume growth

PALL MALL

62 billion

Cigarettes sold in 2008
+22% volume growth

Other International Brands

143 billion cigarettes sold in 2008
+1% volume growth

Kent

63 billion cigarettes sold in 2008
+18% volume growth

Kent had a very strong year, its sixth consecutive year of double-digit growth. With annual sales surpassing 63 billion cigarettes, Kent is our largest premium brand.

Kent continued to record strong volume growth in Russia and also benefited from successful brand migrations in South Africa and Malaysia, increasing Kent's presence in Africa and Asia.

Kent's role at the forefront of innovations continues. Kent Nanotek, a superslim king size variant, was a strong performer in 2008. Nanotek is sold at a premium relative to the Kent main range and achieved significant volume sales in 2008, representing some 10 per cent of Kent's global sales volume. Kent Mintek also yielded positive growth in Japan, Hong Kong, Chile and Malaysia.

Lucky Strike

25 billion cigarettes sold in 2008
+9% volume growth

Lucky Strike saw another year of solid growth, achieving significant volume and share growth in France, Spain and Italy. The brand also saw double-digit volume growth in 7 of its top 10 markets.

Lucky Strike is particularly successful among Adult Smokers Under 30, accounting for more than 60 per cent of its sales. We focus on maintaining popularity in this segment by delivering packaging options and taste experiences that consumers value, such as the 'Barrel Blend' introduced successfully in Latin America.

The introduction of Lucky Strike mentholated variants Piperita and Nites continues to yield positive results for the brand in Germany, Brazil, Peru and Hong Kong.

This year Lucky Strike successfully expanded its offer in France to include roll-your-own. The variants Full and Smooth Taste were launched in Germany to positive consumer response.

Pall Mall

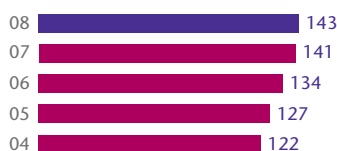
62 billion cigarettes sold in 2008
+22% volume growth

Pall Mall delivered a strong performance in 2008, driven by good organic volume and share growth in established markets such as Romania, the Netherlands, Uzbekistan and Turkey. The brand also continues to grow geographically and is now present in more than 80 markets.

Brand migrations played a significant part in Pall Mall's growth – notably sizeable migrations in Mexico and Pakistan. Migrating consumers from under-performing brands to 1 of our GDBs reduces operational complexity for us and our trading partners.

The Pall Mall range expanded further with the introduction of variants such as Virginia Fine Cut, Krystal-Frost and Extra Kings, as well as snus. Value pack formats were also introduced across western Europe and Australasia, helping drive growth across all tobacco categories where the brand competes.

Other International Brands volume growth billions



Since 2004, other International Brands – excluding the 4 GDBs – have risen by over 17%.

+16%

GDB volume growth in 2008

+5%

Premium organic volume growth in 2008

Other International Brands 143 billion cigarettes sold in 2008 +1% volume growth

In addition to our GDBs, we also support a set of other International Brands, accounting for over 20 per cent of our volumes in 2008. Several of these brands saw good volume growth, notably Kool in Japan, State Express 555 in China and Asia Pacific Global Travel Retail, John Player Gold Leaf in Bangladesh, Pakistan and the Gulf Cooperation Council countries, and Rothmans in Egypt.

Trade marketing and distribution

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

The 'Win Win Win' strategy

Forging partnerships with global trade partners, with whom we can become the long-term chosen partner around the world, gives us a significant competitive advantage. To help us achieve these kinds of relationships, we regularly evaluate our customer service performance among retailers.

In 2008, 23 markets were surveyed and we continued to achieve top scores among global FMCG companies. In 12 markets, British American Tobacco was rated as the best overall supplier in the FMCG industry and in 5 further markets we were the best overall tobacco supplier.

Direct Store Sales (DSS)

Where appropriate, we believe that direct and exclusive distribution, or DSS, is the most effective way of serving retail outlets. DSS gives us greater control over the sales and distribution process, helps to improve retailer relationships, and allows us greater direct access to market and consumer information. Around 48 per cent of our volume sales is now distributed through DSS.



Kent Nanotek

Kent Nanotek builds on the success of our Kent Global Drive Brand and comes with a specially designed contemporary style of pack. It sells at a premium relative to the Kent main range, offering an innovative cigarette in a superslim king size format.

Nanotek is available in 3 variants to suit the different preferences of adult consumers. Volumes have grown by an impressive 300 per cent in 2008 to more than 6 billion cigarettes. It now accounts for some 10 per cent of Kent's global volume.

We launched Kent Nanotek in 16 markets in 2008, bringing the total number of markets where it is now available to 31. It is also sold through Global Travel Retail. It has performed very strongly in eastern Europe during the year, particularly in Russia, Romania and Ukraine.

Productivity



Following the productivity savings of more than £1 billion over 2003-2007, we continued our cost-saving momentum into 2008. The savings are both a source of operating profit growth and revenue for reinvestment in the business.



Image: Employees at our factory in Izmir, Turkey. The number of cigarette factories within the Group has been reduced from 83 to 49 since 2000. This consolidation, undertaken with care for affected employees and communities, has removed excess capacity and means many more factories now serve more than 1 market.



Productivity

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



Our focus is on smart cost management, marketing efficiency and capital effectiveness. This includes ensuring that we use our marketing resources and capabilities in the most efficient way, reducing unnecessary complexity and using our cash and other assets effectively.

We are saving money by turning a multinational business operating in over 180 markets into an integrated global enterprise that can take advantage of its scale. Greater integration across our supply chain is helping us to reduce costs, increase speed to market and improve effectiveness. We are also reducing our overheads and indirect costs (anything other than leaf, wrapping materials, cigarette making machinery and labour).

Savings in supply chain, overheads and indirect costs amounted to £245 million in 2008, keeping us on track to achieve our £800 million savings target by 2012.

Supply chain

Most of the productivity improvements resulted from our continuous focus on primary supply chain efficiencies. These were largely as a result of further standardisation and simplification as supply chain planning and sourcing became less local and more global, in an above-market model.

We have moved or removed more than 400 billion cigarettes worth of capacity internationally since 2003 and have reduced real product costs every year in that period.

The number of cigarette factories within the Group has been reduced from 83 to 49, including acquisitions, since 2000. Both the Zevenaar factory in the Netherlands and the Paarl factory in South Africa ceased production in 2008, while further factories were added with the acquisition of Tekel and the cigarette and snus businesses of Skandinavisk Tobakskompagni.

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

£245 million

Productivity savings in 2008

£800 million

Productivity savings target 2008-2012

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

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

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

Much of the machinery in factories being closed or downsized is transferred elsewhere and we continue to invest in more productive technology. One example is our industry-leading, flexible Robopacker, developed to replace the requirement for hand packing for cigarettes with complex, innovative packs.

Global operations

From 1 January 2009, following the split of our former Europe region into Eastern and Western Europe regions, our European Operations will be managed as part of Global Operations. This will allow European Operations to continue developing and refining its

above-market planning processes, and to work with Global Operations to align the global processes that are expected to leverage further productivity improvements.

Other priorities for 2009 include establishing a global process for Sales and Operations Planning, further aligning standards and specifications, other initiatives to improve cross-regional product sourcing and more effective global roll-out of innovations.

We will continue to build a consumer-led, customer-focused, high-performing, globally-integrated supply chain, dedicated to enabling our companies to win. This is a key aspect of the Group's strategy and we will see many more areas of our supply chain being managed at a global level.

Overheads and indirects

Moving above-market is allowing us to streamline our processes and reduce overheads.

Throughout the year, we continued to improve our management of what we spend on indirect purchases.



Global Leaf Pool Initiative

Our Global Leaf Pool (GLP) organisation, launched at the end of 2007, has given us better visibility of the amount and location of tobacco leaf we have around the Group.

The GLP is now responsible for the planning, procurement and deployment of all internationally traded tobacco leaf across the Group, and for agreeing domestic crop sizes.

This has allowed us to reduce leaf stocks by the equivalent of more than 1 month's supply, saving the business £111 million in working capital at 2007 prices.

The GLP is improving our ability to have the right quantity and quality of tobacco to meet the growth requirements of our brands.

Responsibility



Our approach to responsibility is part of our wider sustainability agenda and we use the Dow Jones Sustainability Indexes (DJSI), an external benchmark, as our primary business measure.

Image: Working towards products that may reduce tobacco-related harm to health is a key element of our business strategy. One such product is Swedish-style snus, a smokeless form of tobacco, as shown in production here at our factory in Malmo, Sweden.



Responsibility

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



Because our products pose real risks to health, we strongly believe that our business must demonstrate responsibility in everything it does.

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

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

Our commitment to responsible behaviour is integral to our sustainability agenda, which addresses key business-related social, environmental and economic impacts in ways that aim to build value for all our stakeholders, including shareholders.

Our sustainability agenda

Our key sustainability issues include developing reduced risk products, the way we operate in the marketplace, responsible management of our supply chain, addressing our environmental impacts and developing our employees within a great workplace culture.

These are covered in detail in our Sustainability Report, available at www.bat.com/sustainability.

Our governance in relation to responsibility and sustainability issues was strengthened in 2008. This included amending the terms of reference of the Board CSR Committee and revising the structures and remits of our regional and local Audit and CSR Committees which monitor our management of significant social, environmental and reputational issues. For more information, see the CSR section of the Corporate governance statement on page 89.

Dow Jones Sustainability Indexes

Our progress in addressing our sustainability issues is reflected in our scores in the Dow Jones Sustainability Indexes (DJSI), which track the economic, environmental and social performance of leading companies and how well they integrate sustainability strategies into their businesses.

Group energy use

gigajoules per million cigarettes equivalent

08	12.08
07	11.82 (10.72)
06	12.21 (11.08)
05	12.60 (11.43)
04	14.44 (13.10)
03	15.71 (14.25)

In 2008, factors for calculating transport energy were updated in line with evolving best practice. To track performance consistently, previous usage is rebased using the updated factors. This does not alter our target reductions. Previously calculated figures are in brackets.

Carbon dioxide

tonnes CO₂ per million cigarettes equivalent

08	0.94
07	0.88 (0.80)
06	0.87 (0.79)
05	0.91 (0.83)
04	1.25 (1.13)
03	1.36 (1.23)
baseline	
00	1.38 (1.25)

CO₂ equivalent reflects the updated energy calculation. To track performance consistently, CO₂ equivalent in previous years and our year 2000 baseline are rebased using the updated factors. This does not alter our target reductions. Previously calculated figures are in brackets.

Dow Jones Sustainability Indexes

Dow Jones criteria

	Was 2008 score same or better than 2007?	Was score higher than sector average?
Economic dimension	✓	✓
Environmental dimension	✓	✓
Social dimension	✓	✓
Economic dimension		
Corporate governance	✓	✓
Risk and crisis management	✓	✓
Codes of conduct/compliance/corruption and bribery	✓	✓
Customer relationship management	✓	✓
Combat smuggling	✓	✓
Environmental dimension		
Environmental policy/management	✓	✓
Environmental performance (eco-efficiency)	✓	✓
Environmental reporting	✓	✓
Fuels for tobacco curing	✓	✓
Raw material sourcing	✓	✓
Social dimension		
Labour practice indicators	✓	✓
Human capital development	✓	✓
Talent attraction and retention	✓	✓
Social standards for suppliers	✓	✓
Corporate citizenship/philanthropy	✗	✓
Social reporting	✓	✓
Responsible marketing policies	✓	✓
Occupational health and safety	✗	✗
TARGET REACHED*		✓

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

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

In 2008, for the seventh consecutive year, we were the only tobacco business included in the DJSI World Index. Our overall score increased from 83 per cent to 84 per cent, while the sector average increased from 44 per cent to 69 per cent. We achieved a score of 100 per cent in 4 categories (Environmental performance, Environmental reporting, Fuels for tobacco curing and Responsible marketing policies); a higher score than the average in 17; the top score in 13; and an improved score in 7.

Environmental performance

We take our impacts on the environment seriously and believe that in a world with finite natural resources and concern about climate change, we must reduce our impacts.

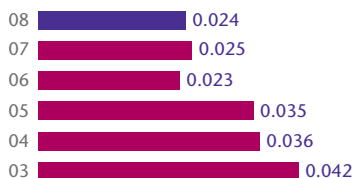
Responsibility for our Environment, Health and Safety policy lies with the Management Board and all our environmental management systems are based on the ISO14001 standard.

Over recent years, we have made significant reductions in energy and water use, the amount of waste sent to landfill and our carbon dioxide equivalent.

Responsibility

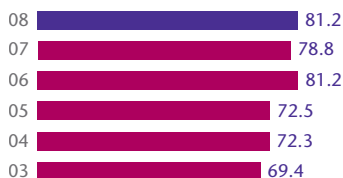
Waste to landfill

tonnes per million cigarettes equivalent



Recycling

percentage of waste recycled



Energy use

Group energy use in 2008 rose by 2.2 per cent from 2007 to 12.08 gigajoules per million cigarettes equivalent, largely due to changes in leaf processing and moderate increases in business travel and fleet fuel usage.

In 2008, factors for calculating transport energy were updated. To track performance consistently, both usage in previous years and our target have been rebased. Our target continues to be a 6.7 per cent reduction from 2007 usage to 11.03 gigajoules per million cigarettes equivalent in 2012.

Carbon dioxide (CO₂)

CO₂ equivalent is largely derived from energy consumption. Group CO₂ equivalent in 2008 rose by 6.8 per cent to 0.94 tonnes per million cigarettes equivalent, primarily for the same reasons that drove increased energy usage.

CO₂ equivalent reflects the updated energy calculation. To track performance consistently, CO₂ equivalent in previous years and our baseline for targets have been rebased. Our targets continue to be CO₂ reductions of 50 per cent by 2030 and 80 per cent by 2050 from our year 2000 baseline of 1.38 tonnes per million cigarettes equivalent.

Landfill and recycling

We aim to reduce waste sent to landfill to 0.022 tonnes per million cigarettes equivalent by 2012 and to recycle more than 75 per cent of waste generated in each year to 2012.

Group waste sent to landfill decreased in 2008 by 4 per cent, to 0.024 tonnes per million cigarettes equivalent. Recycling or re-use increased in the year to 81.2 per cent of waste generated, up from 78.8 per cent in 2007.

Water use

We aim to reduce water use to 4.20 cubic metres per million cigarettes equivalent by 2012.

Group water use in 2008 was down by 2.5 per cent from 2007, at 4.73 cubic metres per million cigarettes equivalent.

For more, see www.bat.com/ehs.

Research and development

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

Harm reduction

Our approach to tobacco harm reduction is to pursue the research, development and test-marketing of innovative tobacco products that will be acceptable to consumers and be recognised by the scientific and public health communities and regulators as posing reduced risks to health.

A harm reduction approach continues to be an important element in our business and we have increased our expenditure and developed our capabilities in this area over recent years.

In 2008, we significantly increased the transparency of our scientific research with the launch of our science website www.bat-science.com. The site is designed to be 'about science, by scientists, for scientists' and demonstrates our commitment to increasing our engagement with the external scientific community.

Snus

Snus is a smokeless oral tobacco product recognised by some members of the scientific and public health communities as having substantially lower overall health risks than cigarettes.

Our companies currently sell snus in Sweden and Norway and have test markets in South Africa and Canada. Our 2008 acquisition of the cigarette and snus businesses of Skandinavisk Tobakskompagni included Fiedler & Lundgren, giving us commercial-scale snus manufacturing capability.

Social and community issues

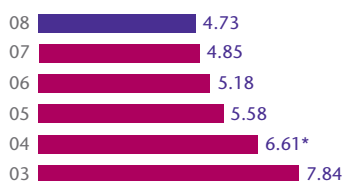
We approach social and community issues primarily in terms of the economic, environmental and social impacts of our core operations and our supply chain. We also invest in a range of philanthropic projects.

Supply chain

Our Group purchases some 380,000 tonnes of tobacco leaf a year, around 80 per cent of it from farmers and suppliers in emerging economies. We also purchase significant quantities of other raw materials, such as packaging, cigarette paper, filter materials, glues, inks and plug wraps.

Water use

cubic metres per million cigarettes equivalent



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

80%

CO₂ reduction target by 2050

£18.4 million

Our global corporate social investment expenditure in 2008

Our supply chain programmes help to evaluate our suppliers' environmental and social performance and support them in achieving high standards.

Our Social Responsibility in Tobacco Production (SRTP) programme addresses issues associated with leaf growing and processing and reaches around 300,000 farmers who supply all the leaf we buy. Issues covered include soil and water conservation, afforestation, appropriate use of agrochemicals, farmers' standard of living and child labour, as well as environmental, occupational health and safety standards.

In 2008, 17 reviews were conducted on our companies and third party suppliers in 9 countries under the programme. Feedback from the reviews was used to help the participants improve on their performance. We plan to conduct 23 reviews in 15 countries in 2009.

Our Business Enabler Survey Tool (BEST) establishes the standards we expect from our suppliers of raw materials other than leaf. It includes 108 criteria for measuring our suppliers' performance. In 2008, BEST was extended to service suppliers with 88 specific criteria. We also refined our approach to focus on suppliers that represent a higher level of risk to the business.

We carried out BEST reviews of 22 global, 6 regional and 6 local materials and machinery suppliers. Of these, 10 gained Approved, 19 gained Qualified and 5 gained Certified status.

Corporate social investment

Our corporate social investment (CSI) activities include a range of community and charitable projects with 3 main themes: Empowerment, Civic Life and Sustainable Agriculture. Our global CSI expenditure in 2008 was £18.4 million as defined by the statutory reporting criteria for charitable donations.

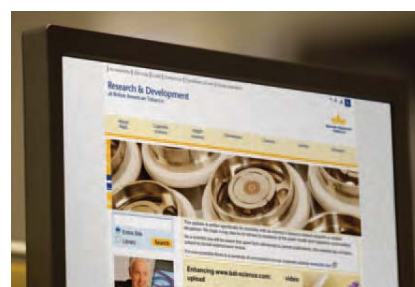
Part of our CSI supports the British American Tobacco Biodiversity Partnership, through which we work with conservation NGOs to understand and minimise our impacts on biodiversity and integrate biodiversity management into our business practices. Since 2001 we have donated £9.5 million to the Partnership, and have committed a further £1.5 million a year until 2010.

For more, see www.batbiodiversity.org.

We also helped to establish the Eliminating Child Labour in Tobacco Growing Foundation in 2001 and have actively supported it since. It brings together the major tobacco manufacturers, leaf suppliers and representatives of the trades unions and growers' associations to support community projects to eliminate child labour in tobacco growing and facilitate access to education.

In 2008, the Foundation supported projects in 7 countries, mostly in Africa. It also advised us on updating our SRTP programme to help leaf suppliers address child labour more effectively.

For more, see www.eclt.org.



www.bat-science.com

Our science website provides an overview of our current research and development programmes, research data and recently published papers.

Developed by scientists for scientists, the website is intended for use by those in the external scientific community with an interest in tobacco-related research. We hope it may also be of interest to members of the public health and regulatory communities.

The science of tobacco harm reduction is complex, extremely challenging and spans many scientific disciplines. We are actively seeking more open and transparent engagement and collaboration with the world's leading scientific institutions and believe that www.bat-science.com will help us to do this.

For non-scientists, there is a summary of our research on our corporate website www.bat.com/science.

Winning organisation



Our business spans some 180 markets and employs more than 50,000 people worldwide. We work hard to ensure we have the right employees and work environment to drive our strategy and deliver results.



Image: Employees in discussion at our global head office in London. We believe that engaged and committed employees at every level of the business are critical to achieving business results and to delivering our Winning organisation strategy.



Winning organisation

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



We aim to develop leaders at all levels, who have a clear vision for the business and will energise those around them. Fostering a confident culture that embraces change and innovation is also central to our strategy, together with attracting, growing and retaining talent and ensuring continuous improvement throughout the Group.

We have robust recruitment and performance management processes and competitive remuneration policies in place to attract, develop and retain the right talent.

Developing talent

Our accelerated global Management Trainee programme enables many of our graduate recruits to go on quickly to senior leadership roles and helps provide us with a sustainable pool of high-calibre managers.

As in previous years, around 1,000 of our people attended our in-house international management development programmes in 2008.

We continue to monitor our succession plans and talent pools via our internal audit process and talent reviews.

90%

Employee response rate in our 2008
Your Voice opinion survey

Our reputation as an employer

During 2008, with the help of independent research consultants IMRB International, we conducted extensive research amongst current and prospective employees in 14 countries to try to capture what makes us unique as an employer, and to help us better communicate these attributes.

This process provided insights into expectations of employers in general and British American Tobacco's desirability as an employer in particular.

Building on the research findings, we have defined a theme of 'Bring Your Difference' that will now become the underlying message of our recruitment campaigns internationally and will help us describe British American Tobacco as an organisation that:

- brings together people from diverse cultures and backgrounds who have new ideas and experiences;
- values individuality and empowers people to excel;
- supports employees with strong systems and inspiring leaders;
- enables employees to contribute to communities where we operate; and
- ensures that our people feel appreciated for the difference they bring.

Employee engagement

We believe that engaged and committed employees at every level of the business are critical to achieving excellent business results and to delivering our Winning organisation strategy.

We encourage employees to contribute to individual discussions, team briefings, publications, internal blogs and surveys, and we work to create an environment where employees feel they can speak honestly about our company and the issues of importance to them.

We also carry out a twice-yearly global communications cascade to support timely and relevant business briefings between leaders and their teams.

Your Voice

To help us measure our progress, we collect views from employees themselves. Our largest employee opinion survey is Your Voice, which involves all our employees internationally, at every level of the business.

Your Voice is conducted every 2 years and was run in late 2008. Response rates are usually very high and some 90 per cent of employees took part in the latest survey.

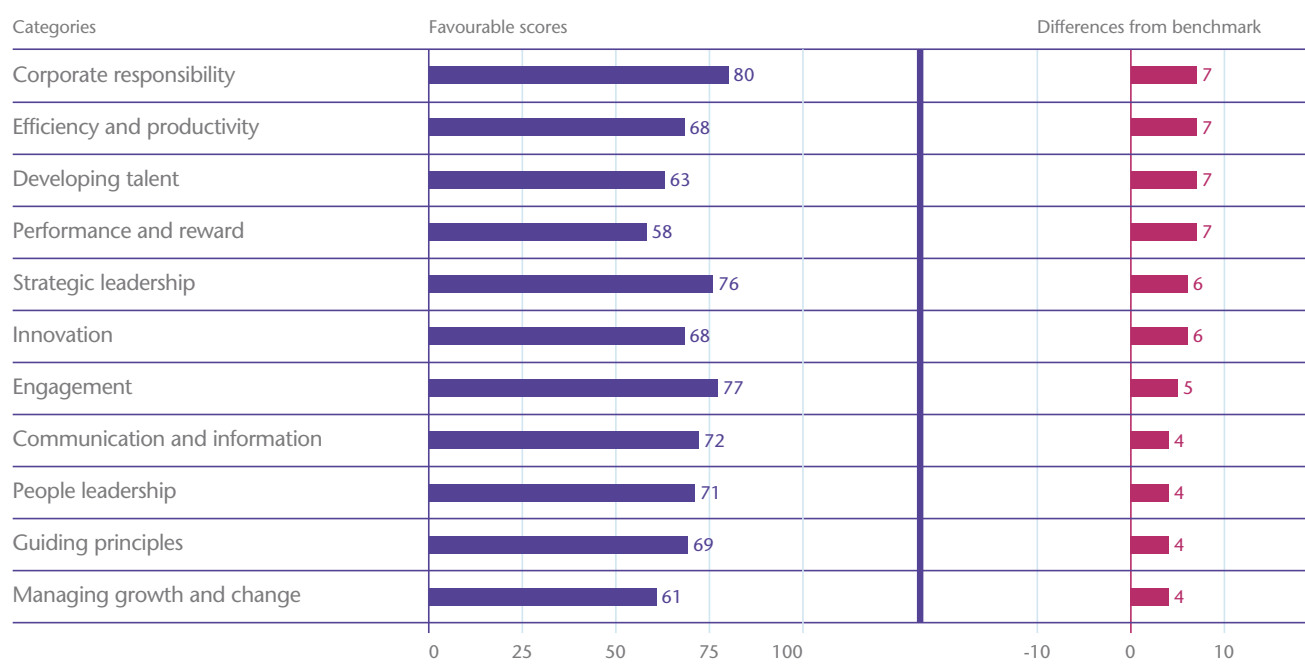
Benchmarking

Your Voice is conducted independently by Towers Perrin ISR, a specialist company that benchmarks employee opinion within British American Tobacco against a comparator group of other Fast Moving Consumer Goods (FMCG) companies. Many of the companies in this group (e.g. Diageo, Nestlé, Coca-Cola and Danone) also appear in the peer group of FMCG companies used to assess our performance in the long term incentive plan (see page 71).

Winning organisation

Your Voice survey 2008

British American Tobacco vs. ISR global FMCG companies' norm



Differences from benchmark bars indicate a statistically significant difference

2008 survey results

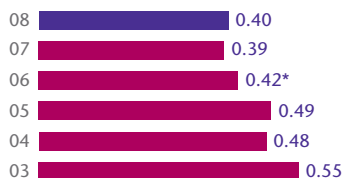
Since the last survey in 2006, we have successfully managed a huge amount of change, from factory closures to large scale acquisitions and re-organisations in many of our regions.

Employees everywhere will have been affected by these changes and we will look closely at the survey results to gauge how our people feel about the way we have managed changes and their impact on the future of the business.

The high-level category results for the 2008 survey are shown above. Our employees have rated us higher than the norm against the comparator group of companies in all 11 categories, from Developing talent (7 per cent higher) to Managing growth and change (4 per cent higher).

Lost Workday Case Incident Rate (LWCIR)

LWCIR: Lost workday cases through injury x 200,000 ÷ total hours worked



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

Challenges ahead

The real benefit of Your Voice comes from our response to it. We will now be discussing the findings further with employees globally, regionally and locally and devising action plans.

In particular, the 2008 survey has pointed to the need to inform our employees more about current business performance, to bring about more integration of our information systems and to be more adept at pursuing and exploiting local business opportunities.

Employee share ownership

We continue to encourage employee share ownership through the provision of employee share plans, including Sharesave, the Partnership Share Scheme and the Share Reward Scheme.

Work environment

We measure how well we create a safe place to work by using the Lost Workday Case Incident Rate (LWCIR). The 2008 LWCIR was 0.40, an increase from 0.39 in 2007 largely due to the 2 acquisitions. The highest proportions of injuries were slips and trips at 26.6 per cent (21 per cent in 2007), manual activity at 21 per cent (9 per cent in 2007) and vehicle related at 17.3 per cent (26 per cent in 2007). Entrapment accidents were reduced to 9.8 per cent compared with 24 per cent in 2007.

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

Employment Principles

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

87%

Of Your Voice respondents proud to be associated with our business



Learning from Your Voice

Our survey in 2008 showed that our people understand the Group's vision and strategy, and we remain ahead of external benchmarks on pay and benefits.

In all 11 categories of the survey, employee opinion at British American Tobacco was more positive than in the other FMCG companies in the Towers Perrin ISR benchmark group.

There are some areas we need to work on. For example, as we move towards more regional and area structures, people think access to information and the integration of IT systems is now more critical.

87 per cent of the respondents were proud to be associated with our business and 90 per cent indicated that they understood how their role contributed to achieving the Group's strategy.

The 2008 survey showed that 82 per cent of respondents would recommend British American Tobacco as a good place to work.

Key Group risk factors

This section identifies the main risk factors that may affect the British American Tobacco Group. The following table provides a brief description of the key risks to which the Group's operations are exposed and identifies, in each case, their potential impact on the Group and the principal processes in place to manage the risk.

It is not the intention to provide an extensive analysis of all risks affecting the Group. Not all of the factors listed are within the control of the Group and

other factors besides those listed may affect the performance of its businesses. Some risks may be unknown at present and other risks, currently regarded as immaterial, could turn out to be material in the future.

The risk factors listed in this section and the specific processes in place to manage them should be considered in the context of the Group's internal control framework, which is addressed in detail in the statement on internal control in the Corporate governance

statement. This section should also be read in the context of the cautionary statement regarding forward-looking statements at the end of this section.

In 2008, a review of the Group risks, including those arising from the current macroeconomic situation, and the mitigation plans in place to address them was undertaken. The Group risk register was reviewed by the Audit Committee in December 2008 and will continue to be reviewed by it at 6 monthly intervals.

Illicit trade

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

Competition from illicit trade

Principal potential causes

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

Potential impact on Group

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

Principal controls in place to address risk

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

Excise and tax

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

Excise shocks from tax rate increases or structure changes

Principal potential causes	Potential impact on Group	Principal controls in place to address risk
<ul style="list-style-type: none"> – government initiatives to raise revenues; – increases advocated within the context of national health policies. 	<ul style="list-style-type: none"> – consumers reject the Group's legitimate tax-paid products for products from illicit sources; – lower volumes or alteration of sales mix. 	<ul style="list-style-type: none"> – requirement for Group companies to have in place formal pricing and excise strategies and contingency plans to manage significant excise changes; – annual review of brand portfolio, brand health and equity.

Risk factors

Financial

Further details on the Group's financial management and treasury operations can be found within the Financial review.

Liquidity risks, including capital structure and leverage

Principal potential causes	Potential impact on Group	Principal controls in place to address risk
<ul style="list-style-type: none"> – downturn in macroeconomic climate and/or failures in financial system – globally or in individual markets; – limited liquidity, access to cash and sources of finance; – fluctuations in interest rates due to movements in international capital markets. 	<ul style="list-style-type: none"> – increased funding costs and requirement to raise or issue equity or seek new sources of capital; – inability to fund strategic opportunities or respond to threats; – underperforming share price and erosion of shareholder value; – damage to corporate reputation. 	<ul style="list-style-type: none"> – established and conservative financing principles, which target a minimum level of liquidity, a minimum average maturity for the total debt portfolio and a maximum allowable proportion of total debt maturing in any 1 year, with regular reporting against those principles; – targeted investment grade rating; – retained cash flow spread across a wide banking group; – maintenance of a substantial committed bank facility which may be drawn at short notice and liquidity pooling structures to access operating company cash balances.

Key Group risk factors continued

Financial continued

Foreign exchange rate exposures

Principal potential causes

- translational foreign exchange (FX) rate exposures for earnings/cash flows from the Group's global business, against sterling, the Group's reporting currency;
- transactional FX rate exposures generated from underlying operations across the Group's global business.

Potential impact on Group

- volatility in results, cash flow and the balance sheet.

Principal controls in place to address risk

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

Counterparty risks

Principal potential causes

- failure of counterparties with whom the Group has dealings.

Potential impact on Group

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

Principal controls in place to address risk

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

Increased cost base

Principal potential causes

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

Potential impact on Group

- higher product costs and/or increased salary costs;
- inability to manage costs leads to lower profits;
- ineffective structural changes restrict future growth potential and increase short-term cost base;
- reduced shareholder confidence.

Principal controls in place to address risk

- multiple sources of key commodities and development of new sources in low-cost countries;
- specification changes and production efficiencies to reduce variable costs;
- programme to achieve costs savings of £800 million by 2012;
- regular tracking of actual productivity savings and forecast improvements in operating margin and supply chain, overheads and indirects projects;
- aggregation of planned productivity savings in the annual 2 year budget.

Financial continued

Missed or wrongly valued acquisition opportunities

Principal potential causes	Potential impact on Group	Principal controls in place to address risk
<ul style="list-style-type: none"> – lack of market intelligence; – over-valuation of assets or understatement of liabilities. 	<ul style="list-style-type: none"> – loss of opportunity; – loss of volume, market share and profit; – damage to corporate reputation. 	<ul style="list-style-type: none"> – specialist and properly resourced mergers and acquisitions department; – transactions must meet defined financial investment criteria; – oversight by senior management or Board where appropriate.

Marketplace

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

Trading environment

Principal potential causes	Potential impact on Group	Principal controls in place to address risk
<ul style="list-style-type: none"> – downturn in macroeconomic climate reduces consumers' disposable incomes and may lead to consumer downtrading; – competitors seek volume growth by price discounts. 	<ul style="list-style-type: none"> – price increases to cover cost rises are not achieved; – profit growth in short term falls below shareholders' expectations; – reduction in funds for investment in long-term growth. 	<ul style="list-style-type: none"> – regular regional and management reviews of budgeted pricing scenarios; – close monitoring of sales to detect changes in consumer purchasing patterns; – development of strong brands and brand portfolios; – price war simulations.

Inability to manufacture product

Principal potential causes	Potential impact on Group	Principal controls in place to address risk
<ul style="list-style-type: none"> – natural disasters, including major impact of climate change; – reduced leaf availability as a result of competition for land use or government initiatives to move farmers away from growing tobacco; – industrial action; – contamination or threat of contamination; – disruptions to the supply chain. 	<ul style="list-style-type: none"> – loss of a key factory or multiple factories and/or constraints on cigarette production leads to insufficient manufacturing capacity to satisfy market demand or a significant increase in demand; – increased blend costs through lack of supply; – potential deterioration in smoke quality impacting consumer; – lower market share, volume, profit and cash flows. 	<ul style="list-style-type: none"> – individual factories have contingency and disaster recovery plans in place and insurance cover against relevant risks; – global standardisation of key product attributes to improve short-term options for alternative sourcing and reduce variable costs; – global sourcing and globally integrated management of leaf supply chain; – long-term contracts with established suppliers and distributors.

Key Group risk factors continued

Marketplace continued

Trading performance in key markets

Principal potential causes

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

Potential impact on Group

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

Principal controls in place to address risk

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

Regulation

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

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

Principal potential causes

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

Potential impact on Group

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

Principal controls in place to address risk

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

Litigation

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

Loss of a smoking and health related court case

Principal potential causes

- outcomes of legal and regulatory court proceedings in various jurisdictions.

Potential impact on Group

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

Principal controls in place to address risk

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

Risk factors

Information technology

The Group is increasingly reliant on information technology systems for its internal communications, controls, reporting and relations with customers and suppliers.

Disruption to Group's information technology systems

Principal potential causes

- loss of wide area of communications;
- effects of computer virus;
- loss of operations in a major data centre.

Potential impact on Group

- loss or delay in sales or cash collections and/or inability to pay suppliers or staff;
- goods unable to be shipped;
- delays in meeting statutory or internal reporting requirements;
- loss of telephony or e-mail systems;
- loss of data.

Principal controls in place to address risk

- all critical financial and planning systems have secure back-up systems and disaster recovery plans;
- largest systems have full back-up designs with dual-site hosting;
- comprehensive anti-virus protection in place Group-wide;
- back-up communication links in place for data centres and major sites;
- strict security standards and firewall protection for external links.

Cautionary statement

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

Regional review



The reported Group revenue was 21 per cent higher at £12,122 million as a result of improved pricing, a better product mix, the acquisitions of Tekel and Skandinavisk Tobakskompagni (ST) made at the half year and favourable exchange rate movements. At constant rates of exchange, revenue would have increased by 11 per cent.

The reported Group profit from operations was 23 per cent higher at £3,572 million, up 24 per cent if adjusting items are excluded. All regions contributed to this strong result at current rates of exchange. Profit from operations, excluding adjusting items, would have been 14 per cent higher at constant rates of exchange, with all regions up.

Group volumes from subsidiaries were 715 billion, up 4 per cent, a combination of organic volume growth of 1 per cent and the benefit of additional volumes from the 2 acquisitions made earlier this year.

The 4 Global Drive Brands continued their strong performance and achieved overall volume growth of 16 per cent. Around a quarter of the growth was contributed by brand migrations.

“The growth of 16 per cent by the Global Drive Brands, improved pricing and a better product mix, resulted in a strong growth in profit from operations. This excellent result was further improved with the 2 acquisitions and the benefit of favourable exchange rate movements.”

Nicandro Durante Chief Operating Officer and Director, America-Pacific

Kent volume grew by 18 per cent with excellent growth in Russia, Romania, Kazakhstan, Ukraine and Chile and from new markets like Kyrgyzstan, Mongolia and Serbia, while it also benefited from a brand migration in South Africa. Volumes were lower in Japan, although market share increased.

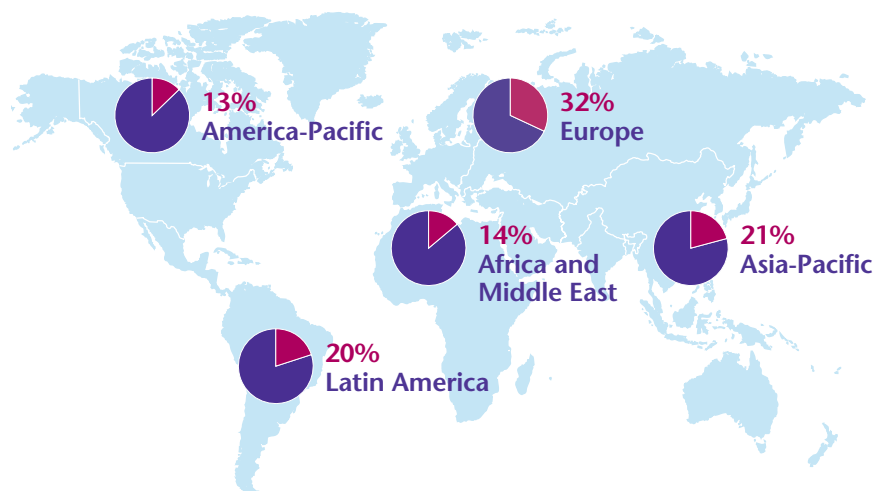
Dunhill rose by 7 per cent, with growth in South Korea, Taiwan, Australia, South Africa, Russia, Romania, France, Italy and Saudi Arabia, while volumes were maintained in Malaysia, leading to an increase in market share.

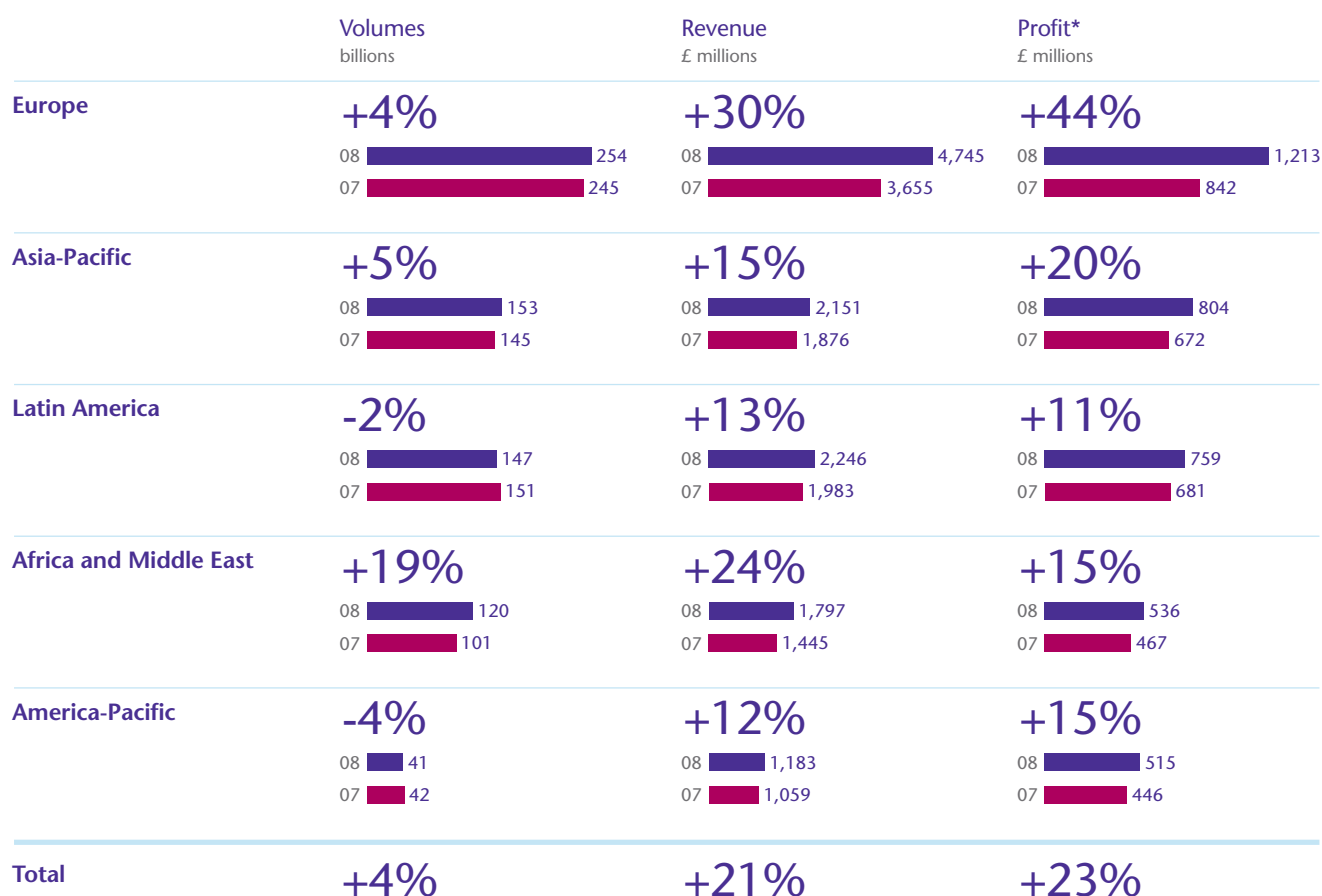
Lucky Strike volumes were up 9 per cent with good growth in Spain, Italy, France, Chile, Brazil and Argentina, partly offset by declines in Japan and Germany as a result of lower industry volumes.

Pall Mall increased volumes by 22 per cent with the geographic roll-out to more markets, such as Pakistan, Malawi, Mexico and Belarus, and the continued growth in Turkey, Romania, Uzbekistan, Hungary, the Netherlands and Malaysia. This was partly offset by lower volumes in Poland, Russia, Spain, Greece and Italy.

In the fourth quarter, revenue grew by 26 per cent to £3,418 million and profit from operations, excluding adjusting items, was up 37 per cent to £962 million, mainly as a result of the inclusion of ST and Tekel in 2008, as well as the benefits from exchange rate movements. This information is shown on the Quarterly analysis of profits.

Percentage of Group profit per region





	Volumes		Revenue		Profit*	
	2008 bns	2007 bns	2008 £m	2007 £m	2008 £m	2007 £m
Europe	253.6	245.0	4,745	3,655	1,213	842
Asia-Pacific	152.5	145.2	2,151	1,876	804	672
Latin America	147.2	150.5	2,246	1,983	759	681
Africa and Middle East	120.5	101.0	1,797	1,445	536	467
America-Pacific	40.8	42.3	1,183	1,059	515	446
Regional total	714.6	684.0	12,122	10,018	3,827	3,108
Unallocated costs					(110)	(106)
*Profit from operations before adjusting items					3,717	3,002

Revenue and profit from operations, before adjusting items, restated at constant rates of exchange

	11,090	10,018	3,422	3,002
--	--------	--------	-------	-------

The profits discussed in the Regional review exclude the impact of restructuring and integration costs, the Canadian settlement, amortisation of trademarks and gains on disposal of businesses and trademarks, as explained on pages 46 and 47.

Unallocated costs are net corporate costs which are not directly attributable to individual segments.

Europe



35%
of Group volume



“The integration of Skandinavisk Tobakskompagni into the Group is largely complete and significant synergy benefits will be delivered over time. The results are in line with expectations.”

Jean-Marc Lévy Director, Western Europe

254 billion

Volumes
+4%

£4,745 million

Revenue
+30%

£1,213 million

Profit
+44%

In **Europe**, profit at £1,213 million was up £371 million, as a result of the ST acquisition and excellent performances in Russia, Uzbekistan, Romania and Spain, with growth in Germany, France, Switzerland and Italy, partially offset by decreases in Hungary, the Czech Republic and Belgium. These results benefited from the more favourable pricing environment, an improved product mix and exchange rates. At constant rates of exchange, profit would have increased by £235 million or 28 per cent.

Excluding the benefit from the acquisition of ST, profit increased by £280 million, up 33 per cent, or £144 million, up 17 per cent at constant rates of exchange.

Regional volumes were up 4 per cent at 254 billion, benefiting from the acquisition of ST. Volume increases in Poland, Romania, Uzbekistan, Switzerland and Spain were more than offset by decreases in Russia, Italy, Germany, Ukraine and the Czech Republic.

The acquisition of ST in the middle of the year resulted in significant additional profit for the region.

In Italy, Lucky Strike performed very well although overall volumes were adversely impacted by the decline of local brands and the disposal of some brands in 2007. Profit increased as a result of lower product costs due to continuing productivity programmes and reduced overheads, partly offset by reduced volumes.

Volumes in Germany declined as industry volumes shrank while market share was slightly lower. However, Pall Mall performed well by growing volume and market share. Profit increased as a result of higher margins from a combination of price increases, reduced product costs and overhead savings.

While industry volumes in France were lower, volume and market share grew, led by Dunhill, Lucky Strike and Pall Mall. Profit increased as a result of higher prices and overhead savings.

In Switzerland, Parisienne, Lucky Strike and Pall Mall continued to grow market share and profit increased due to higher volumes and improved margins.

In the Netherlands, profits were down as a result of slightly lower volumes, despite an increase in market share. Industry volumes in Belgium were severely impacted by last year's excise-driven price increase and, together with the sale of the pipe and cigar business in 2007, resulted in lower profit. Market share improved, assisted by the successful migration of Winfield to Pall Mall.

In Spain, strong profit growth and higher volumes were achieved due to the excellent volume and share growth of Lucky Strike, coupled with a more favourable pricing environment.



“A substantial increase in profit was achieved in Russia, driven by the significant growth in the premium brand portfolio, despite lower overall volumes.”

David Fell Director, Eastern Europe

In Russia, a strong performance by the premium brands, Kent, Dunhill and Vogue, continued to improve the product mix and, with higher prices, profit increased significantly. Volumes were lower as a result of the decline in low price and local brands following price increases that were not immediately followed by competitors.

Profit in Romania increased significantly, benefiting from higher volumes, price increases and the improved product mix, partially offset by higher marketing investment. The strong growth of volumes, driven by the continued success of the Global Drive Brands led to increased market share.

The tobacco market in the Czech Republic was heavily impacted during 2008 by the effect of the trade buying at the end of 2007 in anticipation of an excise increase, resulting in lower profit and volumes.

The accelerated decline of industry shipments in Poland was the result of significant excise-driven price increases during the last 2 years. Competitive market conditions continued and with the increase in illicit trade, profitability was adversely impacted. Volumes increased as a result of the inclusion of the ST businesses.

In Hungary, volumes were slightly down although Dunhill and Pall Mall performed well despite price competition. This, coupled with higher marketing investment, led to lower profit.

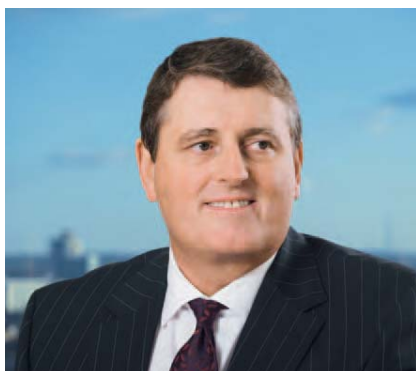
In Ukraine, volume and market share decreased slightly due to the decline of low-priced local brands, largely offset by the excellent performance of Kent. Results improved significantly with the improved mix, price increases and cost control, despite the volume decline and higher marketing spend.

The impressive performance of Kent in Kazakhstan and Pall Mall in Uzbekistan led to increased volumes and, with higher prices and better cost control, resulted in higher profit.

Asia-Pacific



21%
of Group volume



“Very good organic volume growth of 5 per cent led to the strong growth of 15 per cent in revenue and 20 per cent in profit – an excellent result.”

John Daly Director, Asia-Pacific

153 billion

Volumes
+5%

£2,151 million

Revenue
+15%

£804 million

Profit
+20%

In **Asia-Pacific**, profit rose by £132 million to £804 million, mainly attributable to strong performances in Pakistan, Vietnam, Bangladesh, Australia and Malaysia and also benefiting from favourable exchange rates. At constant rates of exchange, profit would have increased by £79 million or 12 per cent. Volumes at 153 billion were 5 per cent higher as good increases in Pakistan, Bangladesh and South Korea were partially offset by lower volumes in Vietnam, Malaysia and Sri Lanka.

Profit in Australia was up as a result of higher margins and exchange rate movements, partially offset by the impact of increased competitor discounting activities. In New Zealand, profit improved, benefiting from price rises, cost efficiencies and exchange movements. Volumes in Australia and New Zealand were similar to last year, but both Dunhill and Pall Mall increased market share.

In Malaysia, strong profit growth was achieved as a result of price increases, a better product mix and continued productivity savings. Dunhill and Pall Mall grew market share, with good results from Kent after its relaunch in August 2008. Volumes were lower due to the overall industry decline, the high levels of illicit trade and another significant excise increase during the third quarter of 2008.

In Vietnam, strong profit growth was achieved through higher prices, a solid performance in the premium segment and cost saving initiatives. Volumes were

down due to lower industry volumes, although market share increased strongly with outstanding performances from Craven 'A', Dunhill and State Express 555.

Volumes in South Korea were higher than last year and market share was up as a result of the good performance from Dunhill. Good profit growth was achieved through higher margins, increased volumes and an improved product mix, partially offset by the weakening of the currency.

In Taiwan, volumes were slightly down despite the significant growth of Dunhill. Profit was lower, adversely impacted by the marketing investment behind Dunhill.

In Pakistan, volume and market share continued to grow strongly. The volume growth, coupled with higher prices, resulted in a profit increase, however, this was more than offset by the weakening of the currency.

In Bangladesh, strong growth in volumes, price increases and a better product mix resulted in an impressive increase in profit.

Profit in Sri Lanka was well ahead, benefiting from price rises, a better product mix and continued productivity improvements. Volumes were lower, although overall market share grew with the good performances of Dunhill and Pall Mall.

Latin America



21%
of Group volume



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

Mark Cobben Director, Latin America and Caribbean

147 billion

Volumes
–2%

£2,246 million

Revenue
+13%

£759 million

Profit
+11%

Profit in **Latin America** increased by £78 million to £759 million, mainly as a result of an excellent performance in Brazil and exchange rate movements. At constant rates of exchange, profit would have increased by £25 million or 4 per cent. Volumes were down 2 per cent at 147 billion after declines in Mexico and Venezuela.

In Brazil, profit grew strongly, benefiting from higher margins, an improved product mix and a stronger local currency. Market share increased on volumes in line with last year. Leaf export results improved substantially, benefiting from higher volumes, higher pricing and the appreciation of the US dollar.

Volumes in Mexico were lower, resulting in a reduced market share. A price increase in January was not sufficient to fully recover the earlier excise increase and, combined with higher marketing investment behind the GDBs, resulted in a reduced profit.

In Argentina, profit rose mainly as a result of a stronger local currency. Higher margins and an improved product mix, due to the good performance of Lucky Strike, were offset by higher variable costs and higher salaries due to inflationary pressures.

In Chile, volumes were slightly up with the strong growth of Kent and Lucky Strike, while profit was higher due to price increases and product mix benefits, partially offset by higher marketing investment.

In Venezuela, volumes were lower following high excise-driven price increases in the last quarter of 2007 and price rises in 2008. Increased illicit trade resulted in a lower market share, adversely affecting profit.

Volumes in the Central America and Caribbean area were down as a result of lower industry volumes and the resurgence in illicit trade. However, profit increased as margins improved and the local currencies strengthened.

Africa and Middle East



17%
of Group volume



“Excellent performances by many markets in the region were complemented by the acquisition of the Tekel cigarette assets. The integration in that market is progressing according to plan.”

Andrew Gray Director, Africa and Middle East

120 billion

Volumes
+19%

£1,797 million

Revenue
+24%

£536 million

Profit
+15%

Profit in the **Africa and Middle East** region grew by £69 million to £536 million mainly as a result of the acquisition of Tekel and the good performance in Nigeria. At constant rates of exchange, profit would have increased by £76 million or 16 per cent. Volumes were 19 per cent higher at 120 billion, following increases in Nigeria, Egypt and Saudi Arabia, coupled with the additional volumes from the acquisition of Tekel during the year. These increases were partially offset by the disposal of the Chesterfield trademark in South Africa.

In South Africa, profit was only slightly higher than last year, adversely impacted by the weaker exchange rate. In local currency, profit growth was achieved as a result of higher prices and an improved product mix, partially offset by the decline in volumes. Volumes and market share were lower following the termination of the Chesterfield trademark license agreement at the end of 2007. Dunhill and Peter Stuyvesant continued to deliver strong share performances, while Kent performed well after its migration from Benson & Hedges.

Profit in Nigeria increased as a result of good volume growth, a favourable exchange rate, an improved product mix, productivity benefits and higher margins.

In the Middle East, profit and volumes were higher due to the impressive growth of Dunhill in Saudi Arabia. Strong sales across the Caucasus led to volume, market share and profit increases as Kent performed well.

In Turkey, the acquisition of the cigarette assets of Tekel was completed in June 2008 and was successfully integrated with the existing business, which reached break even in 2008 following good organic volume growth. GDBs grew strongly with good performances by Kent and Pall Mall.

America-Pacific



6%
of Group volume



“At constant rates of exchange, profit from Canada was slightly lower, while Japan grew. However, both markets benefited from exchange rate movements, resulting in higher profit despite declines in total volumes.”

Nicandro Durante Director, America-Pacific

41 billion

Volumes
–4%

£1,183 million

Revenue
+12%

£515 million

Profit
+15%

Profit from the **America-Pacific** region increased by £69 million to £515 million. This was principally due to the improved contribution from both Canada and Japan and stronger currencies. At constant rates of exchange, profit would have increased by £13 million or 3 per cent. Volumes at 41 billion were 4 per cent lower than last year.

Profit in Canada increased with the contribution to the Group at £297 million. This was the result of higher pricing, lower distribution costs and a stronger exchange rate, partially offset by lower volumes and a weaker product mix. At constant rates of exchange, profit was £272 million, down 2 per cent. Overall market share at 52 per cent was slightly lower than last year as the decline in the premium segment was not offset by the growth in the value-for-money and low-price segments.

In Japan, market share was up due to the strong performance of Kool and stable market shares of Kent and Lucky Strike, although volumes were lower as a result of the continued decline in total industry volumes. Profit was up as a result of a favourable exchange rate, higher pricing and an improved mix.

Associates

Results of associates

Associates principally comprise Reynolds American and ITC. Skandinavisk Tobakskompagni (ST) was an associate until 2 July 2008 when its cigarette and snus businesses were acquired and from that date it was consolidated into the Group results.

The Group's share of the post-tax results of associates increased by £61 million, or 14 per cent, to £503 million. Excluding adjusting items, explained on page 46, the Group's share of the post-tax results of associates increased by £28 million to £477 million, reflecting the increase in profit from Reynolds American and ITC, partially offset by the impact of the ST transaction (see page 46).

The contribution from Reynolds American to the post-tax results was up 20 per cent at £339 million or 12 per cent at constant rates of exchange. Excluding impairment of trademarks, the benefit from the termination of the joint venture agreement and costs of the organisational restructuring in 2008, it was 13 per cent higher at £326 million (2007: post-tax result of £289 million excluding trademark impairments of £7 million). At constant rates of exchange, the contribution would have

been £302 million, or 5 per cent higher than last year. Earnings were up as lower cigarette volumes and higher settlement obligations were more than offset by higher cigarette and moist-snuff pricing, increased productivity at R J Reynolds and double-digit moist-snuff volume growth at Conwood.

The Group's main associate in India, ITC, continued its strong profit growth and its contribution to the Group rose by £9 million, or 8 per cent, to £117 million. At constant rates of exchange, the contribution would have been £113 million, 5 per cent higher than last year.

Associates' volumes decreased by 11 per cent to 205 billion largely as a result of the ST transaction. With the inclusion of associates' volumes, total Group volumes were 919 billion (2007: 914 billion).



“2008 has been a year of turmoil for the financial markets and of uncertain prospects for the world economy. British American Tobacco has delivered an outstanding set of results and remains in a very strong position.”

Ben Stevens Finance Director

- Growth in revenue of 21 per cent and profit from operations of 23 per cent
- Adjusted diluted earnings per share growth of 19 per cent
- Total dividends per share for 2008 of 83.7 pence, up 26 per cent on the prior year
- Strong cash flow, with free cash flow up 52 per cent at £2,604 million and free cash flow per share up 55 per cent
- Interest cover remains strong with interest payable covered 8.5x (2007: 9.4x)
- Committed long-term facilities of £1.75 billion, unused at 31 December 2008
- Well on track to deliver the target set for cost savings of £800 million by 2012

Profit from operations

The reported Group revenue at £12,122 million grew by 21 per cent and profit from operations at £3,572 million grew by 23 per cent.

The percentage increases in revenue and profit from operations as reported and after adjusting items, acquisitions and at constant rates of exchange, are shown in the table below.

In assessing the performance of the business, reported profit can be distorted by adjusting items. For this reason, we also show these items excluded from the profit from operations to demonstrate what management believes to be the underlying profit from the business. These adjusting items are described further below. The profit from operations, excluding adjusting items, grew by 24 per cent.

During 2008, revenue growth was enhanced through the acquisition of the cigarette and snus businesses of Skandinavisk Tobakskompagni (ST) and the purchase of the cigarette assets of Tekel, the Turkish state tobacco company.

2007 was the last year of the 5 year programme of cost savings, achieving annual savings of £1,006 million in total from supply chain, overheads and indirects. The new 5 year target, to achieve annual savings of £800 million by 2012, was announced at the beginning of 2008. It includes areas such as supply chain efficiencies, back office integration and management structures. During the first year of the programme, savings of over £245 million were delivered, putting us very much on track to deliver the annual savings target of £800 million by 2012.

These cost reduction initiatives resulted in the profit from operations excluding adjusting items, as a percentage of revenue, improving to 30.7 per cent compared to 30.0 per cent in 2007 and 28.8 per cent in 2006.

More details of the Group's operating performance, excluding adjusting items and unallocated costs, can be found in the Regional review. Unallocated costs, which are net corporate costs not directly attributable to regional segments of the business, were £110 million (2007: £106 million).

Percentage increases in revenue and in profit from operations

	Revenue growth	Profit growth
As reported	+21%	+23%
Excluding adjusting items	+21%	+24%
Excluding adjusting items and acquisitions	+17%	+20%
Excluding adjusting items and acquisitions, at constant rates of exchange	+7%	+10%

Financial review continued

Profit from operations excluding adjusting items

£ million



+24% in 2008

Interest cover

times



8.5 times in 2008

Underlying tax rate

percentage



30.8% in 2008

Adjusting items

The adjusting items below, all included in the profit from operations, are separately disclosed as memorandum information on the face of the income statement and in the segmental analysis. They help to provide a better understanding of the Group's underlying financial performance.

During 2008, the Group continued its review of manufacturing operations and organisational structure, including initiatives to reduce overheads and indirect costs. Costs were incurred in respect of restructuring announced in prior years, the closing of the Bologna factory in Italy and costs in respect of the integration of the Tekel and ST businesses into existing operations. Total restructuring costs were £160 million for 2008, compared to £173 million for 2007.

On 31 July 2008, Imperial Tobacco Canada announced that it reached a resolution with the federal and provincial governments with regard to the investigation related to the export to the United States of Imperial Tobacco Canada products in the late 1980s and early 1990s. A plea of guilty was entered to a regulatory violation of a single count of Section 240(i)(a) of the Excise Act and Imperial Tobacco Canada paid a fine of Can\$200 million (£102 million) which was expensed in 2008. It has also entered into a 15 year civil agreement with the federal and provincial governments, in order, amongst other

things, to assist the governments in their future efforts against illicit trade. Imperial Tobacco Canada has entered into an agreement to pay a percentage of its annual net sales revenue going forward for 15 years, up to a maximum of Can\$350 million, which will be expensed as it is incurred.

The acquisitions of the assets of Tekel and the ST businesses resulted in the capitalisation of trademarks which are amortised over their expected useful lives. The 2008 amortisation charge in respect of trademarks amounted to £24 million.

As part of the ST transaction, the Group realised a gain of £139 million with the disposal of its 32.35 per cent holding in the non-cigarette and snus businesses of ST.

In 2007, the Group sold its pipe tobacco trademarks to the Danish company, Orlik Tobacco Company A/S, for €24 million, resulting in a gain of £11 million. The Group also sold its Belgian cigar factory and associated trademarks to the cigars division of Skandinavisk Tobakskompagni AS, which realised a gain on disposal of £45 million.

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.

Net finance costs

Net finance costs at £391 million were £122 million higher than last year. The increase principally reflects the costs of financing the 2 acquisitions made during the year and exchange rate movements.

Interest cover

The Group assesses, as 2 principal measures of its financial capacity, cash flow and interest cover. Interest cover is distorted by the pre-tax impact of adjusting items. The chart shows gross interest cover, adjusting for these items, on the basis of profit before interest payable over interest payable. The interest cover remains strong at 8.5x (2007: 9.4x), with the lower cover reflecting the higher profit and contribution of the acquisitions since the middle of the year but also the strong increase in interest costs as a result of the financing arrangements for those acquisitions.

Net interest cover, on the basis of profit before net finance costs over net finance costs, was 11.1x (2007: 12.8x).

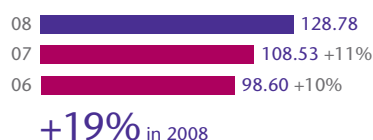
At 31 December 2008, the ratio of floating to fixed rate financial liabilities was 45:55 (2007: 53:47).

Associates

The Group's share of the post-tax results of associates, included at the pre-tax profit level under IFRS, increased by £61 million to £503 million, after net adjusting income of £26 million (2007: £7 million charges). The Group's share

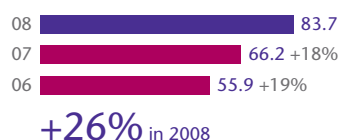
Adjusted diluted EPS

pence



Dividend per share declared

pence



of the net adjusting items in Reynolds American amounted to £13 million income (2007: £7 million expense) and included trademark impairment charges due to modified levels of support between certain trademarks, restructuring charges and a benefit from the termination of a joint venture agreement.

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

Profit before tax

Profit before tax was up £607 million at £3,684 million, principally reflecting the higher profit from operations, the increased contribution from the associates and favourable exchange rates, partially offset by the rise in interest costs.

Effective tax rate

The tax rates in the income statement of 27.8 per cent in 2008 and 25.7 per cent in 2007 are affected by the inclusion of the share of associates' post-tax profit in

the Group's pre-tax results and by the adjusting items.

The underlying tax rate for subsidiaries, adjusted to remove the distortions as reflected in the adjusted earnings per share below, was 30.8 per cent in 2008 and 29.6 per cent in 2007.

Earnings per share

Basic earnings per share for 2008 were 123.28p (2007: 105.19p). With the distortions that adjusting items can cause in profit, as well as the potential dilutive effect of employee share schemes, earnings per share is best viewed on the basis of adjusted diluted earnings per share. The calculation of this measure is explained in note 7. The adjustments relate to restructuring and integration costs, the Canadian settlement, the amortisation of trademarks and the gains on disposal of businesses and trademarks as well as distortions in net finance costs and one-off adjustments in taxation.

On this basis, the earnings per share were 128.78p, a 19 per cent increase over 2007, as a result of the strong operating performance and benefits from foreign exchange movements.

Dividends

As we announced during 2006, the Board decided to raise the ratio of dividends paid as a percentage of long-term sustainable earnings from the previous policy of at least 50 per cent to 65 per cent by 2008 in progressive steps.

With the recommended final dividend of 61.6p, the total dividends per share for 2008 are 83.7p, up 26 per cent on the prior year and represent 65 per cent of long-term sustainable earnings. Under IFRS, the recommended final dividend in respect of a year is only provided in the accounts of the following year. Therefore, the 2008 accounts reflect the 2007 final dividend and the 2008 interim dividend amounting to 69.7p (£1,393 million) in total (2007: 58.8p – £1,198 million). The table below shows the dividends declared in respect of 2008 and 2007.

Total equity

Total equity was £126 million higher at £7,215 million. The profit retained after payment of dividends exceeded the impact of the share buy-back by £664 million. In addition, exchange movements had a £937 million positive impact on shareholders' funds, reflecting the general weakness of sterling at the end of 2008 compared to 2007. This was largely offset by accounting for the actuarial losses on retirement benefit schemes.

Dividends declared

	2008		2007	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim	22.1	440	18.6	377
Final	61.6	1,221	47.6	953
	83.7	1,661	66.2	1,330

Financial review continued

Cash flow

	2008 £m	2007 £m
Net cash from operating activities before restructuring costs and taxation	4,692	3,656
Restructuring costs	(210)	(190)
Taxation	(943)	(866)
Net cash from operating activities	3,539	2,600
Net interest	(280)	(280)
Net capital expenditure	(482)	(436)
Dividends to minority interests	(173)	(173)
Free cash flow	2,604	1,711
Dividends paid to shareholders	(1,393)	(1,198)
Share buy-back	(400)	(750)
Purchase of Tekel cigarette assets	(873)	
Purchase of ST cigarette and snus businesses	(1,243)	
Other net flows	(227)	152
Net cash flows	(1,532)	(85)

IFRS cash flow

Net cash from operating activities	3,539	2,600
Net cash from investing activities	(2,386)	(122)
Net cash from financing activities	(374)	(2,621)
Net cash flows	779	(143)

Cash flow

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

The growth in underlying operating performance, as well as the timing of working capital movements and higher dividends from associates, partially offset by the adverse impact of the £102 million cash outflow arising from the Canadian settlement, explained above, resulted in a £1,036 million increase in cash flow before restructuring costs and taxation, to £4,692 million. Although there was a £77 million increase in tax outflows reflecting higher profits and the timing of payments, with the above operating cash flows and higher restructuring

costs, the Group's net cash flow from operating activities was £939 million higher at £3,539 million.

Free cash flow is the Group's cash flow before dividends, share buy-back and investing activities.

With higher capital expenditure, the free cash flow was £893 million higher than 2007 at £2,604 million. The free cash flow exceeded the total cash outlay on dividends to shareholders and share buy-back by £811 million.

The ratio of free cash flow per share to adjusted diluted earnings per share was 101 per cent (2007: 77 per cent), with free cash flow per share increasing by 55 per cent.

During 2008, the cash outflows of £873 million and £1,243 million on the purchase of Tekel assets and ST

businesses respectively, comprise the purchase price, part of the acquisition costs less acquired net cash and cash equivalents and overdrafts.

The other net flows in 2008 principally reflect the impact of the level of shares purchased by the employee share ownership trusts, together with the impact of flows in respect of certain derivative financial instruments. The comparative figure for 2007 largely relates to the sale of the Belgian cigar factory and associated brands, as well as the disposal of the pipe tobacco business.

The above flows resulted in a net cash outflow of £1,532 million compared to an outflow of £85 million in 2007. After taking account of transactions related to borrowings, the above flows resulted in a net increase of cash and cash equivalents of £779 million compared to a net decrease of £143 million in 2007, as shown in the IFRS cash flow.

Treasury operations

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

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

Clear parameters have been established, including levels of authority, on the type and use of financial instruments to manage the financial risks facing the Group. Such instruments are only used if they relate to an underlying exposure; speculative transactions are expressly forbidden under the Group's treasury policy. The Group's treasury position is monitored by the Group Corporate Finance Committee, which meets regularly throughout the year and is chaired by the Finance Director. Regular reports are provided to senior management

and treasury operations are subject to periodic independent reviews and audits, both internal and external.

One of the principal responsibilities of Treasury is to manage the financial risk 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.

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 2008, the average centrally managed debt maturity was 5.1 years (2007: 5.4 years) and the highest proportion of centrally managed debt maturing in a single year was under 18 per cent (2007: 17 per cent).

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 maintain investment-grade credit ratings; as at 31 December 2008 the ratings from Moody's and S&P were Baa1/BBB+ with a stable outlook (end 2007: Baa1/BBB+). The strength of the ratings has underpinned the debt issuances during 2007 and 2008 and, despite the impact of the turbulence in financial markets, the Group is confident of its ability to successfully access the debt capital markets, as demonstrated with the issue of US\$1 billion bonds in the US bond market in November 2008.

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.

Net debt/financing

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

	2008 £m	2007 £m
Net debt 1 January	(5,581)	(4,994)
Exchange*	(2,622)	(466)
Free cash flow	2,604	1,711
Dividends	(1,393)	(1,198)
Share buy-back	(400)	(750)
Tekel acquisition	(873)	
ST acquisition	(1,243)	
Other net flows	(227)	152
Other non-cash items	(156)	(36)
Net debt 31 December	(9,891)	(5,581)

* Including movements in respect of debt related derivatives.

The maturity profile of net debt at year end:

	2008 £m	2007 £m
Net debt due within 1 year		
Borrowings	(2,724)	(861)
Related derivatives	(91)	(90)
Cash and cash equivalents	2,309	1,258
Investments available-for-sale	79	75
	(427)	382
Net debt due beyond 1 year		
Borrowings	(9,437)	(6,062)
Related derivatives	(27)	99
	(9,464)	(5,963)
Total net debt	(9,891)	(5,581)

Financial review continued

Liquidity

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

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

On 13 February 2008, the Group entered into an acquisition credit facility whereby lenders agreed to make available an amount of US\$2 billion. On 1 May 2008, this facility was syndicated in the market and was redenominated into 2 euro facilities, 1 of €420 million and 1 of €860 million. These facilities expire on 31 October 2009. There was a net draw down on these credit facilities of €1,154 million during the year ended 31 December 2008 (2007: €nil).

In March 2007, €800 million of €1.7 billion bonds with a maturity of February 2009 were replaced by €1 billion bonds with a maturity of 2017. In March 2007, the Group's central banking facility at £1.75 billion was extended on existing terms under a 1 year extension option with final

maturity dates between March 2011 and March 2012, and was undrawn as at 31 December 2008.

Retirement benefit schemes

The Group's subsidiaries operate around 150 retirement benefit arrangements globally. The majority of the scheme members belong to defined benefit schemes, most of which are funded externally and are closed to new entrants. The Group also operates a number of defined contribution schemes.

The overall net liability for all pension and health care schemes in Group subsidiaries amounted to £773 million at the end of 2008, up from £323 million at the end of 2007. The present total value of funded scheme liabilities was £4,647 million (2007: £4,265 million), while unfunded scheme liabilities amounted to £248 million (2007: £232 million).

The increase in the scheme deficits is largely due to an increase in life expectancy and the fall in asset values on world markets, partially offset by higher discount rates for liabilities.

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

Going concern

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

This, together with the maturity profile of debt, spread over a long period with only limited redemptions scheduled for 2009, provides confidence that the Group has sufficient working capital to prepare the annual report and accounts on a going concern basis. See the Directors' report for full details.

Changes in the Group

There were a number of changes in the Group in 2008 and 2007 as described under adjusting items above.

Share buy-back programme

The Group initiated an on-market share buy-back programme at the end of February 2003. During the year to 31 December 2008, 22 million shares were bought back at a cost of £400 million (31 December 2007: 45 million shares at a cost of £750 million). This brought the total of the share buy-back programme to 313 million shares at a cost of £3,342 million and an average share price of £10.68.

The Board has decided to suspend the share buy-back programme for the time being, in order to preserve the Group's financial flexibility during a period of economic uncertainty.

Regional structure from 2009

Given the acquisition of ST and the cigarette assets of Tekel, it was announced that the Group's regional structure would be realigned from 1 January 2009. Europe region splits into Eastern Europe and Western Europe, Americas region includes Latin America, the Caribbean and Canada, while Asia-Pacific includes Japan. The 2008 segmental information, re-allocated on the basis of the new regional structure that is applicable from 2009, is shown as additional information in the segmental analysis note to the accounts.

Cigarette volumes for 2008, based on the structure that is applicable from 2009, are: Eastern Europe 137 billion; Western Europe 123 billion; Asia-Pacific 180 billion; Americas 161 billion and Africa and Middle East 114 billion.

The information in respect of revenue and profit is shown in note 2 on the accounts.

Non-GAAP measures

In the reporting of financial information, the Group uses certain measures that are not required under International Financial Reporting Standards (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, 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. This measure removes the impact of adjusting items from earnings.

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

Following the secondary listing of the ordinary shares of British American Tobacco p.l.c. on the main board of the JSE Limited (JSE) in South Africa, the Group is required to present headline earnings per share and diluted headline earnings per share which are additional alternative measures of earnings per share, calculated in accordance with Circular 8/2007 'Headline Earnings', issued by the South African Institute of Chartered Accountants.

Accounting developments

From 1 January 2005, the Group has reported under IFRS and, generally, the move to IFRS has made the reporting of performance more complex.

During 2008, the Group amended its accounting policy in respect of the recognition of actuarial gains and losses under IAS19 and adopted IFRIC14. As a result, the comparatives for 2007 have been restated with both profit from operations and taxation being reduced by £1 million. Profit for the year was unchanged from that previously reported. Total equity at 31 December 2007 was reduced by £9 million. The impact of the accounting changes for 2008 was to reduce the Group's total equity at 31 December 2008 by £817 million and increase the profit for the year by £4 million.

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

Franked Investment Income Group Litigation Order (FII GLO)

British American Tobacco is the principal test claimant against HM Revenue and Customs in the FII GLO. Over 20 companies are involved in the claim which concerns the treatment for UK corporate tax purposes of profits earned overseas and distributed to the UK. The tentative conclusion reached in the High Court judgment would, if upheld, produce an estimated receivable of about £1.2 billion for the Group. The potential receipt of some or all of this amount has not been recognised in the results of the Group due to the uncertainty of the amount and eventual outcome. The case will now proceed to the Court of Appeal.

Foreign currencies

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

	Average		Closing
	2008	2007	2008
US dollar	1.852	2.001	1.438
Canadian dollar	1.961	2.147	1.775
Euro	1.257	1.462	1.034
South African rand	15.132	14.110	13.292
Brazilian real	3.355	3.894	3.353
Australian dollar	2.187	2.390	2.062
Russian rouble	45.810	51.161	43.902

Directors' report

- 54 Board of Directors
- 55 Management Board
- 56 Directors' report
- 66 Remuneration report
- 82 Corporate governance statement
- 91 Responsibility of Directors

Group financial statements

- 92 Report of the independent auditors
- 94 Group income statement
- 95 Group statement of recognised income and expense
- 96 Group balance sheet
- 98 Group cash flow statement
- 99 Notes on the accounts
- 176 5 year summary
- 177 Quarterly analyses of profit
- 178 Principal subsidiary undertakings
- 180 Principal associate undertakings

Parent Company financial statements

- 181 Report of the independent auditors
- 182 Balance sheet
- 183 Notes on the accounts

Shareholder information

- 186 Shareholder and contact information

Board of Directors

go online at www.bat.com/annualreport2008



1



2



3



4



5



6



7



8



9



10



11

1. Jan du Plessis (British/South African)

Chairman ▲

Appointed Chairman in July 2004, having been a Non-Executive Director since his appointment to the Board in 1999. He is Chairman of the Nominations Committee. He is a Non-Executive Director of Lloyds Banking Group plc, Rio Tinto plc, Rio Tinto Limited and Marks and Spencer Group plc. (55)

2. Sir Nicholas Scheele (British/US)

Non-Executive Director ▲■◆◆

Appointed a Director in 2005, he was appointed Senior Independent Director in May 2008. He is Chairman of The Cambridge-MIT Institute and Key Safety Systems, Inc. (USA) and a Director of Pegasus Holdings Group (USA) and Grupo Proeza (Mexico). (65)

3. Paul Adams (British)

Chief Executive

Appointed a Director in March 2001 and Chief Executive in January 2004. He joined British American Tobacco in July 1991 and held senior appointments as Regional Director, Asia-Pacific and Regional Director, Europe prior to becoming Deputy Managing Director in June 2001 and Managing Director in January 2002. (55)

4. Ben Stevens (British)

Finance Director

Appointed Director, Europe in January 2004 having previously joined the Management Board in 2001 as Development Director. Since joining British American Tobacco in 1989 he has held a number of senior finance and general management roles particularly in western Europe, south Asia and Russia. He was appointed Executive Director with effect from 3 March 2008 and succeeded Paul Rayner as Finance Director on 30 April 2008. (49)

5. Nicandro Durante (Brazilian/Italian)

Chief Operating Officer and Director, America-Pacific Appointed a Director and Chief Operating Officer on 1 January 2008 having previously been Regional Director for Africa and Middle East and a member of the Management Board since March 2006. He previously held senior general management roles in Brazil (including President of Souza Cruz) and also in the UK and Hong Kong. He was appointed a Director of Reynolds American Inc. in December 2008. (52)

6. Karen de Segundo (Dutch)

Non-Executive Director ▲◆◆◆

Appointed a Director in October 2007, she was appointed Chair of the Corporate Social Responsibility Committee in May 2008. Karen retired as CEO Renewables and President Hydrogen of Shell International in 2005. She is currently a Non-Executive Director of Lonmin plc, Blackrock New Energy Investment Trust PLC, Ensus Holdings Limited, E.ON AG, Pöyry Oyj and Ahold NV. (62)

7. Robert Lerwill (British)

Non-Executive Director ▲■◆◆

Appointed a Director in 2005, he is Chairman of the Audit Committee. He is a Non-Executive Director of Synergy Health PLC and was formerly a Director of Cable & Wireless plc, WPP Group PLC, The Anthony Nolan Trust and, until November 2008, Chief Executive of Aegis Group plc. (57)

8. Dr Ana Maria Llopis (Spanish)

Non-Executive Director ▲◆◆◆

Appointed a Director in 2003. She is Executive Deputy Chairman of the J F Llopis Foundation and was a member of the Good Governance Working Group for Spanish listed companies. Ana Maria was appointed a Non-Executive Director of ABN AMRO Bank in April 2007. (58)

9. Christine Morin-Postel (French)

Non-Executive Director ▲■◆◆

Appointed a Director in October 2007. Christine is currently a Non-Executive Director of Royal Dutch Shell PLC and 3i Group plc. She previously held a number of executive positions including Chief Executive of Société Générale de Belgique, Executive Vice-President and member of the Executive Committee of Suez and Chairman and CEO of Crédit Suez S.A. before her retirement in 2003. (62)

10. Anthony Ruys (Dutch)

Non-Executive Director ▲■◆◆

A Director from March 2006, he was appointed Chairman of the Remuneration Committee in May 2008. He is a member of the Supervisory Boards of ABN AMRO Bank and JANIVO Holdings BV (NL) and a Director of Lottomatica S.p.A. (Italy). In April 2009 he will become Chairman of the Supervisory Board of NV Luchthaven Schiphol (NL). (61)

11. Thys Visser (South African)

Non-Executive Director ▲◆◆◆

A Director since 2001. He is CEO of Remgro Limited, having held senior management positions with Rembrandt Group 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. Thys Visser will retire as a Non-Executive Director at the conclusion of the AGM on 30 April 2009. (54)

Board Committees

Committee membership is indicated by the following symbols:

▲ Nominations Committee

■ Audit Committee

◆ Remuneration Committee

◆ Corporate Social Responsibility Committee

Management Board

go online at www.bat.com/annualreport2008

The role of the Management Board

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



1



2



3



4



5



6



7



8



9



10

1. Mark Cobben (Dutch) Director, Americas

Joined British American Tobacco in 1993. He has held a number of senior roles across the Group (including General Manager in Switzerland, Argentina, Russia and Germany). He has been a member of the Management Board since October 2007. (52)

2. John Daly (Irish) Director, Asia-Pacific

Joined the Management Board as Regional Director for Asia-Pacific in October 2004. He held a number of senior management roles for Rothmans International in Europe and the Far East before becoming Area Director for the Middle East and North Africa in 2001. (52)

3. David Fell (British) Director, Eastern Europe

Appointed Director, Eastern Europe in May 2008. He joined British American Tobacco in 1989 and has held a variety of marketing positions in Europe and South East Asia. He was appointed President of British American Tobacco Japan in 2000 before being made Area Director, BAT Australasia and Managing Director, BAT Australia in 2004. (48)

4. Andrew Gray (Brazilian/British) Director, Africa and Middle East

Appointed Director, Africa and Middle East in January 2008. He joined British American Tobacco 22 years ago and has held a variety of senior marketing and general management roles in Latin America (including President of Souza Cruz) and also in Central America, the Caribbean and Malaysia. (44)

5. Rudi Kindts (Belgian) Group Human Resources Director

Joined British American Tobacco in 1988. He has held a number of senior human resources roles in the Group and his responsibilities have covered Europe, Africa, the Middle East and central and south Asia. He has been Group Human Resources Director since July 2004. (51)

6. Jean Marc Levy (Swiss) Director, Western Europe

Appointed Director, Western Europe in April 2008. After beginning his career with the Kraft-Jacobs-Suchard Group he joined British American Tobacco 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. (46)

7. Michael Prideaux (British)
Group Corporate and Regulatory Affairs Director
Appointed Group Corporate and Regulatory Affairs Director in 1998 following the demerger of B.A.T Industries. He joined B.A.T Industries in 1989 from Charles Barker, a leading financial and corporate public relations, advertising and design agency, where he was Chief Executive. (58)

8. Jimmi Rembiszewski (German) Group Marketing Director

Joined the Group as a Marketing Director and as a Territorial Director in 1991, having had various senior marketing and business appointments in Procter & Gamble and Jacobs Suchard. He has been a member of the Management Board since 1996. (58)

9. Peter Taylor (British) Group Operations Director

Joined British American Tobacco in 1980 and has worked in a variety of operational and general management roles across the Group. He was appointed Group Operations Director in 2003. (56)

10. Neil Withington (British) Group Legal and Security Director and General Counsel

Appointed Group Legal and Security Director and General Counsel of British American Tobacco in 2000, having previously been the Group's Deputy General Counsel. He joined the Group in 1993 after a career at the Bar and in the chemical and pharmaceutical industries. He has been a Director of Reynolds American Inc. since July 2004. (52)

Directors' report

Introduction

The Directors present their report and the audited financial statements for the Group and the Company for the year ended 31 December 2008. A report from the Directors on corporate governance is set out in the Corporate governance statement and the Remuneration Committee report is in the Remuneration report.

Business review

The Companies Acts 1985 and 2006 require the Company to set out in this report the development and performance of the business of the Group during the financial year ended 31 December 2008, including an analysis of the position of the Group at the end of the financial year, and a description of the principal risks and uncertainties facing the Group.

The table below sets out the information relevant to the Directors' report (including the information that fulfils the Business review requirements) that may be found in the other sections of the Annual Report. All the information detailed in these sections is incorporated by reference into this Directors' report and is deemed to form part of this report:

Information	Location in Annual Report 2008
Chief Executive's review	Business review
Our strategy – including environmental, social, community and employee matters (covering employee involvement and employment of disabled persons)	Business review
Key Group risk factors	Business review
Regional and financial review	Business review
Directors' responsibilities in relation to the financial statements; Directors' declaration in relation to relevant audit information; Directors' responsibility statement	Responsibility of Directors
Directors' interests in shares (including share options and deferred shares)	Remuneration report
Research and development	Business review
Share capital – employee share plan voting rights	Remuneration report

This Directors' report has been drawn up and is presented in accordance with, and reliance upon, applicable English company law and the liabilities of the Directors in connection with that report shall be subject to the limitations and restrictions provided by such law.

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

Principal activities

British American Tobacco p.l.c. is a holding company which owns, directly or indirectly, investments in the numerous companies constituting the British American Tobacco Group of companies. The principal subsidiaries and associates are listed on the Principal subsidiary undertakings and Principal associate undertakings pages. All subsidiary undertakings are involved in activities directly or indirectly related to the manufacture, distribution or sale of tobacco products.

Group results and dividends

The Group results are addressed fully in the financial statements and in the Business review. The Board recommends to shareholders a final dividend of 61.6p per ordinary share of 25p for the year ended 31 December 2008. If approved by shareholders at the Annual General Meeting to be held on 30 April 2009, the dividend will be payable on 6 May 2009 to shareholders registered on either the UK main register or the new South African branch register on 13 March 2009 (the record date). The ex-dividend trading dates are 9 March 2009 on the JSE Limited (JSE) and 11 March 2009 on the London Stock Exchange (LSE). As the Group reports in sterling, dividends are declared and payable in sterling except for shareholders on the branch register in South Africa whose dividends are payable in rand.

A rate of exchange of £:R = 14.32310 as at 24 February 2009 (the closing rate for that date as quoted on Bloomberg), results in an equivalent final dividend of 882.30296 SA cents per ordinary share. From the close of business on 6 March 2009 until the close of business on 13 March 2009, no transfers between the UK main register and the South African branch register are permitted and no shares may be dematerialised or rematerialised between 9 March 2009 and 13 March 2009, both days inclusive.

Further details of the total amounts of dividends paid in 2008 (with 2007 comparatives) are given in note 8.

Annual General Meeting

The Annual General Meeting will be held at The Mermaid Conference & Events Centre, Puddle Dock, Blackfriars, London EC4V 3DB at 11.30am on 30 April 2009. Details of the business to be proposed at the meeting are contained in the Notice of Annual General Meeting which is sent to all shareholders and is also published on www.bat.com.

Directors

The following persons are the current Directors of the Company:

Chairman

Jan du Plessis

Executive Directors

Paul Adams (Chief Executive)

Ben Stevens (Finance Director)

Nicandro Durante (Chief Operating Officer)

Non-Executive Directors

Sir Nicholas Scheele (Senior Independent Director)

Karen de Segundo

Robert Lerwill

Ana Maria Llopis

Christine Morin-Postel

Anthony Ruys

Thys Visser

Nicandro Durante was appointed to the Board as Chief Operating Officer on 1 January 2008. Paul Rayner ceased to be Finance Director with effect from the conclusion of the Annual General Meeting on 30 April 2008. Ben Stevens was appointed to the Board with effect from 3 March 2008 and succeeded Paul Rayner as Finance Director on 30 April 2008. Kenneth Clarke (Deputy Chairman and Senior Independent Director) also retired as a Director at the conclusion of the Annual General Meeting on 30 April 2008. Sir Nicholas Scheele, a Non-Executive Director, became Senior Independent Director on 1 May 2008.

In accordance with the Articles of Association, the Directors named below retire from the Board at the forthcoming Annual General Meeting and, being eligible, offer themselves for reappointment: Paul Adams; Jan du Plessis; Robert Lerwill; and Sir Nicholas Scheele.

Thys Visser, a Non-Executive Director since 2001, will retire from the Board at the conclusion of the Annual General Meeting on 30 April 2009. The Company is looking to recruit at least 1 further Non-Executive Director to the Board.

Biographical and related information about the Directors is given on the Board of Directors and Management Board pages and will also be given in the Secretary's letter in the Notice of Annual General Meeting for those Directors who are offering themselves for reappointment.

Directors' interests and indemnities

Further details of Directors' contracts and letters of appointment, remuneration and their interests in the shares of the Company (including interests in share options and deferred shares) as at 31 December 2008 are given in the Remuneration report.

No Director had any material interest in a contract of significance (other than a service contract) with the Company or any subsidiary company during the year. Details of the Executive Directors' service contracts and the letters of appointment for the Non-Executive Directors, their emoluments and share interests (including interests in share-based payments) are given in the Remuneration report.

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

Going concern

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

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

Directors' report continued

After reviewing the Group's annual budget, plans and financing arrangements, the Directors consider that the Group has adequate resources to continue operating for the foreseeable future and that it is therefore appropriate to continue to adopt the going concern basis in preparing the Annual Report.

Auditors

Resolutions will be proposed at the Annual General Meeting to reappoint PricewaterhouseCoopers LLP as the Company's auditors and to authorise the Directors to agree their remuneration. The Audit Committee will recommend the appropriate level of fees to the Board following its annual assessment as set out on the Corporate governance pages.

Share capital

As at 31 December 2008, the Company had:

- 1) an authorised share capital comprising 2,858,265,349 ordinary shares of 25p each with an aggregate nominal value of £714.57 million and 241,734,651 convertible redeemable preference shares (CRPS) of 25p each with an aggregate nominal value of £60 million; and
- 2) an allotted and fully paid share capital of 2,025,031,151 ordinary shares of 25p each with an aggregate nominal value of £506 million (including treasury shares and shares owned by the employee share trusts). The CRPS are no longer in issue with 50 per cent being redeemed for cash in June 2000 and 50 per cent converted into the same number of ordinary shares in June 2004, in accordance with the terms of their issue.

Stock market listings

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

On 8 August 2008, Compagnie Financière Richemont SA (CFR), which held an interest of 19.4 per cent in the Company's ordinary shares and Remgro Limited (Remgro), which held an interest of 10.7 per cent, in both cases through R&R Holdings SA, announced details of restructurings that would result in their respective shareholders becoming direct shareholders in the Company (the Restructurings). Previously, the Company had agreed, if requested, to obtain a secondary listing for its ordinary shares on the JSE Limited in South Africa (JSE) with a view to facilitating the Restructurings (the Listing Request).

On 7 August 2008, the Company received the Listing Request and applied to the JSE for a secondary listing of all of the issued ordinary shares of the Company. This was granted by the JSE and the Company's secondary listing in the tobacco sector, under the abbreviated name BATS and the trading

code BTI, came into effect from the commencement of trading on the JSE on 28 October 2008.

The Restructurings resulted in around 90 per cent of the combined shareholding of CFR and Remgro (or around 27 per cent of the issued share capital of the Company) being distributed to their shareholders, with the remaining 10 per cent (or around 3 per cent of the issued share capital of the Company) being retained by Reinet Investments S.C.A. (Reinet), a listed Luxembourg investment company. The distributions, which took place in November 2008, were followed by a rights issue by Reinet in December 2008, which could be subscribed to using the Company's shares. The residual Reinet shareholding in the Company is shown in Significant shareholders below.

As at 23 February 2009, (the latest practicable date prior to publication), 231,499,893 ordinary shares of the Company (being 11.6 per cent of the Company's issued ordinary share capital – excluding treasury shares) were on its South African branch register.

The Company's ordinary shares are also traded on NYSE Alternext U.S. (the rebranded identity of the former American Stock Exchange or Amex), in the form of American Depositary Receipts (ADRs) under the symbol BTI with a CUSIP number 110448107. Each ADR represents 2 of the Company's ordinary shares and at 31 December 2008, 29,391,326 ADRs were outstanding, represented by 58,782,652 ordinary shares. The Company has unlisted trading privileges for its ADR programme and none of its securities are listed on any United States securities exchange or registered pursuant to the securities laws of the United States. On 1 December 2008, Citibank, N.A. succeeded The Bank of New York Mellon as depositary for the Company's ADR programme, a change which is expected to bring enhanced benefits to the holders of ADRs by way of reduced dividend fees and, for many, shorter dividend payment periods.

Significant shareholders

At 25 February 2009, the following substantial interests (3 per cent or more) in the Company's ordinary share capital (voting securities) had been notified to the Company:

	Number of ordinary shares	Percentage of issued share capital
Legal & General Group Plc	100,685,501	5.04
Reinet Investments S.C.A.	84,303,670	4.22

Note:

The percentage of issued share capital shown excludes treasury shares.

Purchase of own shares

From March 2008, the Board continued its on-market programme of buying back the Company's ordinary shares of 25p each under the authority granted by shareholders in

2007. At the 2008 Annual General Meeting, the Company was given authority to purchase up to 201,800,000 of its ordinary shares. The minimum price that may be paid for such shares is 25p and the maximum price is an amount equal to 105 per cent of the average of the middle market prices shown in the quotation for an ordinary share as derived from the London Stock Exchange Daily Official List for the 5 business days immediately preceding the day on which the ordinary share is contracted to be purchased.

During the year ended 31 December 2008, the Company made on-market repurchases totalling 22,071,274 of its own ordinary shares, representing 1.1 per cent of the issued share capital (excluding treasury shares) as at 31 December 2008 and for an aggregate consideration of £400 million. In accordance with the Company's policy, all of these repurchased shares are held as treasury shares and as at 31 December 2008 the number of treasury shares was 28,960,054. Whilst treasury shares are held no dividends are paid on them and they have no voting rights; treasury shares may be resold at a later date.

The present authority for the Company to purchase its own shares will expire at the 2009 Annual General Meeting. In the context of the current financial and macroeconomic climate the Directors have decided, in February 2009, to discontinue the share buy-back programme until further notice. However, the Directors are seeking fresh authority for the Company to purchase its ordinary shares in order that the appropriate mechanisms are in place to enable the share buy-back programme to be reinstated at any time when, in the opinion of the Directors, the exercise of the authority would result in an increase in the Company's earnings per share and would be in the interests of its shareholders generally.

It is proposed that the authority for the Company to purchase its own shares be extended to enable the Company to purchase its shares listed on the JSE. The appropriate resolution will be put to shareholders at the 2009 Annual General Meeting, details of which are contained in the Notice of Annual General Meeting which is sent to all shareholders and is also published on www.bat.com.

Significant agreements – change of control

The following significant agreements contain certain termination and other rights for our counterparties upon a change of control of the Company.

On 8 March 2005, the Company, B.A.T. International Finance p.l.c., B.A.T. Capital Corporation and British American Tobacco Holdings (The Netherlands) B.V. (as borrowers and, in the case of the Company, as a borrower and guarantor) entered into a revolving credit facility agreement with HSBC Bank plc (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrowers

£1.75 billion for general corporate purposes (the Facility). Pursuant to the Facility, should a borrower (other than the Company) cease to be a direct or indirect subsidiary of the Company, such borrower shall immediately repay any outstanding advances made to it. Where there is a change of control in respect of the Company, the lenders can require all amounts outstanding under the Facility to be repaid.

On 7 August 2007, British American Tobacco Mexico, S.A. de C.V. (as borrower) and the Company, B.A.T. International Finance p.l.c. and B.A.T. Capital Corporation (as guarantors) entered into a term credit facility arrangement with Barclays Capital (as mandated lead arranger), HSBC Bank plc (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrower US\$690 million to refinance existing facilities and for general corporate purposes (the Facility). Pursuant to the Facility, should the borrower cease to be a direct or indirect subsidiary of the Company, the borrower shall immediately repay any outstanding amounts. Where there is a change of control in respect of the Company, the lenders can require all amounts outstanding under the Facility to be repaid.

On 13 February 2008, and as amended on 1 May 2008, B.A.T. International Finance p.l.c. and BATIF Dollar Limited (as borrowers) and the Company and B.A.T. International Finance p.l.c. (as guarantors) 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 €420 million to finance certain acquisition activities and other associated costs (the Facility). As at 31 December 2008, €395 million had been drawn under the Facility and no further drawings may be made. Pursuant to the Facility, should a borrower cease to be a direct or indirect subsidiary of the Company, such borrower shall immediately repay any outstanding advances made to it. Where there is a change of control in respect of the Company, the lenders can require all amounts outstanding under the Facility to be repaid.

On 1 May 2008, British American Tobacco Tütün Mamulleri Sanayi ve Ticaret Anonim Şirketi (as borrower) and the Company and B.A.T. International Finance p.l.c. (as guarantors) 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 certain acquisition activities and other associated costs (the Facility). As at 31 December 2008, €759 million had been drawn under the Facility and no further drawings may be made. Pursuant to the Facility, should the borrower cease to be a direct or indirect subsidiary

Directors' report continued

of the Company, the borrower shall immediately repay any outstanding advances. Where there is a change of control in respect of the Company, the lenders can require all amounts outstanding under the Facility to be repaid.

Details of the change of control provisions contained in the Company's long-term incentive plans are given in the Remuneration report.

In connection with the merger of the Company with Rothmans International B.V., the Company entered into a Standstill Agreement dated 11 January 1999 with R&R Holdings S.A. (then named Rothmans International Holdings S.A.), CFR (then called Compagnie Financière Richemont AG) and Rembrandt Group Limited (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 August 2000. Pursuant to the Standstill Agreement, the R and R Parties gave certain undertakings to the Company concerning the acquisition and disposal of its ordinary shares (including concert party arrangements) and the exercise of voting rights at general meetings of the Company. The Company also made certain undertakings regarding the issue and repurchase of its share capital.

Further to the Restructurings referred to above and the terms of the Standstill Agreement, the Standstill Agreement terminated on 3 November 2008 at the point when the number of ordinary shares in the Company held by the R and R Parties fell below 15 per cent. In the context of change of control provisions in force throughout most of 2008, the provisions of the Standstill Agreement would have terminated if: (1) a general offer, made by a person being independent of the R and R Parties, had become wholly unconditional; or (2) the date on which a court scheme, having the effect of giving control of the Company to such a person, had become effective.

Contractual arrangements

Individual operating companies in the Group have contractual and other arrangements with many third parties in support of the Group's business activities covering input materials (filter tow, tobacco leaf and wrapping materials), logistics and distribution. Such contracts and arrangements may be deemed to be essential to 1 or more operating companies but there are no contracts or arrangements considered to be essential to the operation and understanding of the business or the Group as a whole.

Memorandum and Articles of Association

The following description summarises certain provisions of the Company's current Memorandum of Association and its Articles of Association (as adopted by special resolution at the

Annual General Meeting on 30 April 2008) applicable English law, the Companies Act 1985 and the Companies Act 2006 (the Companies Acts). This summary is qualified in its entirety by reference to the Companies Acts and the Company's Memorandum and Articles of Association, a copy of which is available on www.bat.com.

A resolution will be put to the Annual General Meeting to be held on 30 April 2009 to adopt new Articles of Association to: (1) reflect the phased introduction of the provisions of the 2006 Act which will come into effect on 1 October 2009; and (2) to incorporate a minor amendment requested by the JSE following its approval of the Company's secondary listing in October 2008. If adopted, the substance of the new Articles of Association will be reflected in the summary of the articles which will appear in the 2009 Annual Report.

The UK government proposes to implement the EU Shareholder Rights Directive by way of regulations to be published in August 2009 (the Regulations). The Regulations will affect companies' articles of association and the way they run meetings and so, given the timetable for these changes, it is anticipated that shareholders will be asked to approve further amendments to the Company's Articles of Association at the 2010 Annual General Meeting.

Share capital

All of the Company's ordinary shares are fully paid and, accordingly, no further contribution of capital may be required by the Company from the holders of such shares.

Objects and purposes

The Company is incorporated under the name of British American Tobacco p.l.c. and is registered in England and Wales under registered number 3407696. The Company's objects and purposes are set out in the fourth clause of its Memorandum of Association and cover a wide range of activities, including the principal objective of carrying on the business of a holding company. The Memorandum of Association grants the Company a broad range of general powers to effect that objective.

Directors

The Company's Articles of Association provide for a Board of Directors, consisting (unless otherwise determined by ordinary resolution of the shareholders) of not fewer than 5 Directors, not subject to any maximum, who shall manage the business of the Company. The quorum for meetings of Directors is 2 Directors. The Directors may delegate any of their powers to a committee which must consist of 1 or more Directors and (if thought fit) 1 or more other persons. The quorum at a meeting of a committee may be decided upon by the Directors at the meeting at which the committee is appointed, provided that any committee with 2 or more members shall have a quorum of 2 Directors.

The Articles of Association place a general prohibition on a Director voting at a meeting of the Directors on any resolution concerning a matter in which he has an interest other than by virtue of his interest in shares in the Company. However, in the absence of some other interest not indicated below, a Director is entitled to vote and to be counted in a quorum for the purpose of any vote relating to a resolution concerning the following matters:

- 1) the giving to him of a guarantee, security or indemnity in respect of money lent to, or an obligation incurred by him for the benefit of, the Company or any of its subsidiaries;
- 2) the giving to a third party of a guarantee, security or indemnity in respect of an obligation of the Company or any of its subsidiaries for which the Director has assumed responsibility (in whole or part and whether alone or jointly with others) under a guarantee or indemnity or by the giving of security;
- 3) 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;
- 4) any arrangements which relate in any way to a retirement benefits scheme or any arrangement for the benefit of the employees of the Company or any of its subsidiaries including but without being limited to an employees' share scheme, which does not accord to any Director any privilege or advantage not generally accorded to the employees and/or former employees to whom the arrangement relates;
- 5) any transaction or arrangement with any other company, being a company in which the Director is interested only as an officer, creditor or shareholder, provided that he is not the holder of or beneficially interested in 1 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 1 per cent or more of the voting rights available to members of the relevant company (disregarding, for the purposes of this proviso: (i) any shares held by a Director as bare or custodian trustee and in which he has no beneficial interest; (ii) any shares comprised in an authorised unit trust scheme in which the Director is interested only as a unit holder; and (iii) any shares of that class held as treasury shares); and
- 6) any proposal concerning the purchase of Directors' and officers' liability insurance.

The Company may by ordinary resolution suspend or relax to any extent, either generally or in respect of any particular matter, any provision of the Articles prohibiting a Director from voting at a meeting of the Directors or of a committee of the Directors.

Fees for Non-Executive Directors and the Chairman shall be determined by the Directors but shall not exceed in aggregate an annual sum of £2,500,000, unless determined otherwise by ordinary resolution of the shareholders. The remuneration of the Executive Directors is determined by the Remuneration Committee which is comprised of independent Non-Executive Directors.

Directors' appointment and removal

The Directors and the Company (by ordinary resolution) may appoint a person who is willing to act as a Director, either to fill a vacancy or as an additional Director. A Director appointed by the Directors shall retire at the next Annual General Meeting and will put himself/herself forward to be reappointed by the shareholders.

At each Annual General Meeting, at least one-third of the Directors who are subject to retirement by rotation or, if their number is not 3 or a multiple of 3, 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 2 previous Annual General Meetings and who has served as a Director for more than 2 years since his appointment shall retire. Subject to the provisions of the Companies Acts and the Articles of Association, the Directors to retire by rotation will be those who have been in office the longest since their appointment or last reappointment. A Director who retires at an Annual General Meeting and is not reappointed shall retain office until the meeting appoints someone in his place or, if it does not do so, until the end of the meeting.

Without prejudice to the provisions of the Companies Acts or any claim to damages for breach of any contract the Director may have with the Company 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.

Borrowing powers

Without prejudice to their general powers, the Directors may exercise all the powers of the Company to borrow money and to mortgage or charge its undertaking, property, assets (present and future) and uncalled capital or any part thereof, and (subject to the provisions of the Memorandum and Articles of Association) to issue debentures, debenture stock and other securities whether outright or as security for any debt, liability or obligation of the Company or of any third party.

Directors' report continued

Directors' interests

Notwithstanding his office, a Director:

- may be a party to, or otherwise interested in, any transaction or arrangement with the Company or in which the Company 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 the Company or in which the Company is otherwise interested; and
- will not, by reason of his office, be accountable to the Company for any benefit which he derives from any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate and no such transaction or arrangement will be liable to be avoided because of any such interest or benefit.

For the purposes of the Articles, a general notice given to the Directors that he is to be regarded as having an interest of the nature and extent specified in the notice in any transaction or arrangement in which a specified person or class of persons is interested is deemed to be a disclosure that the Director has an interest in any such transaction of the nature and extent so specified; and an interest of which a Director has knowledge and of which it is unreasonable to expect him to have knowledge is not treated as an interest.

A Director will no longer be regarded as having an interest in a transaction by virtue of a person connected to the Director having a relevant interest. However, the Director and the Company must still take a view each time a matter is being considered as to whether the interests of the Director's connected persons mean that a Director should be treated as interested in a transaction.

The Directors may (subject to such terms and conditions, if any, as they may think fit to impose from time to time, and subject always to their right to vary or terminate such authorisation) authorise, to the fullest extent permitted by law:

- 1) any matter which would otherwise result in a Director infringing his duty to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the Company and which may reasonably be regarded as likely to give rise to a conflict of interest (including a conflict of interest and duty or conflict of duties);
- 2) a Director to accept or continue in any office, employment or position in addition to this office as a Director of the Company and may authorise the manner on which a conflict of interest arising out of such office, employment or position

may be dealt with, either before or at the time that such a conflict of interest arises, provided that the authorisation is only effective if:

- i) any requirement as to the quorum at the meeting at which the matter is considered is met without counting the Director in question or any other interested Director; and
- ii) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

If a matter, or office, employment or position, has been authorised by the Directors then (subject to such terms and conditions, if any, as the Directors may think fit to impose from time to time, and subject always to their right to vary or terminate such authorisation or the permissions set out below):

- 1) the Director shall not be required to disclose any confidential information relating to such matter, or such office, employment or position, to the Company if to make such a disclosure would result in a breach of a duty or obligation of confidence owed by him in relation to or in connection with that matter, or that office, employment or position;
- 2) the Director may absent himself from discussions, whether in meetings of the Directors or otherwise, and exclude himself from information which will or may relate to that matter, or that office, employment or position; and
- 3) a Director shall not, by reason of his office as a Director of the Company, be accountable to the Company for any benefit which he derives from any such matter, or from any such office, employment or position.

Dividend rights

Holders of the Company's ordinary shares may, by ordinary resolution, declare dividends but may not declare dividends in excess of the amount recommended by the Directors. The Directors may also pay interim dividends if it appears that such dividends are justified by the profits available for distribution. No dividend shall be paid otherwise than out of profits available as specified under the provisions of the Companies Acts.

The Directors may, with the sanction of an ordinary resolution of the shareholders, offer any holders of ordinary shares the right to elect to receive ordinary shares credited as fully paid instead of cash in respect of the whole or part of all such dividends as may be specified by the resolution. Any general meeting declaring a dividend may, upon the recommendation of the Directors, direct payment or satisfaction of such dividend to be wholly or partly by the distribution of specific assets. Where difficulty arises in regard to distribution, the Directors may ignore fractions or issue fractional certificates, fix the value for distribution of any assets

and may determine that cash shall be paid to any shareholder in order to adjust the rights of such members.

Any dividend which has been unclaimed for 12 years from the date when it became due for payment shall, if the Directors so resolve, be forfeited and shall cease to be owed by the Company.

The Company can cease sending dividend warrants and cheques by post or otherwise if these have been returned undelivered to, or left uncashed by, the shareholder on at least 2 consecutive occasions, or, if following 1 such occasion, reasonable enquiries have failed to establish the member's new address. No dividend shall bear interest against the Company, unless provided by the rights attached to the share.

Voting rights

Voting at any general meeting of shareholders is by a show of hands unless a poll is demanded. On a show of hands, every shareholder who is present in person at a general meeting (and every proxy appointed by a shareholder and present at a general meeting) has 1 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 1 vote for every share held by the shareholder. A shareholder (or his duly appointed proxy) entitled to more than 1 vote need not use all his votes or cast all the votes he uses in the same way. A poll may be demanded by any of the following:

- the chairman of the meeting;
- the Directors;
- not less than 5 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).

Matters are transacted at general meetings of the Company by proposing and passing of 2 kinds of resolutions:

- ordinary resolutions, which can include resolutions for the appointment, reappointment and removal of Directors, the receiving of the Annual Report, the declaration of final dividends, the appointment and reappointment of the external auditor, the increase of authorised share capital and the grant of authority to allot shares; and

- special resolutions, which can include resolutions amending the Company's Memorandum or Articles of Association and resolutions relating to certain matters concerning a winding-up of the Company.

An ordinary resolution requires the affirmative vote of a simple majority of the votes cast at a meeting at which there is a quorum in order to be passed. Special resolutions require the affirmative vote of not less than three-quarters of the votes cast at a meeting at which there is a quorum in order to be passed. The necessary quorum for a meeting of the Company is a minimum of 2 shareholders present in person or by proxy or by a duly authorised representative(s) of a corporation which is a shareholder and entitled to vote.

In the case of an equality of votes, whether on a show of hands or on a poll, the chairman of the meeting is entitled to a casting vote in addition to any other votes he may have.

Winding-up

If the Company is wound up, the liquidator may, with the sanction of a special resolution and any other sanction required by law, subject to the provisions of the Acts, divide among the shareholders the whole or any part of the assets of the Company, and may, for that purpose, value any assets and determine how the division is to take place as between the shareholders or different classes of shareholders. Alternatively, with the same sanction, the liquidator may vest the whole or any part of the assets in trustees upon trusts for the benefit of the shareholders, but no shareholder will be compelled to accept any asset upon which there is a liability.

Transfer of shares

Shares may be transferred by an instrument of transfer in any usual form or in any other form which the Directors may approve and shall be executed by or on behalf of the transferor and, where the share is not fully paid, by or on behalf of the transferee. The Directors can, in their absolute discretion, refuse to register the transfer of a share in certificated form which is not fully paid, provided that such a refusal would not prevent dealings in shares in certificated form which are not fully paid from taking place on a proper basis. The Directors may also refuse to register a transfer of a share in certificated form (whether fully paid or not) unless the instrument of transfer:

- is lodged, duly stamped, and is deposited at the registered office of the Company or such other place as the Directors may appoint and is accompanied by a certificate for the shares to which it relates and such other evidence as the Directors may reasonably require to show the right of the transferor to make the transfer;
- is in respect of only 1 class of share; and
- is in favour of not more than 4 transferees.

Directors' report *continued*

In the case of uncertificated shares transfers shall be registered only in accordance with the terms of the Uncertificated Securities Regulations 2001 so that Directors may refuse to register a transfer which would require shares to be held jointly by more than 4 persons.

If the Directors refuse to register a transfer of shares, they must give the transferee notice of this refusal as soon as practicable and in any event within 2 months of the instrument of transfer being lodged with the Company. 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 30 days in any year, as the Directors may determine.

Pre-emptive rights and new issues of shares

While holders of ordinary shares have no pre-emptive rights under the Articles of Association, the ability of the Directors to cause the Company to issue shares, securities convertible into shares or rights to shares, otherwise than pursuant to an employee share scheme, is restricted. Under the Companies Acts, the Directors of a company are, with certain exceptions, unable to allot any equity securities without express authorisation, which may be contained in a company's Articles of Association or given by its shareholders in general meeting, but which in either event cannot last for more than 5 years. Under the Companies Acts, the Company may also not allot shares for cash (otherwise than pursuant to an employee share scheme) without first making an offer to existing shareholders to allot such shares to them on the same or more favourable terms in proportion to their respective shareholdings, unless this requirement is waived by a special resolution of the shareholders.

Alteration of share capital

The Company may, from time to time, by ordinary resolution:

- 1) increase its share capital by such amount as the resolution prescribes;
- 2) consolidate and divide all or any of its shares into shares of a larger amount than its existing shares;
- 3) sub-divide any of its shares into shares of smaller amount than is fixed by the Company's Memorandum of Association;
- 4) 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
- 5) 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 share so cancelled.

The Company may, by special resolution, reduce its share capital, its capital redemption reserve and any share premium account in any way. Subject to the provisions of the Companies Acts, the Company may purchase its own shares, including redeemable shares, and may hold such shares as treasury shares or cancel them.

Disclosure of interests in the Company's shares

There are no provisions in the Articles of Association whereby persons acquiring, holding or disposing of a certain percentage of the Company's shares are required to make disclosure of their ownership percentage, although there are such requirements under the Companies Acts. The basic disclosure requirement under Part 6 of the Financial Services and Markets Act 2000 and Rule 5 of the Disclosure and Transparency Rules made by the Financial Services Authority imposes a statutory obligation on a person to notify the Company and the Financial Services Authority of the percentage of the voting rights in the Company he directly or indirectly holds or controls, or has rights over, through his direct or indirect holding of certain financial instruments, if the percentage of those voting rights:

- reaches, exceeds or falls below 3 per cent and/or any subsequent whole percentage figure as a result of an acquisition or disposal of shares or financial instruments; or
- reaches, exceeds or falls below any such threshold as a result of any change in the number of voting rights attached to shares in the Company.

The Disclosure and Transparency Rules set out in detail the circumstances in which an obligation of disclosure will arise, as well as certain exemptions from those obligations for specified persons.

Under Section 793 of the Companies Act 2006, the Company may, by notice in writing, require a person that the Company knows or has reasonable cause to believe is or was during the 3 years preceding the date of notice interested in the Company's shares, to indicate whether or not that is the case and, if that person does or did hold an interest in the Company's shares, to provide certain information as set out in that Act. The Disclosure and Transparency Rules further deal with the disclosure by persons of interests in shares or debentures of the companies of which they are Directors and certain associated companies.

The City Code on Takeovers and Mergers also imposes strict disclosure requirements with regard to dealings in the securities of an offeror or offeree company on all parties to a takeover and also on their respective associates during the course of an offer period.

General meetings and notices

At least 21 clear days' written notice of an Annual General Meeting is required. Any general meeting which is not an Annual General Meeting is called an 'Extraordinary General Meeting' for which at least 14 clear days' written notice is required.

Variation of rights

If the capital of the Company is divided into different classes of shares, the rights attached to any class of shares may only be varied, either in such a manner as provided by those rights or in the absence of any provision, with the consent in writing of three-quarters in nominal value of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of holders of such shares. At any separate meeting, the necessary quorum is 2 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 1 person holding shares of the class or his proxy).

Unless otherwise expressly provided by the rights attached to any shares, those rights shall be deemed to be varied by the reduction of the capital paid up on those shares and by the creation or issue of further shares ranking in priority for payment of a dividend or in respect of capital or which confer on the holders voting rights more favourable than those conferred by the first-mentioned shares, but shall not otherwise be deemed to be varied by the creation or issue of further shares ranking *pari passu* with them or subsequent to them.

Repurchase of shares

Subject to authorisation by shareholder resolution, the Company may purchase its own shares in accordance with the Companies Acts. Any shares which have been bought back may be held as treasury shares or, if not so held, must be cancelled immediately upon completion of the purchase, thereby reducing the amount of the Company's issued share capital.

Charitable and political contributions

Payments for charitable purposes in 2008 amounted to £18.4 million (2007: £16.1 million), £2.1 million of which was paid in the UK (2007: £2.2 million). No donation was made to any political party registered in the UK under the Political Parties, Elections and Referendums Act 2000. Subsidiaries of the Company in Australia, Canada and South Africa made contributions to non-EU political parties in their respective countries of incorporation totalling £69,041 (2007: £85,183).

The Company's current authority to make donations to EU political organisations and to incur EU political expenditure expires on 28 April 2009. Although the Company has no current intention of making donations to political parties in the EU or incurring EU political expenditure, it remains possible that circumstances might arise in which it would be considered to be in the interests of the Company to do so.

Accordingly, shareholders' authority will be sought at the Annual General Meeting on 30 April 2009 to renew the existing authority for a further period of 4 years. Full details are set out in the Notice of Meeting.

Creditor payment policy

Given the international nature of the Group's operations, there is not a global standard code for the Group in respect of payments to suppliers. In the UK, the operating subsidiaries have signed up to the Better Payment Practice Code under which each company undertakes to: (1) seek agreement on payment terms with its suppliers at the outset of each transaction; (2) explain its payment procedures to its suppliers; (3) pay bills in accordance with the agreed terms and all legal requirements; and (4) inform suppliers without delay when contesting an invoice and settle disputes quickly. Details of the Code are available on the website, www.payontime.co.uk.

Non-UK operating subsidiaries are responsible for agreeing terms and conditions for their business transactions when orders for goods and services are placed, ensuring that suppliers are aware of the terms of payment and including the relevant terms in contracts where appropriate. These arrangements are adhered to provided that suppliers meet their contractual commitments.

Creditor days have not been calculated for the Company as it is an investment holding Company and had no trade creditors at 31 December 2008.

OECD Guidelines

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

Intra-group pricing

The prices agreed between Group companies for intra-group sales of materials, manufactured goods, charges for royalties, commissions, services and fees are based on the normal commercial practices which would apply between independent businesses.

On behalf of the Board

Nicola Snook
Secretary

25 February 2009

Remuneration report

Overview

The Group's remuneration policy continues to focus on the achievement of corporate and individual goals aligned to the Group's strategy. A sustainable business, which is at the heart of the Group's strategy, is built upon a balanced approach to achieving growth, improving productivity, operating responsibly and developing a winning organisation.

The effectiveness and the market competitiveness of executive remuneration in the context of the Group's strategy and the need to attract, motivate and retain the high-quality executive talent required to deliver the strategy are the key considerations of the Remuneration Committee. Comprehensive business metrics including established Key Performance Indicators (KPIs) measure the delivery of the Group's strategy.

The consistent theme for a number of years, which will continue in 2009, is to build a strong link between executive remuneration and shareholder value. The total shareholder return elements of the Company's long-term incentive plan (LTIP), in particular the total shareholder return measure which compares the Company against a peer group of international FMCG companies, shows that the Company has consistently ranked second within that comparator group of companies in respect of LTIP awards which vested (or will vest) in each of 2007, 2008 and 2009.

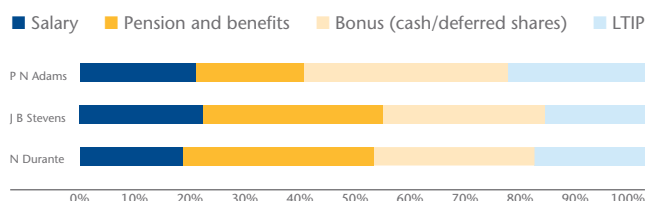
Variable and fixed remuneration

The role of the Remuneration Committee is to determine the policy and framework that apply to the terms of engagement (including remuneration) of the Chairman, the Executive Directors and the members of the Management Board. It also determines the remuneration of each of them (including, where appropriate, awards under share incentive schemes and pension scheme participation) and any compensation payments.

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

The composition in the case of the current Executive Directors for 2008 is illustrated in the bar chart below:

Executive Directors' percentage of fixed and variable remuneration



Notes:

- 1 The above illustration of the current Executive Directors' percentage of fixed and variable remuneration for 2008 is based on a number of assumptions: (1) base salary represents annual salary; (2) pension represents the transfer value of net increase in pension to the UK Pension Fund as disclosed in Table 4; (3) benefits are core benefits such as car/car allowance, private medical and personal accident insurance; (4) bonus is the amount received for performance in 2008 delivered in cash and deferred shares; and (5) LTIP represents the target annualised expected value of the long-term incentive award granted in 2008 expressed as a percentage of base salary.
- 2 Fixed remuneration comprises: salary, pension and benefits. Variable remuneration comprises: bonus (cash and deferred shares) and LTIP.

2008 in focus

The Remuneration Committee continues to promote a simple and transparent approach for the remuneration packages of the senior executive team. The value of this focus is clarity for shareholders and no ambiguity for any eligible participants about the required performance levels.

Responsible benchmarking is a key element of setting the reward opportunity for Executive Directors. As in 2007, the Remuneration Committee considered additional external market reference points to further enhance the robustness of the decision-making framework for pay.

As a result, in 2008, the established peer group of selected FTSE 100 companies (the Pay Comparator Group) was supplemented by market data of FTSE 350 companies taking into account the relative scale and complexity of each company as well as the practice of the FTSE 30 companies. The Pay Comparator Group, which is reviewed annually, is made up of companies with a consumer goods focus, an international spread of operations and those which are considered to be a competitor for top management talent.

The Pay Comparator Group has been in use for a number of years to ensure that base salaries and executive reward continue to be market competitive. During 2008, the constituent companies were reviewed and Associated British Foods was added and Scottish & Newcastle removed for the purposes of the 2009 pay review.

The constituent companies in the Pay Comparator Group as at 31 December 2008 are set out below:

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

From 2009, data on the Company's closest competitor, Philip Morris International, will be taken as an additional reference point for the pay review.

The long-term element of remuneration is delivered through the Company's LTIP. In February 2008, as part of the annual benchmarking review, the Committee considered whether the total potential remuneration continued to be competitive against the market. The review showed that there was a significant shortfall in the total compensation available at higher levels of performance. On this basis, awards made under the LTIP in 2008 were increased from 250 per cent to 300 per cent of salary for the Chief Executive and from 200 per cent to 250 per cent of salary for the Finance Director and Chief Operating Officer. Awards for the Management Board were increased from 150 per cent to 200 per cent of salary. In order to maintain the positioning of the package at 'target' performance, an adjustment was made to the performance schedule for the 2008 award to the Executive Directors and the Management Board such that the same percentage of salary would vest for threshold performance before and after the increase in the award. The maximum award will be achievable only where stretching performance targets are achieved in full.

The Remuneration Committee consulted shareholders prior to making awards in 2008, advising them of the increase in award sizes and offering them the opportunity to comment. The new vesting schedule and award levels will also be applied to the LTIP awards to be made in 2009.

The Company's key remuneration principles for Executive Directors and the Management Board are summarised in the Remuneration policy summary table.

Salary

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

where, with reference to external market practice, salary increases are linked to individual performance.

The Remuneration Committee continues to accept that the requirements of recruitment or retention may on occasion justify the payment of a salary outside the range regarded as appropriate for a particular position.

The remuneration of the Executive Directors is reviewed in February each year, with salary increases effective from April. With effect from 1 April 2009, the base salary for Paul Adams (Chief Executive) will be £1,225,000 (1 April 2008: £1,180,000), for Nicandro Durante £630,000 (1 January 2008, upon becoming Chief Operating Officer: £600,000) and Ben Stevens £590,000 (30 April 2008, upon becoming Finance Director: £560,000).

In addition to basic salary, the Executive Directors and members of the Management Board receive certain benefits in kind, principally a car or car allowance as well as private medical and personal accident insurance. The Executive Directors also receive as a benefit the use of a driver.

Performance-related bonus plans

Details of the International Executive Incentive Scheme (IEIS) are shown in the Remuneration policy summary table.

As reported in 2007, the maximum bonus opportunity was increased in 2008 for the Executive Directors and the Management Board. The annual bonus opportunity, both on-target and maximum, for the Executive Directors and Management Board in 2008, and which will be the same in 2009, are shown in the table below.

Role	On-target bonus %	Maximum bonus %
Chief Executive	100	200
Finance Director	90	180
Chief Operating Officer	90	180
Management Board	67.5	135

The IEIS rewards short-term business performance within the context of longer-term sustainability and any resulting award is delivered as 50 per cent cash and 50 per cent deferred shares (through the Deferred Share Bonus Scheme). Demanding targets are set by the Remuneration Committee at the beginning of each year and are measured in terms of both business and financial performance.

In 2008, the targets reflected the 5 common measures referred to in the Remuneration policy summary table. These are identified as the key drivers of sustained performance and have an equal weighting of 20 per cent. The performance points (described below) are set at the start of the year by reference to the projected performance for each target in the context of the Group's annual budget.

Remuneration report continued

Remuneration policy summary for Executive Directors and the Management Board

Remuneration constituents	Purpose	Delivery	Policy
Base salary	<ul style="list-style-type: none"> – reward individual performance – reflect skills and experience 	<ul style="list-style-type: none"> – cash – monthly 	<ul style="list-style-type: none"> – annual review (or on a significant change of responsibilities) with salary changes effective from April – benchmarked for appropriate salary levels using a company size and complexity model coupled with: (1) the Pay Comparator Group with a mainly international consumer goods focus chosen from the FTSE 100 Index; and (2) published salary data for FTSE 350 companies – Management Board members are reviewed on the Pay Comparator Group – base salary is pensionable
Performance-related bonus	<ul style="list-style-type: none"> – incentivise the attainment of corporate targets on an annual basis 	<ul style="list-style-type: none"> – International Executive Incentive Scheme (IEIS) – annual awards – 50 per cent cash – 50 per cent shares (deferred shares) – deferred shares held in trust for 3 years and participants receive cash sum equivalent to the dividend on the after-tax position of all unvested deferred shares held at the dividend record date 	<ul style="list-style-type: none"> – 6 common measures for performance from 2009: underlying operating profit, market share, Global Drive Brand volume, net revenue and cash flow; and (new for 2009) costs – the ‘on target’ bonus opportunity for the Chief Executive is 100 per cent of the base salary with a maximum award of 200 per cent of salary, and for the Chief Operating Officer and Finance Director the ‘on target’ bonus opportunity is 90 per cent with a maximum award of 180 per cent – for the Management Board the ‘on target’ bonus opportunity is 67.5 per cent of the base salary with a maximum award of 135 per cent of salary – awards are non-pensionable
Long-term incentives (2007 LTIP)	<ul style="list-style-type: none"> – incentivise growth in earnings per share and total shareholder return (TSR) over a 3 year period 	<ul style="list-style-type: none"> – awards of shares – variable due to performance over 3 year period – discretionary annual award – LTIP dividend equivalent – the proportion of shares awarded under an LTIP award which later lapse upon the vesting of an award do not attract the LTIP dividend equivalent 	<ul style="list-style-type: none"> – maximum annual award of 300 per cent of salary – cash LTIP dividend equivalent to the dividends that participants would have received as shareholders from the date of the LTIP award to the award’s vesting date – 3 year performance period – TSR performance (50 per cent of the total award) combines both the share price and dividend performance during the 3 year performance period as against 2 comparator groups (25 per cent for each measure): (1) the constituents of the FTSE 100 Index; and (2) a peer group of FMCG companies – earnings per share measure (50 per cent of the total award) relates to earnings per share growth (on an adjusted diluted basis) relative to inflation
Pension	<ul style="list-style-type: none"> – provision of competitive post-retirement benefits 	<ul style="list-style-type: none"> – British American Tobacco UK Pension Fund; defined benefit plan (up to April 2005) – benefit paid as ongoing pension 	<ul style="list-style-type: none"> – pension accrues at 1/40th of annual basic salary – normal pensionable age of 60 – maximum pension payable will not exceed 2/3 of base salary averaged over the preceding 12 months – UK Pension Fund retains a scheme-specific cap following the introduction of the new UK pension regime in April 2006 – excess benefits continue to be accrued within an unfunded unapproved retirement benefits scheme

Subject to the Committee exercising its judgement in the assessment of the quality of the Company's overall performance, payouts for each measure are determined on a sliding scale with 3 performance points. These are: threshold (which must be exceeded to attract any payment of a bonus for that measure); target; and maximum amount (the level at which the bonus for that measure is capped).

In respect of the year ended 31 December 2008, the bonus payouts under the IEIS were 169.4 per cent for the Chief Executive; 153.5 per cent for each of the Finance Director and Chief Operating Officer; and 116.7 per cent for the members of the Management Board. The actual performance related pay values are shown in Table 1 – annual cash bonus and deferred share bonus.

The Committee receives reports from management to allow it to determine the extent to which performance measures have been achieved. No elements of the bonuses are guaranteed and, as in previous years, the specific targets are commercially sensitive and not made public.

Awards made under the Deferred Share Bonus Scheme (the Deferred Scheme) are in the form of free ordinary shares in the Company which are normally held in trust for 3 years and no further performance conditions apply in that period. In certain circumstances, such as resigning before the end of the 3 year period, participants may forfeit the shares. The Remuneration Committee encourages a culture of 'ownership' of these awarded shares and participants receive a cash sum equivalent to the dividend on the after-tax position of all unvested ordinary shares held in the Deferred Scheme at the dividend record date.

For performance during 2009 and payout in 2010, an additional measure, focusing on costs, has been added to the 5 existing measures to reflect the broader perspective of sustained business performance. The 6 measures will be equally weighted, each contributing 16.67 per cent, and will continue to operate under the current IEIS framework.

Shareholding guidelines

Executive Directors and members of the Management Board are encouraged by the Remuneration Committee to work towards holding ordinary shares in the Company to the levels outlined below. The shareholding guidelines are stated as being the current value of an individual's shareholding expressed as a percentage of salary and excludes shares earned but not yet vested under Company share plans.

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

Of the Executive Directors, Paul Adams (Chief Executive) and Nicandro Durante (Chief Operating Officer) currently meet the shareholding guidelines; there are transitional provisions for individuals joining the Board or becoming members of the Management Board who do not meet the requirements of the shareholding guidelines upon appointment. In such cases, individuals may only sell a maximum of up to 50 per cent of any shares vesting (after tax) under Company share plans until the threshold under the shareholding guidelines has been met.

The interests of the Directors of the Company in the ordinary shares of the Company are shown in Table 2.

Long-term incentive plan

All the Executive Directors, members of the Management Board and senior employees participate in the long-term incentive plan adopted in 2007 (the 2007 LTIP). This plan replaced the LTIP adopted in 1998 (1998 LTIP) which has now expired. The 2007 LTIP provides for awards of free ordinary shares, provided demanding and stretching performance conditions are met over a 3 year period. The first award under the 2007 LTIP was made in May 2007.

The Remuneration policy summary table sets out the key parameters of the plan.

Award levels

During 2008, as explained above, award levels were increased as part of delivering a competitive total remuneration package, and the following LTIP awards were granted, based on salary as at 1 January 2008.

These award levels will continue to apply to awards made in 2009.

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

The maximum annual award under the rules of the 2007 LTIP is 300 per cent of base salary. The Committee continues to review the application of this limit in the context of its policy overall.

For the award made in 2008, the performance schedule was structured such that the same percentage of salary will vest for threshold performance for Executive Directors and the Management Board as for awards made in 2007. This was achieved by reducing the entry level vesting for median ranked performance for each portion of the total shareholder return (TSR) performance condition from 7.5 per cent to 6 per cent of the award; and reducing the entry level vesting for EPS growth from 10 per cent to 8 per cent of the award. This maintains the positioning of the total remuneration package

Remuneration report continued

for 'target' performance, and increases the opportunity for higher levels of performance. This approach will also apply to the LTIP awards to be made in 2009.

For awards made since 2005 (initially under the 1998 LTIP and from May 2007 under the 2007 LTIP), participants have been entitled to receive a cash payment equivalent to the value of the dividends that they would have received as shareholders on their vesting awards (the LTIP Dividend Equivalent). The LTIP Dividend Equivalent continues to be important in aligning further the interests of senior management with those of shareholders. The values of the LTIP Dividend Equivalent payments for the Executive Directors in respect of the 2006 LTIP award that vests in March 2009 are shown in note 9 to Table 5.

To the extent that the performance conditions have been satisfied following assessment by the Remuneration Committee, awards are normally exercisable between 3 and 10 years after they have been made. An award of shares lapses to the extent that the performance conditions are not satisfied in accordance with the measures set out above at the end of the 3 year performance period.

Performance

Awards are based on a combination of total shareholder return (TSR) and earnings per share (EPS) performance conditions measured over 3 years. The Remuneration Committee considers that both of these measures are widely accepted and understood benchmarks of a company's performance. This combination provides an important spread of measures relevant to the Group's business and market conditions as well as giving a balance between the aspirations of the Executive Directors, the members of the Management Board and shareholders. These performance conditions are stated in the Remuneration policy summary table and considered in more detail below.

TSR performance condition

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

These comparator groups, which are kept under review to ensure that they will remain both relevant and representative, are chosen to reflect the Company's financial and business trading environments. The FMCG comparator group for the outstanding LTIP awards is shown below.

TSR continues to be measured according to the return index calculated by Datastream and reviewed by the Company's independent advisers. It is measured on the basis that all companies' dividends are reinvested in the shares of those companies. The return is the percentage increase in each company's index over the 3 year performance period. The opening and closing indices for this calculation are respectively the average of the index numbers for the last quarter preceding the performance period and for the last quarter of the final year of that performance period – this methodology is employed to reflect movements of the indices over that time as accurately as possible.

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

EPS performance condition

50 per cent of an award is based on earnings per share growth relative to inflation. This element of the award will vest fully if EPS growth over the 3 year performance period is an average of at least 8 per cent per annum in excess of inflation. 10 per cent (8 per cent for the award made in 2008) of this element will vest if the EPS growth over the performance period is 3 per cent in excess of inflation. An award will vest on a pro rata basis between these 2 points. The EPS portion of an award does not vest if EPS growth is less than 3 per cent in excess of inflation.

These targets are in line with and support the Company's strategy to deliver high single-digit EPS growth (on average) over the medium to long term. The maximum target would require 8 per cent per annum growth in earnings ahead of inflation and is considered to be very demanding. The Remuneration Committee will keep these targets under review to ensure that they continue to be appropriately stretching.

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

For future awards, the Committee has decided to move to a more standard approach for calculating EPS growth. For awards to be made in 2009, EPS performance will be measured as an increase in adjusted diluted EPS between the base year and the final year of the performance period, expressed as an annual growth rate over the period. Under this approach only the base year and final year adjusted diluted EPS results are considered.

However, on the basis that rolling annual awards are made, all years of performance ultimately will be taken into account in calculating EPS growth over time. This change has been made in order to simplify the approach and to bring it into line with prevailing market practice. Where EPS grows at a relatively constant rate, the 2 methodologies will produce broadly similar results, although the outcome will differ for different growth profiles. Both the previous and new approaches are considered to be a fair and reasonable measure of performance.

1998 LTIP

Following the adoption of the 2007 LTIP, no further awards were made under the 1998 LTIP. However, it is necessary to report on the vesting of the award made under the 1998 LTIP in 2006.

Vesting of LTIP award made in 2006

As reported last year, 100 per cent of the LTIP award granted in 2005 vested on 17 May 2008. The eighth LTIP award was made in 2006, with the performance period being completed at 31 December 2008. The Remuneration Committee has assessed the performance of the Company against the 2 performance conditions outlined above and has determined that 100 per cent of the award will vest. On the TSR measure, the Company ranked seventh out of the FTSE 100 group of companies, giving a vesting of 25 per cent for performance at the upper quartile. A vesting of 25 per cent was achieved for ranking second out of the peer group of international FMCG companies, this being upper quartile. EPS growth was 7.97 per cent per annum in excess of inflation. The Remuneration Committee, in its overall assessment of both LTIP measures, determined that this resulted in a full vesting of 100 per cent. Members of the FMCG peer group are set out below:

FMCG peer group:

Altria Group/PMI ²	Japan Tobacco ⁴
Anheuser-Busch InBev	Johnson & Johnson
Cadbury	Kellogg
Campbell Soup	Kimberly-Clark
Carlsberg	LVMH
Coca-Cola	Nestle
Colgate-Palmolive	PepsiCo
Danone	Pernod Ricard ⁴
Diageo	Procter & Gamble
Heineken	Reckitt Benckiser
HJ Heinz	SABMiller
The Hershey Company ³	Sara Lee
Imperial Tobacco Group	Unilever

1 The following comparator companies have delisted since the relevant dates of grant (2006, 2007 and 2008): Altadis, Gallaher, The Gillette Company, InBev, Scottish & Newcastle and Wrigley.

2 For the 2006 and 2007 awards, Altria Group is tracked until the demerger of Philip Morris International on 17 March 2008, and a market cap weighted basket of Philip Morris International and Altria Group is tracked from March 2008. For the 2008 awards, Philip Morris International is tracked from the point of the demerger.

3 2006 awards only.

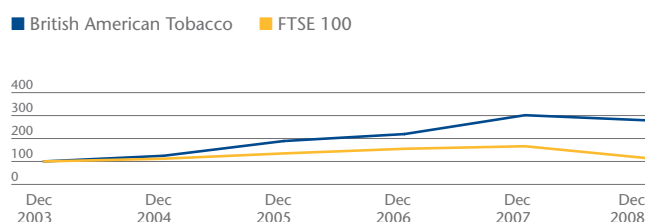
4 2007 and 2008 awards only.

Performance graph

Schedule 7A to the Companies Act 1985 requires that the Company must provide a graph comparing the TSR performance of a hypothetical holding of shares in the Company with a broad equity market index over a 5 year period. In this context, the Directors have again chosen to illustrate the performance of TSR against the FTSE 100 Index over a 5 year period, commencing on 1 January 2004. In the opinion of the Directors, the FTSE 100 Index is the most appropriate index against which TSR should be measured because it is a widely used and understood index of broadly similar sized UK companies to the Company. The performance graph is shown below.

Historical total shareholder return performance

Growth in the value of a hypothetical £100 holding over 5 years
FTSE 100 comparison based on 30 trading day average values.

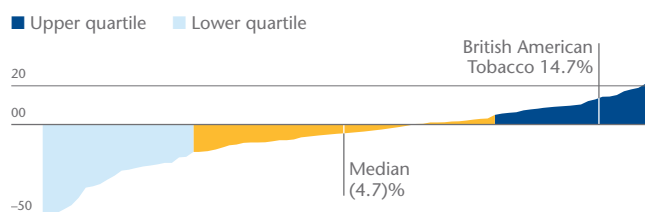


In addition to the performance graph, shown below there are illustrative graphs that show the relative position on the TSR measures for the LTIP award vesting in March 2009.

Total shareholder return (annual %)

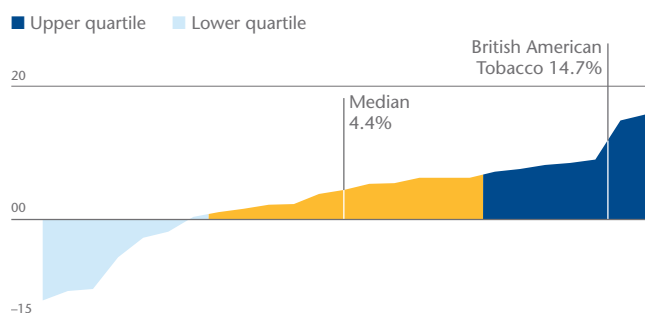
FTSE 100 – 1 January 2006 to 31 December 2008

The FTSE 100 comparison is based on 3 months' average values.



FMCG group – 1 January 2006 to 31 December 2008

The FMCG group comparison is based on 3 months' average values.



Remuneration report continued

LTIPs – change of control

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

Share Option Scheme

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

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

All-employee share schemes

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

Sharesave Scheme

The Sharesave Scheme is approved by HM Revenue & Customs (HMRC). Eligible employees, including the Executive Directors, have been granted employee savings-related share options to subscribe for ordinary shares in the Company. In November 2008, the Company made a further grant of options under the Sharesave Scheme which allows for options granted to be exercisable in conjunction with either a 3 year or 5 year savings contract up to a monthly limit of £250. Options are normally granted at a discount of 20 per cent to the market price at the time of the invitation, as permitted under the rules of the Sharesave Scheme. At 31 December 2008, all the Executive Directors participated in the Sharesave Scheme, each saving the maximum monthly amount.

Employee Share Ownership Plan

The Employee Share Ownership Plan is a HMRC approved share incentive plan, which incorporates a Partnership and Free Shares element. The Partnership Share Scheme is open to all eligible employees, including Executive Directors. Employees can allocate part of their pre-tax salary to purchase shares in the Company. The maximum amount that can be allocated in this way is £1,500 in any year. Shares purchased are held in a UK-based trust, normally capable of transfer to participants tax-free after a 5 year holding period. At 31 December 2008, of the Executive Directors, Paul Adams and Nicandro Durante, participated in the Partnership Share Scheme, each investing the maximum monthly contribution.

The Company also operates the Free Shares element of the plan, known as the Share Reward Scheme. Under this Scheme, eligible employees (including Executive Directors) receive an appropriation of shares in April of each year in which the Scheme operates in respect of performance in the previous financial year. In this way, an award of £2,706 will be made to Executive Directors and members of the Management Board on 1 April 2009 in respect of the year ended 31 December 2008. The performance conditions are aligned to those set for the IEIS in respect of the same performance period. The plan shares are held in a UK-based trust for a minimum period of 3 years and during that time the trust will exercise its voting rights as directed by the plan's participants. The maximum individual award under the Share Reward Scheme is £3,000.

Options and awards outstanding

Employee Share Ownership Trust

To satisfy the future exercise of options or awards under the Group's employee share schemes, ordinary shares are acquired in the market by an existing employee share ownership trust – the British American Tobacco Group Employee Trust (BATGET). During the year, new ordinary shares were issued by the Company in relation to the Sharesave Scheme and to certain participants in the Share Option Scheme resident outside the UK.

Under the Sharesave Scheme, a total of 1,355,709 options over ordinary shares in the Company were outstanding at 31 December 2008. The options outstanding under the Sharesave Scheme are exercisable until June 2014 at option prices ranging from 568p to 1435p.

BATGET is used to satisfy the future exercise of options under the Share Option Scheme and the vesting and exercise of awards of ordinary shares made under the Deferred Scheme, and the 1998 LTIP and the 2007 LTIP respectively. The number of shares held in BATGET to satisfy outstanding awards is consistently monitored by a committee of senior management that reports

to a committee of the Board. BATGET is funded by interest-free loan facilities from the Company totalling £400 million, enabling the trust to facilitate the purchase of ordinary shares to satisfy the future vesting or exercise of options and awards. The loan to BATGET amounted to £193 million at 31 December 2008 (2007: £263 million). The loan is either repaid from the proceeds of the exercise of options or, in the case of ordinary shares acquired by BATGET to satisfy the vesting and exercise of awards, the Company will subsequently waive the loan provided over the life of the awards. If the options lapse, ordinary shares may be sold by BATGET to cover the loan repayment.

BATGET currently waives dividends on the ordinary shares held by it. As at 31 December 2008, BATGET held 14,137,074 ordinary shares with a market value of £254.5 million (1 January 2008: 13,987,584 ordinary shares; £274.9 million). BATGET waived payment of the final dividend for 2007 of £6.5 million in May 2008 and the interim dividend for 2008 of £3.3 million in September 2008.

Where shares held in BATGET have been transferred out to share scheme participants, the participants may exercise their voting rights. Where shares are held by BATGET and have not been transferred out to the participants, the trustee of BATGET does not exercise any voting rights.

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

Executive Directors' pension benefits

Details of the basic pension entitlements are shown in the Remuneration policy summary table. Retirement benefits form an important part of the overall compensation and benefits package provided by the Group and the Executive Directors (with the exception of Nicandro Durante) are, like other employees, eligible for membership of the British American Tobacco UK Pension Fund (Pension Fund).

The Pension Fund, for members who joined before 1 April 2005, is a non-contributory defined benefit scheme and includes provision for spouses' benefits on death in service or after retirement. In the event of death in service, a spouse's pension equal to half of the member's prospective pension at normal retirement age would be payable. A spouse's pension payable in the event of death after retirement is equal to half of the member's full pension, irrespective of any decision to exchange part of the benefit for a lump sum. The early retirement rules in the Pension Fund permit a member to draw the accrued retirement pension within 5 years of normal retirement age without actuarial reduction, subject to the employing company's agreement. Alternatively, an Executive Director may choose

to leave and take a pension at any time on or after his or her 50th birthday without the employing company's agreement, subject to a reduction as determined by the Pension Fund trustee in conjunction with the Pension Fund actuary. Accrual rates differ according to individual circumstances but do not exceed one-fortieth of pensionable salary for each year of pensionable service.

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

Paul Adams, Paul Rayner (who ceased to be a Director on 30 April 2008 and resigned from the Company on 31 July 2008) and Ben Stevens each joined the Pension Fund after 1989. As a result, prior to 6 April 2006, these individuals were subject to the HM Revenue & Customs cap on pensionable earnings (notionally £117,600 for the tax year 2008/09). In addition, each has an unfunded pension promise from the Company in respect of earnings above the cap on an equivalent basis to the benefits provided by the Pension Fund. This is provided through membership of an unfunded unapproved retirement benefit scheme (UURBS).

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

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

At the time of his departure on 31 July 2008, Paul Rayner was 54 years old. The rules of the Pension Fund allow for retirement (with the employing company's consent) at the age of 55 with the payment of an unreduced pension. Given the circumstances of Mr Rayner's departure, the Remuneration Committee exercised its discretion and agreed that Paul Rayner should receive a pension based on his pensionable salary and service at the date of leaving the Company payable from the UURBS until his 60th birthday. At the age of 60, the UURBS benefit will be reduced by the equivalent benefit payable from the Pension Fund, currently £69,000 per annum. Details of the actual benefits paid to Paul Rayner following his retirement and the associated values are set out in Table 4 in this Remuneration report.

Remuneration report continued

Paul Rayner also has an accumulated defined contribution entitlement from Division A of the British American Tobacco Australia Superannuation Fund of about AUD1.7 million and which may be drawn from the age of 55. No contributions were paid to this arrangement on behalf of Paul Rayner from 1 January 2008 to the date of his leaving the Company.

Nicandro Durante, who was appointed an Executive Director with effect from 1 January 2008, is a member of the Fundacao Albino Souza Cruz in Brazil. This is a non-contributory defined benefit scheme and includes a spouse's death in service benefit equal to 37.5 per cent of the member's prospective pension at normal retirement age. Accrual rates do not exceed 1.85 per cent of basic salary (excluding bonus) averaged over the 12 months to normal retirement age, for each year of pensionable service. Nicandro Durante's pensionable salary will be reviewed by the Company annually with reference to the salary of that of a General Manager of Souza Cruz SA which will increase annually in line with local practice. In addition, Nicandro Durante accrues a pension of 0.65 per cent for each year of service based on his 12 month average UK basic salary (excluding bonus) with effect from 1 March 2006, that being the date of his appointment as a member of the Management Board. This benefit is provided through the UURBS.

Executive Directors' service contracts

The Remuneration Committee continues to operate a policy of 1 year rolling contracts for Executive Directors. Each Executive Director has such a contract, executed at the time of his original appointment. The contract may be re-executed during the term of his 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 1 year rolling period.

In addition, the Remuneration Committee maintains discretion in respect of this policy for those future Executive Directors who may be recruited externally or from overseas, when it may be appropriate to offer a contract with an initial period of longer than 1 year, reducing to a 1 year rolling contract after the expiry of the initial period. It is the policy that an Executive Director's 1 year rolling contract incorporates a provision for a termination or compensation payment in lieu of notice.

An Executive Director's compensation payment, in lieu of notice, would comprise: (1) 12 months' salary at his then current base pay; and (2) a cash payment in respect of other benefits under the contract such as medical insurance, or the Company may at its option continue those benefits for a 12 month period. The Committee maintains discretion as to how to deal with any grants or awards made prior to termination under the LTIPs, the Deferred Scheme and the Share Option Scheme

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

The compensation payment is payable where the requisite 12 months' notice is not given to the Executive Director or when he terminates by giving 12 months' notice and the Company does not wish him to serve his notice. If a period of notice is served, the compensation payment is reduced pro rata. In the unlikely event that the contract is terminated for cause (such as gross misconduct), the Company may terminate the contract with immediate effect and therefore 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, Nicandro Durante retains certain termination or compensation rights in respect of his former employment with Souza Cruz SA. In the event of any compensation being payable to Nicandro Durante pursuant to his service contract with the Company, these Souza Cruz rights will be taken into account first in arriving at a final compensation amount in order that he does not benefit twice from these dual arrangements.

External appointments

Executive Directors and members of the Management Board are able to accept 1 substantive external Board appointment provided that permission is respectively sought from the Board or Chairman. The fees from such appointments are retained for a Director's own account, thereby recognising the increasing level of personal commitment and expertise required for non-executive roles. None of the present Executive Directors currently holds such an appointment. During the year ended 31 December 2008, Paul Rayner (who retired as a Director on 30 April 2008) served as a non-executive director of Centrica plc and the fees from this appointment from 1 January 2008 to 30 April 2008 totalled £26,000.

With effect from 5 December 2008, Nicandro Durante, an Executive Director of the Company, was designated by Brown & Williamson Holdings, Inc. (a wholly owned indirect subsidiary of the Company), as its nominee to join the Board of Reynolds American Inc (RAI) (an associated undertaking of the Company) as a non-executive director in succession to Antonio Monteiro de Castro (an Executive Director of the Company until 31 December 2007). The Group received a pro-rated fee of US\$17,427 from RAI in respect of Nicandro Durante's service from his date of appointment to 31 December 2008 and, in accordance with present arrangements, the Group will receive an annual fee of US\$215,020 in respect of his services in that role.

Non-Executive Directors' terms of appointment

The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment. For Non-Executive Directors appointed before 1 October 2007, the terms of appointment of each such Director provide that he or she is appointed for a specified term, being an initial period to the next Annual General Meeting after appointment and, subject to reappointment at that meeting, for a further period ending at the Annual General Meeting held 3 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 2 year term; such appointment being subject to approval by shareholders in accordance with the terms of the provisions of the Company's Articles of Association relating to the rotation of Directors.

The date of appointment and most recent reappointment is shown below for each Non-Executive Director:

	Date of appointment	Date of last reappointment at Annual General Meeting
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
K M A de Segundo	1 October 2007	30 April 2008
M H Visser*	1 April 2001	26 April 2007

*Thys Visser is scheduled to retire at the conclusion of the 2009 Annual General Meeting.

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.

Non-Executive Directors' remuneration policy

The fees for the Non-Executive Directors are considered annually on the recommendation of the Chairman and the Chief Executive. They are determined in light of market best practice and with reference to the time commitment and responsibilities associated with the roles. In order to recognise the increased focus on the roles and responsibilities of the Non-Executive Directors, coupled with the need to ensure that the Company is able to continue to attract and retain high calibre individuals to such non-executive roles, the basic annual fee for Non-Executive Directors was increased from £75,000 to £90,000 with effect from 1 January 2009.

The basic annual fee reflects the Board's view of the inclusive nature of the duties of the Non-Executive Directors which is reflected in its policy that Non-Executive Directors do not receive additional fees for attendance at Board Committee

meetings. It is expected that all Non-Executive Directors will sit on the Remuneration and the Nominations Committees and will either be a member of the Audit Committee or the Corporate Social Responsibility Committee.

Kenneth Clarke retired from the Board at the conclusion of the Company's Annual General Meeting on 30 April 2008 and therefore ceased to be the Deputy Chairman and Chairman of the Corporate Social Responsibility and the Remuneration Committees. Following his retirement, the position of Deputy Chairman ceased and the Board adopted a new fee structure for the Non-Executive Directors. The Board agreed (with effect from 1 May 2008) to introduce a supplemental annual fee of £25,000 for the Senior Independent Director (SID); to increase the annual supplement for the Chairman of the Audit Committee to £25,000 (an increase of £5,000) and to introduce supplemental annual fees of £20,000 for each of the respective Chairs of the Corporate Social Responsibility (CSR) Committee and the Remuneration Committee.

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

	May-Dec 2008 £	Jan-Dec 2009 £
Basic fee	75,000	90,000
SID supplement	25,000	25,000
Audit Committee Chair	25,000	25,000
CSR Committee Chair	20,000	20,000
Remuneration Committee Chair	20,000	20,000

Non-Executive Directors' fees are determined within the overall aggregate annual limit of £2,500,000 authorised by shareholders with reference to the Company's Articles of Association. An increase in this annual aggregate limit from £2,000,000 to £2,500,000 was approved by shareholders as part of a revision of the Company's Articles of Association at the 2008 Annual General Meeting. The Board as a whole considers the policy and structure for the Non-Executive Directors' fees; the Non-Executive Directors do not participate in discussions on their specific levels of remuneration.

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

Anthony Ruys, a Non-Executive Director, was appointed as a non-executive director of ITC Limited (ITC) (an associated undertaking of the Company) with effect from 20 January 2009. Anthony Ruys will receive a fee from ITC which will be supplemented by the Group so that he receives a total annual fee for this appointment of £75,000.

Remuneration report continued

Chairman's terms of appointment and remuneration

The Remuneration Committee is responsible for determining the terms of engagement and fees payable to the Chairman. This process takes into account the breadth of that role coupled with its associated levels of commitment and expertise. Jan du Plessis' terms of appointment provide that he holds the office of Chairman of the Company with effect from 1 July 2007 for a period of 3 years unless terminated earlier by: (1) the Company giving 3 months' notice or a discretionary compensation payment in lieu of notice; or (2) by the Chairman giving 1 month's written notice with the Company having discretion to make a compensation payment in lieu of such notice. The compensation payment is limited to any fees which are payable for such part of the relevant notice period as the Board does not require the Chairman to perform his duties.

As a Director of the Company, the Chairman is subject to the reappointment of Directors provisions contained in the Company's Articles of Association. The date of his last reappointment as a Director was at the Annual General Meeting held on 30 April 2008. The terms of Jan du Plessis' appointment provide for: (1) an annual fee of £600,000; (2) the benefit of the use of a driver; and (3) private medical insurance and personal accident insurance benefits. In common with the Non-Executive Directors, the Chairman does not participate in the British American Tobacco share schemes, bonus schemes or incentive plans and is not a member of any Group pension plan.

Following the end of the year, the Committee reviewed the fees for the Chairman against practice in the FTSE 30 and agreed to increase his fees to £620,000 with effect from 1 April 2009.

Copies of the Executive Directors' service contracts and the details of the terms of appointment of each Non-Executive Director and the Chairman are available for inspection during normal business hours at the Company's registered office and will also be available for inspection at the Annual General Meeting on 30 April 2009.

Appendices to the Remuneration report

The Remuneration Committee

Terms of reference

The terms of reference of the Remuneration Committee, together with an explanation of its role and the authorities delegated to it by the Board, are available from the Company Secretary on request and can be accessed on the Corporate governance section of www.bat.com. The terms of reference of the Remuneration Committee do not currently provide for the Committee to consider corporate performance on environmental, social and governance (ESG) issues when

setting the reward structure for Executive Directors and the members of the Management Board. However, the Board continues to recognise the importance of ESG issues. Governance is embedded in the organisation as evidenced by our strong governance structure – see the corporate governance statement. In addition, the delivery of our strategic vision encompasses the business measure of Responsibility for which we have used the Dow Jones Sustainability Indexes (an external benchmark) as our primary measure to assess our successful performance to date.

Membership

At the date of this report, the Committee comprises the following independent Non-Executive Directors of the Company: Anthony Ruys (Chairman of the Remuneration Committee); Karen de Segundo; Robert Lerwill; Ana Maria Llopis; Christine Morin-Postel; and Sir Nicholas Scheele. Kenneth Clarke ceased to be Chairman of the Remuneration Committee upon his retirement as a Non-Executive Director at the conclusion of the Annual General Meeting of the Company on 30 April 2008.

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

No Executive Director or other member of the Management Board plays any part in determining his or her remuneration. During the year ended 31 December 2008, the Chief Executive was consulted and invited to attend meetings of the Committee, except when his own remuneration was under consideration. In determining remuneration for the year, the Committee consulted the Chief Executive, and the Director, Human Resources and the Head of Reward. The Chairman, Jan du Plessis, was also consulted and invited to attend meetings of the Committee, except when his own remuneration was under consideration. Further information on meetings held and Directors' attendance is disclosed in the Corporate governance statement.

Since 1 January 2008, Deloitte LLP have been appointed to provide remuneration services and advice to the Company with specific reference to the needs of the Remuneration Committee. Deloitte is an international professional services firm which has also provided tax, corporate finance and consulting services to British American Tobacco Group companies around the world during the year.

Herbert Smith LLP has also been retained by the Company to provide legal advice in respect of the Company's share schemes, as well as providing other legal services to British American Tobacco as a whole. In addition, Ernst & Young LLP provides tax advice to international assignees and in respect of the Company's share schemes.

Table 1. Directors' remuneration – audited

	Salary/fees £	Performance- related pay: annual cash bonus £	Performance- related pay: deferred share bonus ² £	Benefits in kind ³ £	2008 Total £	2007 Total £
J P du Plessis	592,500	–	–	93,641	686,141	646,474
P N Adams	1,417,687	999,460	1,056,337	105,104	3,578,588	2,229,273
J B Stevens ¹	528,901	356,992	372,329	96,565	1,354,787	–
N Durante ^{1,4}	516,791	460,500	471,864	279,144	1,728,299	–
K M A de Segundo	88,333	–	–	16,651	104,984	18,796
R E Lerwill	98,333	–	–	19,102	117,435	95,515
A M Llopis	75,000	–	–	–	75,000	75,000
C J M Morin-Postel	75,000	–	–	–	75,000	18,750
A Ruys	88,333	–	–	19,763	108,096	75,562
Sir Nicholas Scheele	91,667	–	–	20,443	112,110	75,887
M H Visser	75,000	–	–	11,018	86,018	81,879
Former Directors						
P E Beyers ¹	–	–	–	–	–	37,500
K H Clarke ¹	55,000	–	–	46,450	101,450	173,909
A Monteiro de Castro ^{1,5}	173,166	–	–	135,875	309,041	1,878,877
P A Rayner ^{1,6}	644,683	626,792	20,798	241,476	1,533,749	1,444,257
R L Pennant-Rea ¹	–	–	–	–	–	25,000
Total remuneration	4,520,394	2,443,744	1,921,328	1,085,232	9,970,698	6,876,679

Notes:

- 1 Rupert Pennant-Rea retired on 26 April 2007; Piet Beyers retired on 30 June 2007; Antonio Monteiro de Castro retired on 31 December 2007; Nicandro Durante and Ben Stevens were appointed on 1 January 2008 and 3 March 2008 respectively; Kenneth Clarke retired on 30 April 2008; and Paul Rayner ceased to be a Director on 30 April 2008 and remained an employee until 31 July 2008. The amounts shown for Ben Stevens have been apportioned to reflect the salary, deferred share bonus payments and benefits in kind received or receivable by him since his date of appointment.
- 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 Executive Directors) in the Deferred Share Bonus Scheme at each dividend record date. For the year ended 31 December 2008, these payments for Executive Directors were as follows: Paul Adams £56,877 (2007: £41,156); Ben Stevens £15,337 (2007: £nil); Nicandro Durante £11,364 (2007: £nil); and Paul Rayner £20,798 (2007: £27,770). Paul Rayner will receive a pro rata cash award in March 2009 in respect of the performance of the Company in 2008 which will include the cash equivalent of the shares which would normally have been awarded under the Deferred Share Bonus Scheme in 2009.
- 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 and/or corporate hospitality events. Non-Executive Directors receive benefits under (c) only.
- 4 Nicandro Durante: benefits in kind include (a) an accommodation allowance of £98,078 payable in respect of his relocation from Brazil; (b) certain travel and related allowances totalling £42,535; and (c) tax payments of £39,045.
- 5 Antonio Monteiro de Castro: (a) amounts shown as 'salary' comprised outstanding holiday entitlement of £56,210 and £116,956 as an LTIP dividend equivalent payment on the vesting of his outstanding LTIP awards – see note 6 to Table 5; and (b) benefits in kind included (i) tax advice (£99,474) in respect of his former contractual arrangements up to 1 January 2004, prior to which date he received his emoluments in both the UK and Brazil; and (ii) payments totalling £36,630 in respect of relocation associated with his retirement.
- 6 Paul Rayner: benefits in kind include (a) payments in respect of family education (£32,867) which followed his relocation to the UK from Australia in 2002; and (b) payments totalling £185,805 in respect of relocation associated with his return to Australia in 2008.
- 7 The Directors' remuneration shown above does not include the illustrative value (as at 23 February 2009) of the Executive Directors' LTIP awards made in March 2006 which will vest on 15 March 2009. Reference should be made to note 7 to Table 5.

Remuneration report continued

Table 2. Directors' interests in British American Tobacco p.l.c. ordinary shares of 25p

	At 1 Jan 2008 or date of appointment	At 31 Dec 2008	Changes from 31 Dec 2008	At 23 Feb 2009
J P du Plessis	50,000	202,836	–	202,836²
P N Adams	143,743	144,147	14	144,161
J B Stevens ¹	19,939	35,196	–	35,196
N Durante ¹	97,594	101,274	13	101,287
K M A de Segundo	5,000	4,050	–	4,050
R E Lerwill	3,000	3,000	–	3,000
A M Llopis	2,200	2,200	–	2,200
C J M Morin-Postel	4,700	4,700	–	4,700
A Ruys	3,000	3,000	–	3,000
Sir Nicholas Scheele	–	5,000	–	5,000
M H Visser	–	597,466	(2)	597,464²

Notes:

- 1 Nicandro Durante and Ben Stevens were appointed Directors on 1 January 2008 and 3 March 2008 respectively. Paul Rayner ceased to be a Director on 30 April 2008 and remained an employee until 31 July 2008.
- 2 Jan du Plessis and Thys Visser held interests in Compagnie Financière Richemont S.A. and Remgro Limited respectively and received a distribution of shares in the Company in accordance with the Restructurings referred to in the Stock Market Listings section of the Directors' report.
- 3 The changes in Directors' interests since 31 December 2008 relate to (a) Paul Adams and Nicandro Durante: the purchase of shares pursuant to the Company's Partnership share scheme; and (b) Thys Visser: revised notification of final number of shares received in accordance with the Restructurings referred to in note 2 above.
- 4 At 1 January 2008 Nicandro Durante also had an interest in 7,100 shares of no par value in the Common Stock of Souza Cruz S.A. (Souza Cruz) of Brazil, the listed company in which British American Tobacco has a 75 per cent interest (31 December 2008: nil shares).
- 5 In addition to the shares shown above, the Executive Directors have the following interests in the ordinary shares of the Company which are held in trust pursuant to the British American Tobacco Deferred share bonus scheme:

	At 1 Jan 2008	Awarded 13 Mar 2008	Released 17 Mar 2008	At 31 Dec 2008
P N Adams	118,683	25,603	37,742	106,544
J B Stevens	32,192	6,655	10,360	28,487
N Durante ^{1,6,7}	10,566 ⁶	6,028	–	16,594⁷
Former Directors				
A Monteiro de Castro ⁸	81,966	–	–	–⁸
P A Rayner ^{1,9}	74,057	15,502	23,977	–⁹

- 6 In addition to these shares, as at 1 January 2008 Nicandro Durante held cash-based awards on equivalent terms to the Deferred share bonus scheme with a value equivalent to 11,983 Deferred shares. These awards will be cash settled by the Company's subsidiary, Souza Cruz, a former employing company of Nicandro Durante.
- 7 6,603 Deferred shares were released to Nicandro Durante in March 2008 and were cash settled by Souza Cruz. In addition to those shown above, at 31 December 2008, Nicandro Durante held cash-based awards on equivalent terms to the Deferred share bonus scheme with a value equivalent to 5,380 Deferred shares that remain outstanding and which will be cash settled by Souza Cruz.
- 8 In the case of the unvested grants made to Antonio Monteiro de Castro, a former Director, under the Deferred share bonus scheme, the Remuneration Committee agreed that these grants would vest in full immediately upon his retirement on 31 December 2007 in accordance with the rules of the scheme. These were released to him in March 2008 and the shares transferred into his own name.
- 9 The Remuneration Committee agreed that, in accordance with the rules of the scheme, the unvested grants made to Paul Rayner under the Deferred share bonus scheme would vest fully upon his leaving the employment of the Company on 31 July 2008. The shares awarded to him in March 2008 were in respect of performance for the year ended 31 December 2007. Subsequently, on 1 August 2008, the vested shares were sold at 1,816p per share.
- 10 The cost of these shares has been included as Directors' emoluments in the prior year. Details of the Deferred share bonus scheme are given in the Remuneration report.
- 11 Based on the performance for 2008, the Executive Directors will each be awarded a number of ordinary shares to the value of £2,706 pursuant to an appropriation of shares under the Share reward scheme on 1 April 2009.
- 12 On 31 December 2008, the Group's employee share ownership trust referred to in the Remuneration report held a total of 14,137,074 ordinary shares in the Company. All participating employees, including the Executive Directors, are deemed to have a beneficial interest in these shares.

Table 3. Executive Directors' share options over British American Tobacco p.l.c. ordinary shares of 25p – audited

Sharesave Scheme

	At 1 Jan 2008 or date of appointment number of shares	Grant price	Granted in 2008 number of shares	Exercised in 2008 ^{2,4} number of shares	At 31 Dec 2008 number of shares	Dates from which exercisable	Latest expiry date
P N Adams	2,492	663.0p	–	–	2,492	Jan 2010	Jun 2010
J B Stevens ¹	2,492	663.0p	–	–	2,492	Jan 2010	Jun 2010
N Durante ¹	1,421	1,152.0p	–	–	1,421	Jan 2012	Jun 2012
Former Director							
P A Rayner ^{1,3}	1,421	1,152.0p	–	–	–³	Jan 2012	Jun 2012

Notes:

- Nicandro Durante and Ben Stevens were appointed Directors on 1 January 2008 and 3 March 2008 respectively. Paul Rayner ceased to be a Director on 30 April 2008 and remained an employee until 31 July 2008.
- Sharesave Scheme: in respect of the Executive Directors, no options lapsed during the year ended 31 December 2008. There have been no variations in the terms and conditions of these interests in share options during the year. Options granted under the Sharesave Scheme are exercisable in conjunction with a 3 year or 5 year savings contract up to a monthly limit of £250. Options are normally granted at a discount of 20 per cent to the market price at the time of the invitation, as permitted under the rules of the Sharesave Scheme.
- Paul Rayner's Sharesave options lapsed upon his leaving the employment of the Company on 31 July 2008 in accordance with the rules of the Sharesave Scheme.
- There were no Sharesave awards exercised by Executive Directors during the year and therefore no aggregate gains were made. The aggregate gain on the exercise of share options during 2007 was £52,656.
- The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 31 December 2008 was 1,800p and the range during the year was 1,450p to 2,049p. The mid-market price on 31 December 2008 exceeded the grant price of all the options detailed in Table 3 above.

Table 4. Executive Directors' pension entitlements – audited

The following Directors were members of defined benefit schemes provided by the Group during the year. Pension entitlements and corresponding transfer values increased as follows during the year:

	Normal retirement age	Total accrued pension at 31 Dec 2008 £	Gross increase in accrued pension £	Increase in accrued pension net of inflation £	Transfer value of net increase in accrual over period £	Transfer value of accrued pension at 31 Dec 2007 £	Transfer value of accrued pension at 31 Dec 2008 £	Total change in transfer value during period £
P N Adams	60	511,300	66,238	62,018	1,271,011	8,571,089	10,478,739	1,907,651
N Durante ^{1,8}	60	287,105	52,802	50,580	924,121	3,992,784	5,245,580	1,252,796
J B Stevens ¹	60	128,804	30,712	29,782	502,450	1,537,795	2,173,058	635,262
Former Director								
P A Rayner ^{1,7}	60	110,825	13,580	12,657	305,416	1,818,705	2,674,163	855,458

Notes:

- Nicandro Durante and Ben Stevens were appointed Directors on 1 January 2008 and 3 March 2008 respectively. Paul Rayner ceased to be a Director on 30 April 2008 and remained an employee until 31 July 2008.
 - The amount of total accrued pension is the pension that would be paid annually on retirement based on service to the end of the year, excluding any increases granted under statute before retirement.
 - The value of net increase in accrued pension represents the incremental value to the Executive Director of his service during the year, calculated on the assumption service terminated at the year end.
 - Changes in the transfer values reflect both individual Executive Director's circumstances such as the date of joining the Pension Fund and changes in salary during the year together with the application of market value adjustments in accordance with actuarial and legislative requirements. At 1 October 2008, new transfer value regulations came into effect. The Trustee of the Pension Fund reviewed the method and assumptions used to calculate transfer values and decided to continue with the transfer value basis in place at that time. Previously, transfer values were calculated in accordance with section 1.5 of version 9.2 of Actuarial Guidance Note GN11 issued by the actuarial profession, but this Guidance Note was withdrawn with effect from 1 October 2008 to coincide with the regulation changes. The Trustee's agreed transfer value basis is consistent with that used for the ongoing funding of the Pension Fund. The transfer values of the accrued entitlement represent the value of assets that the Pension Fund would need to transfer to another pension provider on transferring the Pension Fund's liability in respect of Executive Directors' pension benefits. They do not represent sums payable to individual Executive Directors and, therefore, cannot be added meaningfully to annual remuneration. Further, although Nicandro Durante is not a member of the Pension Fund, the transfer values shown above have been calculated in accordance with the method used for the Pension Fund.
- Although Paul Adams, Paul Rayner and Ben Stevens receive a significant element of their overall entitlement from an unfunded unapproved retirement benefit scheme, the transfer values calculated above have been calculated in accordance with the method used for the Pension Fund.
- The Pension Fund is non-contributory; voluntary contributions paid by Executive Directors and resulting benefits are not shown. No excess retirement benefits have been paid to or are receivable by any Executive Director or past Executive Director of the Company.
 - Antonio Monteiro de Castro retired as an Executive Director on 31 December 2007 and in order to deliver the overall entitlement of £337,372 per annum, a top-up benefit amounting to £133,581 per annum (which was provided through the UURBS) was payable from 1 January 2008. Antonio Monteiro de Castro was also provided with the option of receiving a lump sum in lieu of the annual pension amounting to £2,124,000. This amount was paid on 7 April 2008.
 - Paul Rayner ceased to be an Executive Director on 30 April 2008 and left the Company on 31 July 2008. He started to receive a pension from 1 August 2008. This is payable entirely from the UURBS until age 60. After this time, part of the pension will be paid from the Pension Fund and the remainder met by the Company.
 - Nicandro Durante is entitled to a benefit promise of 0.65% of final sterling pensionable salary (calculated as a 12 month average) in relation to service from 1 March 2006. In addition, he is entitled to a pension from the Souza Cruz Pension Scheme based on an accrual rate of 1.85% of final Brazilian real pensionable salary (calculated as a 12 month average) in relation to service from December 1981. The accrued pension amount and transfer values shown above are based on the sum of these promises (i.e. with accrual since 1 March 2006 being a total of 2.5%). Nicandro Durante is entitled to receive that part of the promise from the Souza Cruz Pension Scheme (based on 1.85% accrual rate) with immediate effect; this entitlement has been ignored for the purposes of the above transfer value.

Remuneration report continued

Table 5. Executive Directors' Long-term incentive plans awards over British American Tobacco p.l.c. ordinary shares of 25p – audited

	LTIP plan	Performance period ending	Award date	At 1 Jan 2008 or date of appointment number of shares	Awarded in 2008 number of shares	Vested in 2008 number of shares	Lapsed in 2008 number of shares	At 31 Dec 2008 number of shares	Value vested 2008 ⁴ £	Vesting date
P N Adams	1998	2007	17 May 2005	143,442	–	143,442	–	–	2,821,504	17 May 2008
	1998	2008	15 Mar 2006	113,493	–	–	–	113,493	–	15 Mar 2009
	2007	2009	15 May 2007	159,337	–	–	–	159,337	–	15 May 2010
	2007	2010	15 May 2008	–	163,418	–	–	163,418	–	15 May 2011
Total				416,272				436,248		
J B Stevens ¹	1998	2007	17 May 2005	42,189	–	42,189	–	–	829,858	17 May 2008
	1998	2008	15 Mar 2006	33,124	–	–	–	33,124	–	15 Mar 2009
	2007	2009	15 May 2007	38,240	–	–	–	38,240	–	15 May 2010
	2007	2010	15 May 2008	–	53,098	–	–	53,098	–	15 May 2011
Total				113,553				124,462		
N Durante ^{1,2}	2007	2010	15 May 2008	–	74,962	–	–	74,962	–	15 May 2011
Total								74,962		
Total of awards vested in 2008						185,631			3,651,362	

Notes:

- Nicandro Durante and Ben Stevens were appointed Directors on 1 January 2008 and 3 March 2008 respectively.
- Nicandro Durante also received, in May 2005, a cash-based award equivalent in value to 19,057 shares from the Company's subsidiary, Souza Cruz. This award vested and was cash settled by Souza Cruz during 2008. He also received cash-based awards granted by the Company in March 2006 and May 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.
- The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 17 May 2005 was 1,030p, on 15 March 2006 was 1,435p, on 15 May 2007 was 1,590p, and on 19 May 2008 was 1,967p (the vesting date of 17 May 2008 not being a business day). The 2005 cash-based award granted to Nicandro Durante was cash settled by Souza Cruz at the rate of 1,916p per share.
- The vesting of the awards on 17 May 2008 was reported in the Company's Directors' Report and Accounts 2007 showing illustrative vesting values based on the mid-market price of ordinary shares of 1,874p at 25 February 2008, being the latest practicable date prior to publication of that Report.
- In respect of the awards outstanding for Paul Rayner (who ceased to be an Executive Director on 30 April 2008) at the time of his leaving the employment of the Company on 31 July 2008, the Remuneration Committee agreed that, in accordance with the rules of the LTIPs, he would receive: (1) 77.6 per cent of the award made in March 2006 (39,225 shares); (2) 52.8 per cent of the May 2007 award (41,374 shares); and (3) 19.4 per cent of the May 2008 award (16,033 shares). These awards vested on his leaving the Company and were exercised on 1 August 2008 at a price of 1,822p per share.
- In respect of the awards outstanding for Antonio Monteiro de Castro at 31 December 2007, the date of his retirement as an Executive Director, the Remuneration Committee agreed that, in accordance with the rules of the LTIPs, he would receive: (1) 100 per cent of the award made in May 2005 (72,324 shares); (2) 57.6 per cent of the March 2006 award (32,133 shares); and (3) 31.9 per cent of the May 2007 award (27,650 shares). All of his outstanding LTIP awards were exercised on 18 April 2008 at a price of 1,992p per share.

- 7 The March 2006 award will vest on 15 March 2009 at 100 per cent in the manner described in the Remuneration report. For illustrative purposes only, the share price on 23 February 2009, being the latest practicable date prior to publication, was 1,719p, valuing the vesting awards as follows:

	Award granted number of shares	Award vesting number of shares	Award vesting illustrative value £
P N Adams	113,493	113,493	1,950,945
J B Stevens	33,124	33,124	569,402
Total	146,617	146,617	2,520,347

- 8 The cash-based award, equivalent to 31,380 shares, granted to Nicandro Durante in March 2006 will also vest on 15 March 2009 and will be cash settled by the Company. Based on the share price on 23 February 2009 (the latest practicable date prior to publication) of 1,719p, he will receive a cash payment of £539,422.
- 9 For awards made since 2005, participants have been entitled to receive a cash payment equivalent to the value of the dividends that they would have received as shareholders on their vesting awards (the 'LTIP Dividend Equivalent'). The value of the LTIP Dividend Equivalent to be paid to the Executive Directors on the March 2006 awards shown above at the time the awards vest are as follows: Paul Adams £233,569; Ben Stevens £68,169 and Nicandro Durante £64,580.
- 10 The performance conditions applicable to the LTIP awards relate to an apportionment between measures relating to total shareholder return ('TSR') and earnings per share based criteria with reference to a 3 year performance period. TSR combines both the share price and dividend performance of the Company as set against 2 comparator groups: (a) the FTSE 100 Index at the beginning of the performance period; and (b) a peer group of FMCG companies. A total of 50 per cent of the total award is based upon each of 2 separate measures (25 per cent for each measure). In the event of upper quartile performance by the Company relative to the comparator groups referred to above, 25 per cent of the total award vests in full. For median performance, not more than 7.5 per cent (6 per cent for the award made in 2008) of the total award will vest with pro rata vesting between these 2 points. The TSR portions of an LTIP award do not vest for below median performance. 50 per cent of an award is based on earnings per share (EPS) growth relative to inflation. This element of the award will vest fully if EPS growth over the 3 year performance period is an average of at least 8 per cent per annum in excess of inflation. 10 per cent (8 per cent for the award made in 2008) of this element will vest if the EPS growth over the performance period is 3 per cent in excess of inflation. An award will vest on a pro rata basis between these 2 points. The EPS portion of an award does not vest if EPS growth is less than 3 per cent in excess of inflation.
- 11 There have been no variations in the terms and conditions of the interests in LTIPs during the year.
- 12 The awards made in May 2007 and May 2008 are due to vest in May 2010 and May 2011 respectively. At 31 December 2008, the performance percentage reflecting performance to date was 100 per cent for the May 2007 award and 100 per cent for the May 2008 award.

Status of Remuneration report

This report has been prepared in accordance with Schedule 7A to the Companies Act 1985. The report also meets the relevant requirements of the Listing Rules of the UK Listing Authority and describes how the Board has applied the Principles of Good Governance relating to Directors' remuneration as set out in the Combined Code on Corporate Governance referred to in the Corporate governance statement. As required by the Companies Act 1985, a resolution to approve the Directors' Remuneration report (the Report) will be proposed at the Annual General Meeting of the Company on 30 April 2009, at which the financial statements will be presented for approval. The vote will have advisory status, will be in respect of the remuneration policy and overall remuneration packages and will not be specific to individual levels of remuneration. The

Companies Act 1985 requires the auditors to report to the Company's shareholders on the 'audited information' within the Report and to state whether, in their opinion, those parts of the Report have been prepared in accordance with the Companies Act 1985. The Report of the independent auditors in respect of the Company addresses those aspects of this Report which have been subject to audit have been clearly marked: Table 1, Table 3, Table 4 and Table 5.

On behalf of the Board

Anthony Ruys

Chairman of the Remuneration Committee

25 February 2009

Corporate governance statement

British American Tobacco has long been committed to maintaining high standards of corporate governance. Our corporate governance framework is directed towards achieving our business objectives in a manner which is responsible and in accordance with high standards of honesty, transparency and accountability.

These principles are reflected in our Standards of Business Conduct, which have been in place for many years. They were expanded and updated with effect from 1 January 2008 and continue to be kept under review in order to ensure that they remain at the forefront of best business practice. Every Group company and every employee worldwide is expected to live up to them and guidance on them is communicated regularly throughout the Group, including through training and awareness programmes. In addition, the principles set out within our Statement of Business Principles are designed to help meet the expectations placed on us by our various stakeholders. Both documents are available from the Company Secretary and on www.bat.com.

The principal governance rules applying to UK companies listed on the London Stock Exchange are contained in the Combined Code on Corporate Governance adopted by the Financial Reporting Council in June 2006 (the Code). An updated version of the Code was published in June 2008 and applies to reporting years beginning on or after 29 June 2008. While, in preparing this statement, we have taken account of the updated Code, our formal obligation for 2008 is to report by reference to the June 2006 version of the Code. Accordingly, references in this statement are to the 2006 version of the Code. The Code is published by the Financial Reporting Council and is available from its website (www.frc.org.uk).

As required by the Code, this statement reports on how the Code's principles are applied by the Company and provides our formal report on compliance with the Code's provisions. The Group's statement on going concern (as required by the Code), together with those matters required in respect of the Disclosure and Transparency Rules, are included in the Directors' report.

The Board

The Board is responsible to the Company's shareholders for the success of the Group and for its overall strategic direction, its values and its governance. It provides the leadership necessary to enable the Group's business objectives to be met within the framework of the internal controls described below, while also ensuring that the Company's obligations to its shareholders and others are met.

Directors

The Company currently has a Board of 11 Directors: the Chairman, 3 Executive Directors – the Chief Executive, the Chief Operating Officer and the Finance Director – and 7 Non-Executive Directors. They are listed in the Directors' report and their details appear on the Board of Directors page.

Nicandro Durante was appointed to the Board as Chief Operating Officer on 1 January 2008. Paul Rayner ceased to be Finance Director with effect from the conclusion of the Annual General Meeting on 30 April 2008. Ben Stevens was appointed to the Board with effect from 3 March 2008 and succeeded Paul Rayner as Finance Director on 30 April 2008. Kenneth Clarke (Deputy Chairman and Senior Independent Director) also retired as a Director at the conclusion of the Annual General Meeting on 30 April 2008. The position of Deputy Chairman ceased on that date and Sir Nicholas Scheele assumed the role of Senior Independent Director on 1 May 2008.

Thys Visser, a Non-Executive Director since 2001, will retire from the Board at the conclusion of the Annual General Meeting on 30 April 2009.

Meetings of the Board

The Board held 10 meetings in 2008, 7 of which were scheduled and 3 of which were called at short notice to address additional business, including appointments to the Management Board, the Tekel acquisition in Turkey and the secondary listing on the JSE in South Africa. The Board is scheduled to hold 7 meetings in 2009.

Among the key matters on which the Board alone may make decisions are the Group's business strategy, its budget, dividends and major corporate activities. It is also responsible for reviewing the Company's internal controls and governance system and for approving the Standards of Business Conduct and other Group policies. In addition, the Board annually:

- approves the Annual Report, recommends the final dividend and agrees the agenda for the Annual General Meeting;
- reviews the Company's periodic financial results and declares an interim dividend;
- agrees succession plans and evaluates the Board's performance over the preceding year; and
- agrees the 2 year budget.

The agenda for Board meetings is set by the Chairman in consultation with the Chief Executive and the Company Secretary. In addition to the Company Secretary, the General Counsel to the Company ordinarily attends all meetings of the Board.

The Non-Executive Directors, led by the Chairman, meet, if required, prior to meetings of the Board without the Executive Directors present and also meet annually, led by the Senior Independent Director, without the Chairman present.

All Directors are aware of their responsibility to take decisions objectively which promote the success of the Company for the benefit of its members. The Chairman will always seek to obtain consensus at Board meetings but, in exceptional circumstances, decisions will be taken by majority. If any Director has concerns about the running of the Company or a proposed action which cannot be resolved, such concerns will be recorded in the Board minutes. No such concerns arose in 2008.

Management Board

The Board delegates to the Management Board responsibility for overseeing the implementation by the Group's operating subsidiaries of the policies and strategy which it sets, and for creating the conditions for their successful day-to-day operation. The Management Board is chaired by the Chief Executive and its other members are the Finance Director, the Chief Operating Officer and the 10 senior Group executives, whose names appear on the Management Board page. It held 10 meetings in 2008 and is scheduled to hold 9 meetings in 2009. Members of the Management Board are also invited to attend meetings of the Board from time to time, in particular when the Group's future strategy and 2 year budget are under discussion.

Board Committees

The Board has established 4 principal Board Committees, to which it has delegated certain of its responsibilities. They are the Audit Committee, the Nominations Committee, the Remuneration Committee and the Corporate Social Responsibility (CSR) Committee. Each has its own clear terms of reference, which are available from the Company Secretary and on www.bat.com. The roles and membership of these Committees are described in more detail where appropriate below.

With effect from 1 October 2008, membership of the Audit and CSR Committees was split between the Non-Executive Directors on the basis that smaller Committees were considered likely to promote more effective debate. Sir Nicholas Scheele currently remains a member of both Committees. All Non-Executive Directors continue to serve on both the Nominations Committee and the Remuneration Committee.

Scheduled Board and Committee meetings held in 2008

The following table shows the total number of Board and Committee meetings held in 2008 and the number attended by their respective members. Where a Director was not a member of the Board or a Committee throughout the year,

the figure in brackets indicates the number of meetings held during their period of tenure on the Board or Committee. All Directors attended the Annual General Meeting in April 2008.

	Board	Audit	Nominations	Remuneration	CSR
Number held	10	5	3	4	2
Number attended					
J P du Plessis	10	–	3	–	–
K H Clarke ¹	4 (4)	1 (2)	2 (2)	3 (3)	1 (1)
P N Adams	10	–	–	–	–
P A Rayner ¹	3 (4)*	–	–	–	–
J B Stevens ¹	7 (8)*	–	–	–	–
N Durante	9*	–	–	–	–
R E Lerwill ³	10	5	3	4	1 (1)
A M Llopis ²	9	3 (3)	3	4	2
C Morin-Postel ³	10	5	3	4	1 (1)
A Ruys ³	10	5	3	4	1 (1)
Sir Nicholas Scheele	9*	5	3	4	2
K de Segundo ²	10	3 (3)	3	4	2
M H Visser	9*	–	3	–	2

– Indicates not a member of that Committee (the Chairman and Executive Directors attend meetings of the Board Committees, as appropriate, at the invitation of the Committee Chairmen).

* Indicates absence from a meeting called at short notice.

Notes:

1 Kenneth Clarke and Paul Rayner retired from the Board on 30 April 2008; Ben Stevens was appointed to the Board with effect from 3 March 2008.

2 Ana Maria Llopis and Karen de Segundo stood down from the Audit Committee with effect from 1 October 2008.

3 Robert Lerwill, Christine Morin-Postel and Anthony Ruys stood down from the CSR Committee with effect from 1 October 2008.

Chairman and Chief Executive

The Chairman and Chief Executive are responsible for the profitable operation of the Group. Their roles 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 facilitating the productive contribution of both Executive and Non-Executive Directors. He is also responsible for ensuring that the interests of the Company's shareholders are safeguarded and that there is effective communication with the Company's shareholders. The Chairman is accountable to the Board for leading the direction of the Group's corporate and financial strategy and for the overall supervision of the Group's policies governing the conduct of its business.

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

Corporate governance statement continued

Senior Independent Director

Sir Nicholas Scheele is the Senior Independent Director. He will, if required, preside at meetings of the Board and shareholders in the absence of the Chairman and he also chairs the Nominations Committee when it is considering the succession of the Chairman. He is available should occasion arise where there is a need to convey concerns to the Main Board other than through the Chairman or Chief Executive. He and the other Non-Executive Directors are available to meet with major investors in order to understand their views and concerns.

Board balance and independence

The Board considers that 6 of the 7 Non-Executive Directors are independent, meaning that they are free from any business or other relationships which could materially interfere with or appear to affect the exercise of their judgement and have not previously been involved in the management of the Group. Thys Visser is presumed not to be independent because of the shareholding that he represented throughout much of 2008. Accordingly, he does not sit on the Audit or Remuneration Committees, both of which comprise solely independent Non-Executive Directors. He will be retiring from the Board at the conclusion of the Company's Annual General Meeting on 30 April 2009. The Company is currently looking to recruit a further Non-Executive Director to the Board.

Conflicts of interest

The Board has established formal procedures for managing compliance with the conflict of interest provisions of the Companies Act 2006, which came into effect on 1 October 2008. Under these provisions:

- directors may not allow any situation to arise in which they will have, or may have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company (situational conflicts), unless the matter has been authorised in advance by the company's board in accordance with its Articles of Association; and
- directors must declare in advance any interest in a proposed transaction or arrangement with the company (transactional conflicts).

The Company's Articles of Association (as amended by special resolution adopted on 30 April 2008) permit the Board to authorise situational conflicts (see the section on Directors interests in the summary of the Memorandum and Articles of Association in the Directors' report). The Board has established a Conflicts Committee to consider and, where appropriate, authorise situational conflicts notified to the Company by Directors between scheduled meetings of the Main Board. The Conflicts Committee comprises all members of the Board and has a quorum of 2 Directors.

Directors are required to give advance notice of any situational and transactional conflicts to the Company Secretary and any such matters will be considered either at the next Board meeting or, if the conflict or potential conflict is due to arise prior to the next scheduled Board meeting, the Conflicts Committee. Where a Director seeks authorisation in respect of a situational conflict, he or she (together with any other interested Director) will be excluded from the quorum and the vote. The Board or Conflicts Committee (as the case may be) will note any declared transactional conflicts and consider and, where it sees fit, authorise any declared situational conflicts. The full Board will be notified of any matters authorised by the Conflicts Committee at its next meeting. Annually, at the first Board meeting following the year end, the Board will review all situational conflicts which have previously been authorised by it or by the Conflicts Committee. The review will take the form of a fresh consideration of each situational conflict.

The Company Secretary maintains a register of all conflicts which have been addressed under these procedures.

Appointments to the Board

The Board's Nominations Committee is responsible for making recommendations on suitable candidates for appointment to the Board and for promotion to the Management Board, ensuring that both Boards have the appropriate balance of expertise and ability. It is chaired by Jan du Plessis and its remaining membership comprises all of the Non-Executive Directors. The Chief Executive and the Management Board member responsible for Human Resources regularly attend meetings by invitation but are not members.

The Nominations Committee is responsible for ensuring that the procedure for appointing new Directors is rigorous and transparent and that appointments are made on merit and against objective criteria for the purpose. It reviews forthcoming retirements at least once a year and considers the need to identify candidates to fill vacancies on the Board. This process includes an evaluation of the skills and experience to be looked for in those candidates to ensure continuing Board balance. The selection process will generally involve interviews with a selection of candidates, using where appropriate the services of executive search firms specialising in board-level recruitment. This process is currently being followed in connection with the efforts underway to recruit an additional Non-Executive Director to join the Board.

Directors are submitted for reappointment at regular intervals by application of the Company's Articles of Association. These require that at each Annual General Meeting: (1) not less than one-third of the Directors who are subject to retirement by rotation must retire; and (2) any Director has to retire who was not appointed at either of the 2 previous Annual General

Meetings and who has served as a Director for more than 2 years since appointment or last reappointment.

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 3 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 2 year term, such appointment being subject to approval by shareholders in accordance with the terms of the provisions of the Company's Articles of Association relating to the rotation of Directors. There is a general assumption on the part of the Board that Non-Executive Directors will not normally be invited to stand for reappointment after serving 9 years.

The Nominations Committee has made recommendations to the Board as to the Directors who are retiring and being put forward for reappointment at the Annual General Meeting on 30 April 2009.

Information and professional development

All Directors receive induction on joining the Board, covering their duties and responsibilities as Directors. Non-Executive Directors also receive at least 2 days' briefings on all areas of the Company's business from the Executive Directors, Management Board members and other senior executives, and they may request such further information as they consider necessary. Karen de Segundo and Christine Morin-Postel, who were both appointed to the Board in October 2007, completed their induction early in 2008. In addition, all Directors have the opportunity to update their skills and knowledge on a regular basis, for example through further briefings on the business and on legal and regulatory requirements, and by visits to Company sites. They also make use of the opportunity to attend meetings of the Group's regional audit and CSR committees.

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

During 2008, the Board was briefed on relevant aspects of the Companies Act 2006, including in particular the provisions relating to directors' conflicts of interest which came into force on 1 October 2008 (see above). The Board and its Committees also continue to be updated on relevant developments in the field of corporate governance, including for example, the updated Guidance on Audit Committees issued by the Financial Reporting Council in October 2008.

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

Evaluation of Board performance

The Board conducts a critical evaluation of its activities on an annual basis. A questionnaire-based peer review of the performance of the Chairman, the Executive Directors, the Non-Executive Directors, the Board and its Committees is conducted by the Company Secretary. In 2008, this was followed by separate interviews between the Company Secretary and each Director to allow a further opportunity to explore particular areas in more detail:

- the results of the review of the Committees and the Board are discussed with the Chairman and presented to the Board;
- the results of the review of the individual performance of each Director (excluding the Chairman) are raised by the Chairman with that Director, as appropriate; and
- the results of the review of the Chairman's performance are discussed by the Non-Executive Directors without the Chairman present and feedback is given by the Senior Independent Director on a one-to-one basis.

The Chairman also discusses the effectiveness and performance of Directors immediately before they make themselves available for reappointment and, in addition, the Remuneration Committee evaluates the effectiveness of the Chairman and the Chief Executive annually.

The process in 2008 confirmed that all Directors considered the Board to be working well, to be efficient and effective, and to have a good balance of the necessary skills required, although there was a general consensus that, with the forthcoming retirement of Thys Visser, a further Non-Executive Director should be appointed in due course (this is currently being pursued – see above). The decision to split membership of the Audit and CSR Committees (see above) was also universally welcomed, and a review was suggested in 12 months' time to see how the new structures are working. The Non-Executive Directors were highly supportive of the Executive team and

Corporate governance statement continued

expressed their appreciation of the culture of openness and transparency within the Group. In particular, they welcomed their access to management below the level of the Management Board, most frequently at the regional audit and CSR committee meetings.

The Notice for this year's Annual General Meeting confirms that the performance of the Directors being proposed for reappointment continues to be effective and that they continue to show commitment to their role.

Remuneration

It is the role of the Remuneration Committee to determine the framework and policy on terms of engagement (including remuneration) of the Chairman, Executive Directors and members of the Management Board, and the specific remuneration of each Executive Director and Management Board member (including entitlements under share incentive schemes and pension schemes) and any compensation payments. The fees paid to the Non-Executive Directors are considered annually and are based upon the recommendation of the Chairman and Chief Executive. The terms of engagement of, and fees payable to, the Chairman are also reviewed annually, taking account of the breadth of the role coupled with the required levels of commitment and expertise.

Anthony Ruys assumed chairmanship of the Remuneration Committee upon Kenneth Clarke's retirement on 30 April 2008. Its other members are Robert Lerwill, Ana Maria Llopis, Christine Morin-Postel, Sir Nicholas Scheele and Karen de Segundo. The Chairman, Chief Executive and the Management Board member responsible for Human Resources regularly attend meetings by invitation but are not members.

Details of the Directors' remuneration are set out in Table 1 of the Remuneration report.

Accountability and audit

Financial reporting

The Board is satisfied that it has met its obligation to present a balanced and understandable assessment of the Company's position and prospects in the Directors' report and accounts and the Business review and in interim reports, reports to regulators and price-sensitive announcements. A summary of the Directors' responsibilities for the financial statements and their statement concerning relevant audit information is included in the Directors' report. The Directors' statement that it is appropriate to continue to adopt the going concern basis in preparing the accounts is also set out in the Directors' report.

Audit Committee

The Board's obligation to establish formal and transparent arrangements for considering how it should apply financial reporting and internal control principles, and for maintaining an appropriate relationship with the Company's external

auditors, PricewaterhouseCoopers LLP, is met through the Audit Committee. The role of the Audit Committee is to monitor the integrity of the financial statements of the Company and review and, when appropriate, make recommendations to the Main Board on business risks, internal controls and compliance. The Committee satisfies itself, by means of suitable steps and appropriate information, that proper and satisfactory internal control systems are in place to identify and manage business risks and that the Company's business, and that of its subsidiaries, is conducted in a proper and economically sound manner.

The Audit Committee is chaired by Robert Lerwill and comprises 3 other independent Non-Executive Directors – Christine Morin-Postel, Anthony Ruys and Sir Nicholas Scheele. Karen de Segundo and Ana Maria Llopis were members of the Audit Committee until 1 October 2008. At that time, membership of the Audit Committee, together with that of the CSR Committee, was revised to allow more efficient and focused debate. The Chief Operating Officer and the Finance Director regularly attend meetings of the Committee by invitation but are not members. The Committee's meetings are also regularly attended by the Head of Audit and Business Risk, the General Counsel to the Company and a representative of the external auditors. As a matter of best practice, the Committee meets alone with the external auditors at the end of every meeting.

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

The Chairman of the Committee reports to the subsequent meeting of the Board on the Committee's work and the Board receives a copy of the minutes of each meeting. The papers considered by the Committee are available to any Director who is not a member, should they wish to receive them. The Committee's effectiveness is reviewed annually as part of the Board evaluation process. In 2008, the Board concluded that it continues to operate effectively.

Activities of the Audit Committee in 2008

The Audit Committee met 5 times during 2008, including immediately before the Company's full year results were published. It follows an agreed annual work programme comprising both regular items and areas considered to require particular focus. During 2008, it continued to

monitor the integrity of the Company's financial statements and all formal announcements concerning the Company's financial performance, to review significant financial reporting judgements contained in them, and to keep under review the consistency of accounting policies applied across the Group. It met regularly with management and with the internal and external auditors to review the effectiveness of internal controls and business risk management, and received reports from the Head of Audit and Business Risk, the Head of Group Security and the Group's regional audit and CSR committees and corporate audit committee. The specific items considered by the Audit Committee during 2008 included:

- a comprehensive review of Group risks in light of the current macroeconomic situation, and the risk mitigation plans in place to manage identified risks (see Key Group risk factors);
- the Group's position with regard to counterparty risks and liquidity issues in the light of volatility in the financial markets and the failure of a number of significant financial institutions;
- a revised audit and CSR committee framework, which recommended the merging of regional and (where possible) area and individual market audit and CSR committees to enhance their efficiency and effectiveness;
- compliance with the Standards of Business Conduct;
- compliance with records management procedures;
- the annual works plan for the Group's internal audit function;
- an independent review of the internal audit function and the implementation of proposals arising from the review; and
- revised Guidance on Audit Committees issued by the Financial Reporting Council.

It has satisfied itself that proper and satisfactory internal controls remain in place to identify and contain business risks, and that the Company's business, and that of its subsidiaries, is being conducted in a proper and economically sound manner.

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

External auditors

The Audit Committee assesses annually the qualification, expertise and resources, and independence of the external auditors and the effectiveness of the audit process. The Committee's assessment is made with reference to a satisfaction survey of the external auditors completed by members of senior management.

PricewaterhouseCoopers LLP have been the Company's auditors since it listed on the London Stock Exchange in September 1998. The Audit Committee considers that the relationship with the auditors is working well and remains satisfied with their effectiveness. Accordingly, it has not considered it necessary to date to require the firm to tender for the audit work. The external auditors are required to rotate the audit partners responsible for the Group and subsidiary audits every 5 years and the current lead audit partner has been in place for 4 years. There are no contractual obligations restricting the Company's choice of external auditor.

The Audit Committee has an established policy aimed at safeguarding and supporting the external auditors' independence and objectivity. Pursuant to this policy, it keeps under review the ratio of audit fees to non-audit fees charged by the external auditors to ensure that neither their independence nor their objectivity is put at risk, and takes steps to ensure that they do not audit their own work. It remains confident that the objectivity and independence of the external auditors are not in any way impaired by reason of the non-audit services which they provide to the Group. Moreover, the Committee is satisfied that such work is best handled by them, either because of their knowledge of the Group or because they have been awarded it through a competitive tendering process. A breakdown of non-audit fees charged by the auditors is disclosed in note 3(d) in the Notes on the accounts.

The Audit Committee has completed its assessment of the external auditors for the financial period under review. Having satisfied itself as to their qualification, expertise, resources and independence and the effectiveness of the audit process, it has recommended to the Board, for approval by shareholders, the reappointment of PricewaterhouseCoopers LLP as the Company's external auditors and approved their fees and terms of engagement.

Internal control

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

Corporate governance statement continued

Overview

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

The main features of the risk management processes and system of internal control operated within the Group are identified below. They do not cover the Group's associate undertakings. Save to the extent indicated (in relation to developments which occurred during the year), they have been in place throughout the year under review and remain in place.

Audit and CSR Committee framework

During 2008, the Group's Audit Committee and CSR Committee networks were merged at regional level and (where possible) at area and individual market levels, on the basis that many of the issues being considered by them at regional level and below were similar or related (for example, financial and reputational risk factors). The Audit and CSR Committee framework supports the Board's Audit and CSR Committees and provides a continuing process for managing the significant risks faced by the Company and its subsidiaries, including not only financial risks but also significant social, environmental and reputational risks. It is designed to capture and evaluate failings and weaknesses and to ensure that appropriate remedial action is taken where necessary.

The Group's regional audit and CSR committees (which are all chaired by an Executive Director) focus on risks and the control environment within each region and are in turn supported by area and/or individual market audit and CSR committees. The Group's corporate audit committee focuses on the risks and the control environment within the Group's operations which do not fall under the responsibility of the regional, area and local audit and CSR committees, for example head office central functions, global programmes and above-region projects. It comprises members of the Management Board and is chaired by a Management Board member responsible for 1 of the Group's regions to maximise its independence from central executive management.

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

Risk management and internal control processes

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

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

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

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

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

Review

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

The processes described above, and the reports that they give rise to, enable the Board and the Audit Committee to monitor the internal control framework on a continuing basis throughout the year and to review its effectiveness at the year

end. The Board, with advice from its Audit Committee, has completed its annual review of the effectiveness of the system of internal control for the period since 1 January 2008. No significant failings or weaknesses were identified and the Board is satisfied that, where specific areas for improvement have been identified, processes are in place to ensure that the necessary remedial action is taken and that progress is monitored. The Board is satisfied that the system of internal control is in accordance with the Guidance.

Relations with shareholders

The Board maintains a dialogue with shareholders directed towards ensuring a mutual understanding of objectives. Its primary contact with shareholders is through the Chief Executive and Finance Director, but the Chairman also maintains contact with major shareholders in order to understand their issues and concerns. Where appropriate, major institutional shareholders are consulted on significant changes to the structure of the Directors' remuneration. The Chairman and the Executive Directors also undertook a series of presentations to potential institutional investors in South Africa as part of the preparations for the Company's secondary listing on the JSE Limited (JSE) in October 2008.

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

The Annual General Meeting is the principal opportunity for the Board to meet investors and for the Chairman to explain the Company's progress and receive questions from its owners, the shareholders. At its Annual General Meetings, the Company provides for the vote on each resolution to be by poll, using its Registrar's electronic voting system, rather than by show of hands. This provides for greater transparency and allows the votes of all shareholders to be counted, including those cast by proxy. The Chairman announces the provisional voting results at the Meeting, and the final results are announced on the same day through the Regulatory News Service and on www.bat.com. In 2008, for the first time, the Company appointed an independent assessor to scrutinise the Annual General Meeting and to produce a report of the meeting, covering the proxy voting process, attendance and an audit of the poll procedures. The report confirmed the adequacy, accuracy and fairness of the proxy process and the voting procedures and systems. It is planned that this will be repeated at future Annual General Meetings, including in 2009.

The Company continues to engage with its shareholders in other areas. In recognition of the fact that some shareholders can find it inconvenient or uneconomical to hold a small number of shares, the Company made available (for a limited

period during May and June 2008) a postal 'Commission Free Share Dealing Service' to those holding 500 or fewer shares. This initiative was well received, with a number of small shareholders taking up the offer.

On a broader level, the Company is aware that its shareholders (in common with those of many other companies) have received unsolicited telephone calls or mail concerning investment matters. These are typically from people stating that they are brokers based abroad and, in what are known as 'boiler room scams', they target UK shareholders offering to sell what often turn out to be worthless or high risk shares in US or UK investments. To reinforce an earlier initiative from February 2007, the Company wrote to its shareholders in the latter part of 2008 to remind them of the continued growth in unsolicited investment advice and to advise of the actions that they should take if approached in this way.

Corporate social responsibility

The CSR Committee supports the Company's commitment to social and environmental issues. Its role is to keep under review and make appropriate recommendations to the Board as regards the Group's management of significant social, environmental and reputational issues and the conduct of business in accordance with the Statement of business principles.

The CSR Committee is chaired by Karen de Segundo, who assumed chairmanship following the retirement of Kenneth Clarke on 30 April 2008. Its other members are Ana Maria Llopis, Sir Nicholas Scheele and Thys Visser. Robert Lerwill, Christine Morin-Postel and Anthony Ruys were members of the CSR Committee until 1 October 2008, when the decision to change the composition of the CSR Committee and the Audit Committee was implemented. The Chairman, Chief Executive and the Management Board member responsible for Corporate and Regulatory Affairs regularly attend meetings by invitation but are not members.

The CSR Committee's terms of reference were reviewed and amended with effect from 2 December 2008, in order to clarify its remit following the merger of audit and CSR committees across the Group (see below). As a result of the Committee's revised remit, and in order to establish greater continuity between meetings, an additional scheduled CSR Committee meeting will be held in July each year from 2009.

The Company's Social Reports have detailed its social, ethical and environmental performance and performance against commitments each year since the first Social Report in 2002. In 2008, the Company published its first Sustainability Report outlining the 5 key elements of its sustainability agenda. The Company will continue to publish an annual Sustainability Report in place of the previous Social Report, outlining progress in each area of the sustainability agenda. Further details of the

Corporate governance statement continued

Company's performance on social, ethical and environmental issues can be found on www.bat.com.

Sustainability reporting, like the social reporting that preceded it, is conducted using a robust methodology, including independent assurance, in line with the latest AA1000 Assurance Standard. Engagement with key stakeholders is a major requirement of the Standard.

The principles of CSR continue to be strongly embedded in the Group. During 2008, following a review of CSR governance processes, the Group's CSR committees were merged with its audit committees at regional level and (where possible) at area and individual market levels in order to standardise financial and non-financial risk management and internal control processes. The CSR Checklist, first used in 2006, has been updated and incorporated into Control Navigator, the Group's internal audit control checklist. Oversight of CSR governance continues to be provided by the CSR Committee.

The Company has been included in both the Dow Jones Sustainability World Index (DJSI World) and the Dow Jones STOXX Sustainability Index for the seventh successive year. It was placed in the second highest (Gold) Band in the Corporate Responsibility Index 2007 run by Business in the Community, the 700 member organisation established in the UK to help business improve its positive impact on society. The Company was rated first in its sector and included in the highest (Platinum) Band for environmental performance in the Business in the Environment Index for 2007.

American Depositary Receipts

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

Compliance

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

In the interests of further transparency, we have again prepared a report which summarises the matters addressed in this statement, as appropriate, by reference to each Principle and Provision of the Code. The updated report will be available on the Corporate governance section of www.bat.com from the date of publication of the Directors' report and accounts.

Responsibility of Directors

Directors' responsibilities in relation to the financial statements

The following statement sets out the responsibilities of the Directors in relation to the financial statements of both the Group and the Company. The reports of the independent auditors for the Group and the Company set out their responsibilities in relation to those financial statements.

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss of the Group and the Company for the financial year. In preparing those financial statements, the Directors are required to:

- select appropriate accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures being disclosed and explained; and
- prepare the financial statements on the going concern basis, unless they consider that to be inappropriate.

The applicable accounting standards referred to above are: (a) United Kingdom Generally Accepted Accounting Principles (UK GAAP) for the Company; and (b) International Financial Reporting Standards (IFRS) as adopted by the European Union and implemented in the UK for the Group.

The Directors are responsible for ensuring that the Company keeps sufficient accounting records to disclose with reasonable accuracy the financial position of the Company and the Group and to enable them to ensure that the Group financial statements comply with the Companies Act 1985 and Article 4 of the IAS Regulation, and that the Company financial statements and the Directors' Remuneration report comply with the Companies Act 1985. They are also responsible for taking reasonable steps to safeguard the assets of the Company and the Group and, in that context, having proper regard to the establishment of appropriate systems of internal control with a view to the prevention and detection of fraud and other irregularities.

The Directors are required to prepare financial statements and to provide the auditors with every opportunity to take whatever steps and undertake whatever inspections the auditors consider to be appropriate for the purpose of enabling them to give their audit report.

The Directors are responsible for the maintenance and integrity of the Annual Report on www.bat.com in accordance with the UK legislation governing the preparation and dissemination of financial statements. Access to the website is available from outside the UK, where comparable legislation may be different.

The Directors consider that they have pursued the actions necessary to meet their responsibilities as set out in this statement.

Directors' declaration in relation to relevant audit information

Having made enquiries of fellow Directors and of the Company's auditors, each of the Directors confirms that:

- to the best of his or her knowledge and belief, there is no relevant audit information of which the Company's auditors are unaware; and
- he or she has taken all steps that a Director might reasonably be expected to have taken in order to make himself or herself aware of relevant audit information and to establish that the Company's auditors are aware of that information.

Directors' responsibility statement

The Directors confirm to the best of their knowledge and belief that:

- the financial statements, prepared in accordance with the applicable accounting standards identified above, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the Group; and
- the Directors' report and Business review include a fair review of the development and performance of the business and the position of the Group and the Company, together with a description of the principal risks and uncertainties that they face.

The names of the Directors are listed in this Directors' report and their details appear on the Board of Directors page.

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

The responsibility statement was approved by the Board of Directors on 25 February 2009 and signed on its behalf by:

Jan du Plessis
Chairman

Ben Stevens
Finance Director

Report of the independent auditors

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 2008 which comprise the Group income statement, the Group statement of recognised income and expense, the Group balance sheet, the Group cash flow statement, the related notes and 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 2008 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, 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 Directors' responsibilities in relation to the financial statements, included in the Responsibility of Directors.

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 Business review that is cross referred from 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 9 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 consider whether it is consistent with the audited Group financial statements. The other information comprises only the Business review, the Directors' report, the 5 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 2008 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

25 February 2009

Group income statement

For the year ended 31 December

	Notes	2008 £m	2007 restated £m
Gross turnover (including duty, excise and other taxes of £21,799 million (2007: £17,086 million))		33,921	27,104
Revenue	2	12,122	10,018
Raw materials and consumables used		(3,335)	(2,802)
Changes in inventories of finished goods and work in progress		19	30
Employee benefit costs	3a	(1,907)	(1,587)
Depreciation and amortisation costs	3b	(430)	(336)
Other operating income	3c	281	205
Other operating expenses	3d	(3,178)	(2,624)
Profit from operations	2	3,572	2,904
after (charging)/crediting			
– restructuring and integration costs	3e	(160)	(173)
– Canadian settlement	3f	(102)	
– amortisation of trademarks	3g	(24)	
– gains on disposal of businesses and trademarks	3h	141	75
Finance income		267	136
Finance costs		(658)	(405)
Net finance costs	4	(391)	(269)
Share of post-tax results of associates and joint ventures	5	503	442
after (charging)/crediting			
– trademark impairments	5	(20)	(7)
– additional ST income	5	13	
– termination of joint venture	5	45	
– restructuring costs	5	(12)	
Profit before taxation		3,684	3,077
Taxation on ordinary activities	6	(1,025)	(790)
Profit for the year		2,659	2,287
Attributable to:			
Shareholders' equity		2,457	2,130
Minority interests		202	157
Earnings per share			
Basic	7	123.28p	105.19p
Diluted	7	122.54p	104.46p

The restatement of the 2007 results reflects the change in the Group's accounting policy for recognition of actuarial gains and losses together with the adoption of IFRIC14 as explained in note 1.

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

The accompanying notes are an integral part of the Group financial statements.

Group statement of recognised income and expense

For the year ended 31 December

	Notes	2008 £m	2007 restated £m
Differences on exchange		937	320
Differences on exchange reclassified and reported in profit for the year		(22)	
Cash flow hedges			
– net fair value gains		180	15
– reclassified and reported in profit for the year		(173)	(42)
– reclassified and reported in net assets		1	
Available-for-sale investments			
– net fair value gains		1	1
– reclassified and reported in profit for the year		(6)	1
Net investment hedges			
– net fair value losses		(672)	(35)
– differences on exchange on borrowings		(178)	
Revaluation of existing business	26	179	
Retirement benefit schemes			
– actuarial (losses)/gains in respect of subsidiaries	12	(547)	95
– surplus recognition in respect of subsidiaries	12		9
– actuarial (losses)/gains in respect of associates	11	(396)	17
Tax on items recognised directly in SORIE	6d	184	(53)
Net (losses)/gains		(512)	328
Profit for the year		2,659	2,287
Total recognised income for the year		2,147	2,615
– shareholders' equity		1,913	2,443
– minority interests		234	172
Effect of changes in accounting policy at 1 January 2007:			
– shareholders' equity	12		(104)
– minority interests			

The Group has presented a Statement of recognised income and expense (SORIE) rather than a Statement of changes in total equity as previously presented following the accounting policy change for recognition of actuarial gains and losses together with a prior year adjustment following the early adoption of IFRIC14 as explained further in note 1.

The accompanying notes are an integral part of the Group financial statements.

Group balance sheet

At 31 December

	Notes	2008 £m	2007 restated £m
Assets			
Non-current assets			
Intangible assets	9	12,318	8,105
Property, plant and equipment	10	3,076	2,378
Investments in associates and joint ventures	11	2,552	2,316
Retirement benefit assets	12	75	37
Deferred tax assets	13	392	264
Trade and other receivables	14	193	123
Available-for-sale investments	15	27	22
Derivative financial instruments	16	176	153
Total non-current assets		18,809	13,398
Current assets			
Inventories	17	3,177	1,985
Income tax receivable	18	137	85
Trade and other receivables	14	2,395	1,845
Available-for-sale investments	15	79	75
Derivative financial instruments	16	420	82
Cash and cash equivalents	19	2,309	1,258
		8,517	5,330
Assets classified as held-for-sale	26	225	36
Total current assets		8,742	5,366
Total assets		27,551	18,764

	Notes	2008 £m	2007 restated £m
Equity			
Capital and reserves			
Share capital		506	506
Share premium, capital redemption and merger reserves		3,905	3,902
Other reserves		955	658
Retained earnings		1,578	1,805
Shareholders' funds		6,944	6,871
after deducting – cost of treasury shares		(745)	(296)
Minority interests		271	218
Total equity	20	7,215	7,089
Liabilities			
Non-current liabilities			
Borrowings	21	9,437	6,062
Retirement benefit liabilities	12	848	360
Deferred tax liabilities	13	599	336
Other provisions for liabilities and charges	22	186	165
Trade and other payables	23	166	149
Derivative financial instruments	16	199	49
Total non-current liabilities		11,435	7,121
Current liabilities			
Borrowings	21	2,724	861
Income tax payable	18	300	227
Other provisions for liabilities and charges	22	295	263
Trade and other payables	23	4,718	2,976
Derivative financial instruments	16	864	225
		8,901	4,552
Liabilities directly associated with assets classified as held-for-sale	26		2
Total current liabilities		8,901	4,554
Total equity and liabilities		27,551	18,764

The restatement of the 2007 balance sheet reflects the change in Group accounting policy for recognition of actuarial gains and losses together with the adoption of IFRIC14 as explained in note 1.

The accompanying notes are an integral part of the Group financial statements.

On behalf of the Board

Jan du Plessis

Chairman

25 February 2009

Group cash flow statement

For the year ended 31 December

	Notes	2008 £m	2007 £m
Cash flows from operating activities			
Cash generated from operations	25	4,156	3,181
Dividends received from associates		326	285
Tax paid		(943)	(866)
Net cash from operating activities		3,539	2,600
Cash flows from investing activities			
Interest received		125	114
Dividends received from investments		2	2
Purchases of property, plant and equipment		(448)	(416)
Proceeds on disposal of property, plant and equipment		62	46
Purchases of intangibles		(96)	(66)
Proceeds on disposal of intangibles	25	17	16
Purchases and disposals of investments	25	9	71
Proceeds from associates' share buy-backs	25	42	
Purchase of Tekel cigarette assets	25	(873)	
Purchase of ST cigarette and snus businesses	25	(1,243)	
Purchases of other subsidiaries and minority interests	25	(9)	(15)
Proceeds on disposal of subsidiaries	25	26	126
Net cash from investing activities		(2,386)	(122)
Cash flows from financing activities			
Interest paid		(400)	(384)
Interest element of finance lease rental payments		(3)	(3)
Capital element of finance lease rental payments		(30)	(21)
Proceeds from issue of shares to Group shareholders		3	5
Proceeds from the exercise of options over own shares held in employee share ownership trusts		7	22
Proceeds from increases in and new borrowings	25	3,518	438
Movements relating to derivative financial instruments	25	(656)	(89)
Purchases of own shares		(400)	(750)
Purchases of own shares held in employee share ownership trusts		(116)	(41)
Reductions in and repayments of borrowings	25	(731)	(427)
Dividends paid to shareholders	8	(1,393)	(1,198)
Dividends paid to minority interests		(173)	(173)
Net cash from financing activities		(374)	(2,621)
Net cash flows from operating, investing and financing activities		779	(143)
Differences on exchange		261	47
Increase/(decrease) in net cash and cash equivalents in the year		1,040	(96)
Net cash and cash equivalents at 1 January		1,180	1,276
Net cash and cash equivalents at 31 December	19	2,220	1,180

The accompanying notes are an integral part of the Group financial statements.

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 1985/2006 applicable to companies reporting under IFRS.

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

In 2008, the Group has amended its treatment with regard to the recognition of actuarial gains and losses of retirement benefit schemes under IAS19. Previously, actuarial gains and losses that arose subsequent to 1 January 2004, the date of transition to IFRS, were recognised only to the extent that cumulatively they exceeded 10 per cent of the greater of the present value of the defined benefit obligation and the fair value of the scheme assets, and that portion was 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 were not recognised, except where there were unrecognised scheme surpluses: in such instances the actuarial gains and losses were recognised as they occurred. The Group believes that fully recognising actuarial gains and losses when they occur results in a better presentation of the financial statements which is more in line with current market practice and expected financial reporting developments thus providing more comparable market information.

In addition, in 2008 the Group adopted IFRIC14 (IAS19 – The Limit on a Defined Benefit Asset Minimum Funding Requirements and their Interaction) early. The interpretation clarifies the conditions under which a surplus in a post-employment benefit scheme can be recognised in the financial statements, as well as setting out the accounting implications where minimum funding requirements exist. The recognition of this change resulted in a £4 million charge to reported equity net of tax at 1 January 2008 and a £nil million impact on reported equity at 31 December 2008.

Following the change in accounting policy, the Group now recognises actuarial gains and losses in the period in which they occur, in the Statement of recognised income and expense, together with movements in surplus restrictions, and related deferred taxation. A Statement of recognised income and expense had not previously been required to be presented by the Group. Comparative periods have been restated to reflect these changes from 1 January 2004. These changes are set out in detail in note 12.

In 2008, the Group also updated its accounting policy on 'intangible assets other than goodwill' to address trademarks acquired by the Group's subsidiary undertakings as set out below.

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 below;
- the review of asset values, especially goodwill and impairment testing. The key assumptions used in respect of goodwill and impairment testing are the determination of cash-generating units, the long-term growth rate for cash flow projections and the rate used to discount the cash flow projections. These are described in note 9;
- the estimation of and accounting for retirement benefit costs. The determination of the carrying value of assets and liabilities, as well as the charge for the year, and amounts recognised in the Statement of recognised income and expense, 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 assumptions used by the Group and sensitivity analysis are described in note 12;
- the estimation of amounts to be recognised in respect of taxation and legal matters, and the estimation of other provisions for liabilities and charges are subject to uncertain future events, may extend over several years and so the amount and/or timing may differ from current assumptions. The accounting policy for taxation is explained below and the recognised deferred tax assets and liabilities, together with a note of unrecognised amounts, are shown in note 13. Other provisions for liabilities and charges are as set out in note 22. The accounting policy on contingent liabilities, which are not provided for, is set out below and the contingent liabilities of the Group are explained in note 30;

Notes on the accounts continued

1 Accounting policies continued

- the definition of adjusting items, which are separately disclosed as memorandum information, is explained below and the impact of these on the calculation of adjusted earnings is described in note 7; and
- the estimation of the fair values of acquired net assets arising in a business combination under IFRS3 and the allocation of the purchase consideration between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair values. These estimates are prepared in conjunction with the advice of independent valuation experts where appropriate. The relevant transactions for 2007 and 2008 are described in note 26.

Such estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable in the circumstances and constitute management's best 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 adjusted, where appropriate, for any surplus restrictions including minimum funding requirements.

As permitted under IFRS1, all actuarial gains and losses as at 1 January 2004, the date of transition to IFRS, were fully recognised. Actuarial gains and losses and changes in unrecognised scheme surpluses that arise subsequent to that date, have been recognised in full through the statement of recognised income and expense.

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

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

For defined benefit schemes, the actuarial cost charged to profit from operations consists of current service cost, interest cost, expected return on plan assets, past service cost and the impact of any settlements or curtailments.

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

Share-based payments

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

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

Research and development

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

Taxation

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

Notes on the accounts continued

1 Accounting policies continued

The current income tax charge is calculated on the basis of tax laws enacted or substantially enacted at the balance sheet date in the countries where the Group's subsidiaries, associates and joint ventures operate and generate taxable income.

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

The Group has exposures in respect of the payment or recovery of a number of taxes. Liabilities or assets for these payments or recoveries are recognised at such time as an outcome becomes probable and when the amount can reasonably be estimated.

Intangible assets other than goodwill

The intangible assets shown on the Group balance sheet consist mainly of trademarks acquired by the Group's subsidiary undertakings and computer software.

Acquired trademarks are carried at cost less accumulated amortisation and impairment. Trademarks with indefinite lives are not amortised but are reviewed annually for impairment. Intangible assets other than goodwill classified as held for sale are not amortised. Other trademarks are amortised on a straight-line basis over their remaining useful lives, consistent with the pattern of economic benefits expected to be received, which do not exceed 20 years. Any impairments of trademarks are recognised in the income statement but increases in trademark values are not recognised.

Computer software is carried at cost less accumulated amortisation and impairment, and is amortised on a straight-line basis over a period ranging from 3 to 5 years.

The investments in associates shown in the Group balance sheet include trademarks arising from the combination of Brown & Williamson (B&W) and R J Reynolds (RJR) in 2004 to form Reynolds American Inc. (RAI), as well as those arising on the acquisition of Conwood by RAI in 2006. As the combination of B&W and RJR for the Group involved the partial disposal of B&W and an investment in RAI, fair values were assigned to trademarks formerly owned by RJR but not to those formerly owned by B&W. Most of the carrying value of the trademarks relates to trademarks which are deemed to have indefinite lives and each trademark is subject to an annual impairment test. Certain minor trademarks are being amortised over their remaining lives.

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and impairment. Depreciation is calculated on a straight-line basis to write off the assets over their useful economic life. No depreciation is provided on freehold land or assets classified as held for sale. Freehold and long leasehold property are depreciated at rates between 2.5 per cent and 4 per cent per annum, and plant and equipment at rates between 7 per cent and 25 per cent per annum. 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 IFRIC4, 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 3 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.

Notes on the accounts continued

1 Accounting policies continued

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

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

- for derivatives that are designated as cash flow hedges, the changes in their fair values are recognised directly in equity, to the extent that they are effective, with the ineffective portion being recognised in the income statement. Where the hedged item results in a non-financial asset, the accumulated gains and losses, previously recognised in equity, are included in the initial carrying value of the asset (basis adjustment) and recognised in the income statement in the same periods as the hedged item. Where the underlying transaction does not result in such an asset, the accumulated gains and losses are recognised in the income statement in the same periods as the hedged item;
- for derivatives that are designated as fair value hedges, the carrying value of the hedged item is adjusted for the fair value changes attributable to the risk being hedged, with the corresponding entry being made in the income statement. The changes in fair value of these derivatives are also recognised in the income statement;
- for derivatives that are designated as hedges of net investments in foreign operations, the changes in their fair values are recognised directly in equity, to the extent that they are effective, with the 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 intra-group sales of materials, manufactured goods, charges for royalties, commissions, services and fees, are based on normal commercial practices which would apply between independent businesses. Royalty income, less related expenditure, is included in the region in which the licensor is based.

Adjusting items

Adjusting items are distorting items in the profit from operations and the Group share of the post-tax results of associates and joint ventures which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. These items are separately disclosed either as memorandum information on the face of the income statement and in the segmental analyses, or in the notes to the accounts as appropriate.

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.

These changes are effective from 1 January 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 significant change to the segments currently reported by the Group, but there will be some additional disclosures;
- the Amendment to IFRS2 (Share-Based Payment: Vesting Conditions and Cancellations) has been endorsed by the EU. This interpretation clarifies that vesting conditions are service conditions and performance conditions only, and specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. It is not expected that this change would materially affect the Group's reported profit or equity;
- the revised IAS1 (Presentation of financial statements) has been endorsed by the EU. 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) has been endorsed by the EU. This standard requires borrowing costs directly attributable to the acquisition, construction or production of an asset that takes a substantial period of time to get ready for its intended use or sale, to be capitalised as part of the cost of the asset. The Group's 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.

The annual Improvements to IFRS have been endorsed by the EU, and have varying application dates commencing on or after 1 January 2009. The main effect will be a reclassification of certain derivative balances between current and non-current on the balance sheet.

IFRIC16 (Hedges of a Net Investment in a Foreign Operation) is awaiting EU endorsement. This interpretation clarifies the specific hedge accounting requirements for net investment hedges. 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. These changes have not yet been endorsed by the EU and will only be applicable once that endorsement has occurred.

Notes on the accounts continued

2 Segmental analyses

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

	Europe		Asia-Pacific	
	2008	2007 restated	2008	2007 restated
	£m	£m	£m	£m
Revenue				
External sales	4,720	3,621	2,146	1,874
Inter-segment sales	258	225	19	22
Revenue	4,978	3,846	2,165	1,896
Results				
Segment result before restructuring and integration costs, Canadian settlement, amortisation of trademarks and gains on disposal of businesses and trademarks	1,213	842	804	672
Restructuring and integration costs	(117)	(116)	(2)	(5)
Canadian settlement				
Amortisation of trademarks	(19)			
Gains on disposal of businesses and trademarks	141	56		
Segmental result	1,218	782	802	667
Unallocated costs				
Profit from operations				
Net finance costs				
Share of post-tax results of associates and joint ventures				
Profit 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	306	245	83	70
Depreciation and amortisation	186	138	60	45
Impairment, accelerated depreciation and amounts written off	19	4		3
Assets				
Segment assets	10,566	6,081	2,900	2,376
Investments in associates and joint ventures		203	644	508
Assets classified as held-for-sale	201	5	4	27
Unallocated assets				
Total assets				
Liabilities				
Segment liabilities	2,828	1,778	668	525
Liabilities directly associated with assets classified as held-for-sale				2
Unallocated liabilities				
Total liabilities				

The restructuring and integration costs, Canadian settlement, amortisation of trademarks and gains on disposal of businesses and trademarks are explained in note 3.

Latin America		Africa and Middle East		America-Pacific		Elimination		Consolidated	
2008	2007 restated	2008	2007 restated	2008	2007 restated	2008	2007 restated	2008	2007 restated
£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
2,232	1,979	1,572	1,224	560	473			11,230	9,171
615	585		15					892	847
2,847	2,564	1,572	1,239	560	473			12,122	10,018
759	681	536	467	515	446			3,827	3,108
		(46)	(42)	5	(10)			(160)	(173)
		(5)		(102)				(102)	
			19					(24)	
								141	75
759	681	485	444	418	436			3,682	3,010
								(110)	(106)
								3,572	2,904
								(391)	(269)
								503	442
								3,684	3,077
								(1,025)	(790)
								2,659	2,287
								2,457	2,130
								202	157
105	110	95	72	30	32			619	529
74	63	42	37	39	31			401	314
		10	11		4			29	22
1,659	1,493	2,782	1,712	2,886	2,561	(749)	(412)	20,044	13,811
5	3	18	11	1,885	1,591			2,552	2,316
	1	17	1	3	2			225	36
								4,730	2,601
								27,551	18,764
841	669	864	580	729	536	(836)	(657)	5,094	3,431
								15,242	8,242
								20,336	11,675

The restatement of the 2007 results reflects the change in the Group's accounting policy for recognition of actuarial gains and losses together with the early adoption of IFRIC14 as explained in note 1.

Segment assets and liabilities include inter-company balances with entities reported as corporate liabilities and corporate assets.

Notes on the accounts continued

2 Segmental analyses continued

(a) Segment revenue

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

	2008 £m	2007 £m
Europe	4,745	3,655
Asia-Pacific	2,151	1,876
Latin America	2,246	1,983
Africa and Middle East	1,797	1,445
America-Pacific	1,183	1,059
Segment revenue	12,122	10,018

(b) Segment assets

	2008 £m	2007 restated £m
Total assets	27,551	18,764
Less		
– investments in associates and joint ventures	2,552	2,316
– available-for-sale investments (note 15)	106	97
– deferred tax assets	392	264
– interest receivable (note 14)	9	11
– income tax receivable	137	85
– dividends receivable from associates (note 14)	72	53
– derivatives in respect of net debt (note 16)	436	188
– loans	111	77
– interest bearing cash and cash equivalents	2,268	1,063
– assets classified as held-for-sale	225	36
– corporate assets	1,199	763
Segment assets	20,044	13,811

(c) Segment liabilities

	2008 £m	2007 restated £m
Total current and non-current liabilities	20,336	11,675
Less		
– borrowings (note 21)	12,161	6,923
– deferred tax liabilities	599	336
– derivatives in respect of net debt (note 16)	554	179
– dividends payable	7	5
– income tax payable	300	227
– interest payable (note 23)	2	4
– liabilities directly associated with assets classified as held-for-sale		2
– corporate liabilities	1,619	568
Segment liabilities	5,094	3,431

2 Segmental analyses continued

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

External revenue

	2008 £m	2007 £m
Europe	466	763
Asia-Pacific	656	547
Latin America	1	1
Africa and Middle East	26	9
America-Pacific	2,011	1,888
	3,160	3,208

Post-tax results

	Segment result		Adjusted segment result*	
	2008 £m	2007 £m	2008 £m	2007 £m
Europe	39	48	26	48
Asia-Pacific	121	110	121	110
Latin America	2	1	2	1
Africa and Middle East	2	1	2	1
America-Pacific	339	282	326	289
	503	442	477	449

*Excluding charges for trademark impairments, additional ST income, the gain on termination of joint venture and restructuring costs.

(e) Segmental analysis of revenue and profit for 2008 for the regional structure that will be applicable from 2009

The acquisition of ST (Skandinavisk Tobakskompagni) and Tekel, and the growth of the global business have prompted a review of the Group's regional structure. The Group has decided, from 1 January 2009, to separate Europe into 2 regions, Eastern and Western. In addition, Canada forms part of a new Americas region, which include the markets of Latin America and the Caribbean, while Japan becomes part of the Asia-Pacific region. The following segmental analysis of revenue and profit is being provided as additional information:

Revenue

	Year ended 31 December 2008 £m
Eastern Europe	1,594
Western Europe	3,218
Asia-Pacific	2,717
Americas	2,863
Africa and Middle East	1,730
	12,122

Based on location of sales.

Notes on the accounts continued

2 Segmental analyses continued

Profit from operations

	Year ended 31 December 2008	
	Profit from operations 2008 £m	Adjusted profit from operations* 2008 £m
Eastern Europe	468	468
Western Europe	765	760
Asia-Pacific	922	924
Americas	956	1,052
Africa and Middle East	461	513
	3,572	3,717

All centre costs are allocated to regions in the new regional structure.

*Adjusted profit from operations excludes restructuring and integration costs, Canadian settlement, amortisation of trademarks and gains on disposal of businesses and trademarks as explained in note 3.

Group's share of the post-tax results of associates and joint ventures

	Year ended 31 December 2008	
	Post-tax profit 2008 £m	Adjusted post-tax profit* 2008 £m
Eastern Europe		
Western Europe	39	26
Asia-Pacific	121	121
Americas	341	328
Africa and Middle East	2	2
	503	477

*Adjusted post-tax profit of associates and joint ventures excludes charges for trademark impairments, additional ST income, the gain on termination of joint venture and restructuring costs.

3 Profit from operations

(a) Employee benefit costs

	2008 £m	2007 restated £m
Wages and salaries	1,577	1,301
Social security costs	196	164
Other pension and retirement benefit costs (note 12)	71	61
Share-based payments (note 27)	63	61
	1,907	1,587

The restatement of 2007 reflects the change in the Group's accounting policy for recognition of actuarial gains and losses as explained in note 1 and note 12.

3 Profit from operations continued

(b) Depreciation and amortisation costs

	2008 £m	2007 £m
Intangibles including goodwill – amortisation other than trademarks	56	37
– amounts written off		6
– amortisation of trademarks (<i>note 3(g)</i>)	24	
Property, plant and equipment – depreciation	345	277
– impairment and accelerated depreciation	5	16
	430	336

Impairment and accelerated depreciation in respect of property, plant and equipment arose in relation to the restructuring costs (*note 3(e)*). 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 trademarks, property disposals, service fees and other shared costs charged to third parties, manufacturing fees and trademark income.

(d) Other operating expenses include:

	2008 £m	2007 £m
Research and development expenses (excluding employee benefit costs and depreciation)	50	43
Exchange differences	(63)	(18)
Rent of plant and equipment (operating leases)		
– minimum lease payments	31	25
– contingent rents	1	2
Rent of property (operating leases)		
– minimum lease payments	80	64
– sublease payments	4	2
Fees payable for audit services pursuant to legislation:		
– fees payable to PricewaterhouseCoopers LLP for Parent Company and Group audit	1.6	1.5
– fees payable to other PricewaterhouseCoopers firms and associates for local statutory and Group reporting audits	8.5	6.7
Audit fees payable to PricewaterhouseCoopers firms and associates	10.1	8.2
Audit fees payable to other firms	0.6	0.5
Total audit fees payable	10.7	8.7
Fees payable to PricewaterhouseCoopers firms and associates for other services:		
– other services pursuant to statutory legislation	0.7	0.3
– tax advisory services	3.5	3.7
– tax compliance	1.4	0.5
– services relating to information technology	0.8	0.3
– other non-audit services	0.6	0.8
	7.0	5.6

The total fees payable to PricewaterhouseCoopers firms and associates included above are £17.1 million (2007: £13.8 million).

Total research and development costs including employee benefit costs and depreciation were £105.1 million (2007: £90.9 million).

Notes on the accounts continued

3 Profit from operations continued

(e) Restructuring and integration 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 as well as integrating acquired businesses into existing operations and are included in the profit from operations under the following headings:

	2008 £m	2007 £m
Employee benefit costs	92	84
Depreciation and amortisation costs	5	22
Other operating expenses	82	73
Other operating income	(19)	(6)
	160	173

Restructuring costs in 2008 principally relate to costs in respect of the integration of ST and Tekel into existing operations, the reorganisation of the business in the Netherlands, as well as further costs in respect of restructurings announced in 2007 and earlier years. The restructuring costs in 2007 principally related to costs associated with restructuring the operations in Italy, 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.

Other operating income relates to gains on property disposals and also, in 2008, a gain on disposal of a non-core business in the Asia-Pacific region arising from the restructuring exercises.

(f) Canadian settlement

On 31 July 2008, the Group's subsidiary in Canada (Imperial Tobacco Canada) announced that it had reached a resolution with the federal and provincial governments with regard to the investigation related to the export to the United States of Imperial Tobacco Canada tobacco products in the late 1980s and early 1990s. The subsidiary entered a plea of guilty to a regulatory violation of a single count of Section 240(i) (a) of the Excise Act and has paid a fine of £102 million which was included in other operating expenses in the profit from operations for the year ended 31 December 2008.

Imperial Tobacco Canada has also entered into a 15-year civil agreement with the federal and provincial governments. In order, amongst other things, to assist the governments in their future efforts against illicit trade, Imperial Tobacco Canada has agreed to pay a percentage of annual net sales revenue each year going forward for 15 years, up to a maximum of Can\$350 million, which will be expensed as it is incurred.

(g) Amortisation of trademarks

The acquisitions of Tekel and ST resulted in the capitalisation of trademarks which are amortised over their expected useful lives, which do not exceed 20 years. The amortisation charge of £24 million is included in depreciation and amortisation costs in the profit from operations for the year ended 31 December 2008.

(h) Gains on disposal of businesses and trademarks

The gain on disposal of businesses and trademarks for the year ended 31 December 2008 was £141 million, of which £139 million arose on 2 July 2008 with the disposal of the Group's 32.35 per cent holding in the non-cigarette and snus businesses of ST (as described in note 26(a)). The gain is included in other operating income in the profit from operations for the year ended 31 December 2008.

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 of 2007 and resulted in a gain of £11 million included in other operating income in profit from operations. However, the Group retained the Dunhill and Captain Black pipe tobacco trademarks.

On 23 May 2007, the Group announced that it had agreed to sell its Belgian cigar factory and associated trademarks to the cigars division of ST. 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 profit from operations for the year ended 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 profit from operations for the year ended 31 December 2007.

4 Net finance costs

	2008	2007
	£m	£m
Finance costs		
– interest payable	535	382
– fair value changes	521	143
– exchange differences	(398)	(120)
	658	405
Finance income		
– interest and dividend income	(131)	(111)
– exchange differences	(136)	(25)
	(267)	(136)
Net finance costs	391	269
Net finance costs comprise:		
Interest payable		
– bank borrowings	83	67
– finance leases	4	3
– facility fees	4	2
– other	444	310
	535	382
Interest receivable	(129)	(109)
Dividend income	(2)	(2)
	(131)	(111)
Fair value changes		
– cash flow hedges transferred from equity	(201)	(26)
– fair value changes on hedged items	168	(6)
– fair value hedges	(22)	(14)
– ineffective portion of fair value hedges	(2)	8
– instruments not designated as hedges	578	181
	521	143
Exchange differences	(534)	(145)
	(13)	(2)
	391	269

Other interest payable includes interest on the bonds and notes detailed in note 21. Facility fees are in respect of the Group's central banking facility of £1.75 billion as well as acquisition facilities of €420 million and €860 million to fund the purchase of Tekel in 2008.

Included within the interest receivable is £1 million (2007: £3 million) in respect of available-for-sale investments. Included within dividend income is £1 million (2007: £1 million) in respect of available-for-sale investments.

Included within exchange differences is a gain of £133 million (2007: £35 million loss) in respect of items subject to fair value hedges.

IFRS requires fair value changes for derivatives, which do not meet the tests for hedge accounting under 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 year ended 31 December 2008 (note 7) 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 the Statement of recognised income and expense.

Notes on the accounts continued

5 Associates and joint ventures

	2008		2007	
	Total £m	Group's share £m	Total £m	Group's share £m
Gross turnover (including duty, excise and other taxes)	11,279	4,205	12,089	4,436
Duty, excise and other taxes	(2,935)	(1,045)	(3,503)	(1,228)
Revenue	8,344	3,160	8,586	3,208
Profit from operations	2,201	850	1,926	735
Net finance costs	(140)	(58)	(99)	(42)
Profit on ordinary activities before taxation	2,061	792	1,827	693
Taxation on ordinary activities	(736)	(284)	(646)	(246)
Profit on ordinary activities after taxation	1,325	508	1,181	447
after (charging)/crediting				
– trademark impairments	(46)	(20)	(16)	(7)
– additional ST income	42	13		
– termination of joint venture	107	45		
– restructuring costs	(29)	(12)		
Attributable to:				
British American Tobacco's shareholders		503		442
Minority interests		5		5
Dividends				
– listed investments		(278)		(245)
– unlisted investments		(48)		(45)
		(326)		(290)

The share of post-tax results of associates and joint ventures is after trademark impairments, additional ST income, the gain on termination of joint venture and restructuring costs. These items have been treated as adjusting items and excluded from the calculation of adjusted earnings per share as set out in note 7.

In the year ended 31 December 2008, Reynolds American modified the previously anticipated level of support between certain trademarks and the projected net sales of certain trademarks, resulting in a trademark impairment charge of which the Group's share amounted to £20 million (net of tax) (2007: £7 million).

The year end of ST, an associate of the Group until 2 July 2008, was 30 June, and, for practical reasons, the Group had previously equity accounted for its interest based on the information available from ST which was 3 months in arrears to that of the Group. As explained in note 26(a), the Group acquired 100 per cent of ST's cigarette and snus businesses on 2 July 2008. In order to account for the Group's share of the net assets of ST at the date of the acquisition, the results of ST for the period up to 2 July 2008 have been included in the results from associates for 2008, resulting in 1 additional quarter's income in 2008. This contributed an additional £13 million to the share of post-tax results of associates and joint ventures.

On 21 February 2008, Reynolds American announced that it would receive a payment from Gallaher Limited resulting from the termination of a joint venture agreement. While the payment will be received over a number of years, in the year ended 31 December 2008, Reynolds American recognised a pre-tax gain of US\$328 million. The Group's share of this gain included in the results for the year amounts to £45 million (net of tax).

5 Associates and joint ventures continued

On 9 September 2008, Reynolds American Inc. further announced planned changes in the organisational structure at Reynolds American Inc. and its largest subsidiary, R J Reynolds Tobacco Company. The charge for the year ended 31 December 2008 amounts to US\$90 million. The Group's share of this charge included in the results for the year ended 31 December 2008 amounts to £12 million (net of tax).

Following the change in Group accounting policy for the recognition of actuarial gains and losses as explained in note 1 and note 12, the investment in associates and joint ventures on the Group balance sheet at 31 December 2007 has been increased by £47 million (note 11), with a corresponding entry to equity. The change in accounting policy did not have any impact on the results from associates for 2008 and 2007.

6 Taxation on ordinary activities

(a) Summary of tax on ordinary activities

	2008 £m	2007 restated £m
UK corporation tax		
comprising		
– current year tax expense	1,103	977
– double taxation relief	(1,103)	(977)
Overseas tax	945	765
comprising		
– current year tax expense	959	816
– adjustments in respect of prior periods	(14)	(51)
Total current tax	945	765
Deferred tax	80	25
comprising		
– deferred tax relating to origination and reversal of temporary differences	77	37
– deferred tax relating to changes in tax rates	3	(12)
	1,025	790

(b) Franked Investment Income Group Litigation Order

British American Tobacco is the principal test claimant in an action in the United Kingdom against HM Revenue and Customs in the Franked Investment Income Group Litigation Order (FII GLO). There are over 20 companies in the FII GLO. The case concerns the treatment for UK corporate tax purposes of profits earned overseas and distributed to the UK. The claim was filed in 2003 and the case was heard in the European Court of Justice (ECJ) in 2005 and a decision of the ECJ received in December 2006. In July 2008, the case reverted to a trial in the UK High Court for the UK Court to determine how the principles of the ECJ decision should be applied in a UK context.

The High Court judgment in November 2008 concludes, amongst many other things, that dividends received from EU subsidiaries should be, and should have been, exempt from UK taxation. It also concludes that certain dividends received before 5 April 1999 from the EU and, in some limited circumstances after 1993 from outside the EU, should have been treated as franked investment income with the consequence that advance corporation tax need not have been paid. Claims for the repayment of UK tax incurred where the dividends were from the EU can be made back to 1973. The case will now proceed to the Court of Appeal.

The tentative conclusion reached in the judgment would, if upheld, produce an estimated receivable of about £1.2 billion for British American Tobacco.

The potential receipt of some or all of the amount referred to above has not been recognised in the results of the Group due to uncertainty of the amounts and eventual outcome.

Notes on the accounts continued

6 Taxation on ordinary activities continued

(c) Factors affecting the tax charge

The taxation charge differs from the standard 28 per cent rate of corporation tax in the UK. The major causes of this difference are listed below:

	2008		2007 restated	
	£m	%	£m	%
Profit before tax	3,684		3,077	
Less: share of associates post-tax profit	(503)		(442)	
	3,181		2,635	
Tax at 28% (2007: 30%) on the above	891	28.0	790	30.0
Factors affecting the tax rate:				
Tax at standard rates other than UK corporation tax rate	(74)	(2.3)	(72)	(2.7)
Other national tax charges	15	0.5	18	0.7
State and local taxes	48	1.5	52	2.0
Permanent differences	(35)	(1.1)	(39)	(1.5)
Overseas withholding taxes	79	2.5	63	2.4
Double taxation relief on UK profits	(11)	(0.3)	(8)	(0.3)
Unutilised tax losses	42	1.3	16	0.6
Adjustments in respect of previous periods	(14)	(0.4)	(51)	(1.9)
Deferred tax charges at other tax rates	81	2.5	33	1.2
Deferred tax attributable to an increase/(decrease) in the rate of domestic income tax	3	0.1	(12)	(0.5)
	1,025	32.3	790	30.0

(d) Tax on items recognised directly in the Statement of recognised income and expense (SORIE)

	2008 £m	2007 restated £m
Current tax	28	(25)
Deferred tax	156	(28)
Credited/(charged) to SORIE	184	(53)

The tax charge for 2008 includes a one-off deferred tax charge of £26 million as a result of the acquisition of the cigarette assets of Tekel. This has been excluded from the adjusted earnings per share calculation as set out in note 7.

The restatement of the 2007 results reflects the change in the Group's accounting policy for recognition of actuarial gains and losses together with the adoption of IFRIC14 as explained in note 1 and note 12.

7 Earnings per share

Basic earnings per share are based on profit for the year attributable to ordinary shareholders of £2,457 million (2007: £2,130 million) and 1,993 million (2007: 2,025 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 2,005 million (2007: 2,039 million) to reflect the potential dilutive effect of employee share schemes.

	2008			2007		
	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	2,457	1,993	123.28	2,130	2,025	105.19
Share options		12	(0.74)		14	(0.73)
Diluted earnings per share	2,457	2,005	122.54	2,130	2,039	104.46

Earnings have been affected by a number of adjusting items, together with certain distortions to net finance costs and to deferred tax as explained in note 4 and note 6 respectively. To illustrate the impact of these, an adjusted earnings per share is shown below:

Adjusted earnings per share calculation

	2008		Diluted 2007		2008		Basic 2007	
	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	2,457	122.54	2,130	104.46	2,457	123.28	2,130	105.19
Effect of restructuring and integration costs	160	7.98	173	8.49	160	8.03	173	8.54
Tax and minority interests on restructuring and integration costs	(38)	(1.90)	(41)	(2.01)	(38)	(1.91)	(41)	(2.02)
Effect of Canadian settlement	102	5.09			102	5.12		
Amortisation of trademarks	24	1.20			24	1.20		
Tax on amortisation of trademarks	(6)	(0.30)			(6)	(0.30)		
Gain on disposal of businesses and trademarks	(141)	(7.03)	(75)	(3.68)	(141)	(7.07)	(75)	(3.70)
Tax relating to disposal of businesses and trademarks	13	0.65	19	0.93	13	0.65	19	0.94
Net finance cost adjustment	11	0.55			11	0.55		
Effect of associates' trademark impairments, restructuring costs and termination of joint venture	(13)	(0.65)	7	0.34	(13)	(0.65)	7	0.34
Effect of additional ST income	(13)	(0.65)			(13)	(0.65)		
Effect of deferred tax adjustment	26	1.30			26	1.30		
Adjusted earnings per share	2,582	128.78	2,213	108.53	2,582	129.55	2,213	109.29

Notes on the accounts continued

7 Earnings per share continued

British American Tobacco p.l.c. obtained a secondary listing of its ordinary shares on the main board of the JSE Limited (JSE) in South Africa. In accordance with the JSE Listing Requirements, the Group is required to present headline earnings per share and diluted headline earnings per share which are additional alternative measures of earnings per share, calculated in accordance with Circular 8/2007, 'Headline Earnings' issued by the South African Institute of Chartered Accountants. These are calculated as shown below:

Headline earnings per share as required by the JSE Limited

	2008		Diluted 2007		2008		Basic 2007	
	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	2,457	122.54	2,130	104.46	2,457	123.28	2,130	105.19
Effect of impairment of goodwill and property, plant and equipment	5	0.25	22	1.08	5	0.25	22	1.09
Tax and minority interests on impairment of goodwill and property, plant and equipment			(5)	(0.24)			(5)	(0.25)
Effect of gains on disposal of property, plant and equipment	(11)	(0.55)	(6)	(0.29)	(11)	(0.55)	(6)	(0.30)
Tax and minority interests on gains on disposal of property, plant and equipment	2	0.10	2	0.10	2	0.10	2	0.10
Effect of gains on disposal of businesses and trademarks	(149)	(7.43)	(75)	(3.68)	(149)	(7.48)	(75)	(3.70)
Tax relating to and minority interests on disposal of businesses and trademarks	15	0.75	19	0.93	15	0.75	19	0.94
Effect of (gains)/losses reclassified from the available-for-sale reserve	(6)	(0.30)	2	0.10	(6)	(0.30)	2	0.10
Tax and minority interests on (gains)/losses reclassified from the available-for-sale reserve			(1)	(0.05)			(1)	(0.05)
Share of associates' trademark impairments and termination of joint venture	(42)	(2.10)	11	0.54	(42)	(2.10)	11	0.54
Tax and minority interests on share of associates' trademark impairments and termination of joint venture	17	0.85	(4)	(0.20)	17	0.85	(4)	(0.20)
Headline earnings per share	2,288	114.11	2,095	102.75	2,288	114.80	2,095	103.46

8 Dividends and other appropriations

	2008		2007	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim				
2008 paid 17 September 2008	22.1	440		
2007 paid 12 September 2007			18.6	377
Final				
2007 paid 7 May 2008	47.6	953		
2006 paid 3 May 2007			40.2	821
	69.70	1,393	58.8	1,198

The Directors have recommended to shareholders a final dividend of 61.60 pence per share for the year ended 31 December 2008. If approved, this dividend will be paid to shareholders on 6 May 2009. 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 £1,221 million which takes the total dividends declared in respect of 2008 to £1,661 million (2007: £1,330 million) representing 83.70 pence per share (2007: 66.20 pence per share).

9 Intangible assets

	Goodwill £m	Computer software £m	Trademarks and licences £m	Assets in the course of development £m	Total £m
1 January 2008					
Cost	7,942	305	29	48	8,324
Accumulated amortisation		(201)	(18)		(219)
Net book value at 1 January 2008	7,942	104	11	48	8,105
Differences on exchange	1,895	23	118	4	2,040
Additions					
– internal development		5		28	33
– acquisitions of subsidiaries and minority interests	1,553		606	1	2,160
– separately acquired	1	22	2	48	73
Reallocations		44		(44)	
Amortisation charge		(59)	(32)		(91)
Disposals		(2)			(2)
31 December 2008					
Cost	11,391	388	758	85	12,622
Accumulated amortisation		(251)	(53)		(304)
Net book value at 31 December 2008	11,391	137	705	85	12,318
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

Included in computer software and assets in the course of development are internally developed assets with a carrying value of £137 million (2007: £104 million). The costs of internally developed assets include capitalised expenses of third-party consultants as well as software licence fees from third-party suppliers.

The principal acquisitions were in respect of the Tekel cigarette assets and the cigarette and snus businesses of ST as explained in note 26. In addition, a number of smaller acquisitions of minority interests in Group companies were made during 2008 in Africa and Middle East and Europe.

Notes on the accounts continued

9 Intangible assets continued

Impairment testing for intangible assets with indefinite lives including goodwill

Goodwill of £11,391 million (2007: £7,942 million) included in intangible assets in the balance sheet is mainly the result of the following acquisitions: Rothmans Group £4,974 million (2007: £4,067 million); Imperial Tobacco Canada £2,261 million (2007: £2,046 million); ETI (Italy) £1,591 million (2007: £1,212 million) as well as the 2 acquisitions made during 2008 ST (principally Scandinavia) £1,200 million; and Tekel (Turkey) £619 million. The principal allocations of goodwill in the Rothmans' acquisition are to the cash-generating units of 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 15 (2007: 13) individual cash-generating units – 5 in Europe (2007: 4), 2 in Africa and Middle East (2007: 1), 3 in Asia-Pacific (2007: 3), 3 in Latin America (2007: 3) and 2 in America-Pacific (2007: 2). The carrying amounts of goodwill allocated to the cash-generating units of South Africa £833 million (2007: £814 million), Australia (includes Rothmans and other acquisitions) £650 million (2007: £591 million), Malaysia £474 million (2007: £358 million), Singapore £516 million (2007: £373 million), Europe (includes Rothmans and other acquisitions) £2,293 million (2007: £1,697 million), Canada £2,261 million (2007: £2,046 million), Italy £1,600 million (2007: £1,218 million) and in respect of the acquisitions made during 2008, ST (principally Scandinavia) £1,200 million and Turkey £619 million are considered significant in comparison with the total carrying amount of goodwill.

The recoverable amount of all cash-generating units has been determined on a value-in-use basis. The key assumptions for the recoverable amount of all units are the long-term growth rate and the discount rate. The long-term growth rate 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 2 year period, with cash flow beyond 2 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. The growth rate of 3 per cent per annum is considered a conservative rate given the Group's history of growth, its well balanced portfolio of brands and the industry in which it operates. 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 5 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 (2007: 7.9 per cent to 18.7 per cent) were used, based on the Group's weighted average cost of capital, together with any premium applicable for 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 11.5 per cent for South Africa (2007: 12.1 per cent), 9.3 per cent for Europe (2007: 9.3 per cent), 9.7 per cent for Canada (2007: 10.0 per cent), 9.8 per cent for Italy (2007: 10.7 per cent), 8.7 per cent for ST (principally Scandinavia) and 13.1 per cent for Turkey.

Aside from the amounts written off in 2007 and shown as part of restructuring costs (note 3 (e)), no impairment charges were recognised in 2008 or 2007. 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 2008					
Cost	810	212	3,573	239	4,834
Accumulated depreciation and impairment	(298)	(71)	(2,087)		(2,456)
Net book value at 1 January 2008	512	141	1,486	239	2,378
Differences on exchange	76	27	291	27	421
Additions	13	3	231	267	514
Acquisitions of subsidiaries	102		125	8	235
Reallocations	31	3	191	(225)	
Depreciation	(28)	(11)	(352)		(391)
Impairment	(4)		(6)		(10)
Disposals	(20)	(1)	(29)		(50)
Reclassification as held-for-sale	(19)		(2)		(21)
31 December 2008					
Cost	1,014	257	4,565	316	6,152
Accumulated depreciation and impairment	(351)	(95)	(2,630)		(3,076)
Net book value at 31 December 2008	663	162	1,935	316	3,076
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
Assets held under finance leases					
31 December 2008					
Cost		4	170		174
Accumulated depreciation and impairment		(2)	(100)		(102)
Net book value at 31 December 2008		2	70		72
31 December 2007					
Cost		3	106		109
Accumulated depreciation and impairment		(1)	(47)		(48)
Net book value at 31 December 2007		2	59		61

Assets held under finance leases are secured under finance lease obligations in note 21.

Notes on the accounts continued

10 Property, plant and equipment continued

	2008 £m	2007 £m
Cost of freehold land within freehold property on which no depreciation is provided	91	63
Leasehold property comprises		
– net book value of long leasehold	120	98
– net book value of short leasehold	42	43
	162	141
Contracts placed for future expenditure	36	34

Bank borrowings are secured by property, plant and equipment to the value of £14 million (2007: £8 million).

11 Investments in associates and joint ventures

	2008 £m	2007 restated £m
1 January	2,316	2,108
Change in accounting policy (<i>note 12</i>)		30
	2,316	2,138
Differences on exchange	724	38
Share of profit after taxation (<i>note 5</i>)	503	442
Dividends (<i>note 5</i>)	(326)	(290)
Share buy-backs	(62)	
Actuarial (losses)/gains relating to pensions and other post-retirement benefits	(396)	17
Disposals	(214)	
Other equity movements	7	(29)
31 December	2,552	2,316
Non-current assets	4,534	3,551
Current assets	2,066	1,733
Non-current liabilities	(2,667)	(1,650)
Current liabilities	(1,381)	(1,318)
	2,552	2,316
Reynolds American Inc. (market value £3,435 million (2007: £4,121 million))	1,884	1,591
Other listed associates (market value £2,968 million (2007: £3,245 million))	638	502
Unlisted	30	223
	2,552	2,316

The restatement of 2007 reflects the change in the Group's accounting policy for recognition of actuarial gains and losses as explained in note 1 and note 12.

As explained in note 26(a), the Group acquired 100 per cent of ST's cigarette and snus businesses on 2 July 2008. The transaction has been accounted for as an acquisition of 67.65 per cent of the cigarette and snus businesses' net assets of ST and a disposal of the Group's existing 32.35 per cent interest in the non-cigarette and snus businesses of ST previously reflected in the above table.

The Group's share of non-current assets above includes £1,643 million (2007: £1,187 million) of goodwill and £641 million (2007: £463 million) of trademarks arising from the Reynolds American transaction in 2004. In addition, the non-current assets above includes £733 million (2007: £529 million) of goodwill and £361 million (2007: £290 million) of trademarks arising from the acquisition of Conwood by Reynolds American in 2006.

11 Investments in associates and joint ventures continued

Details of the Group's contingent liabilities are set out in note 30. In addition to US litigation involving Group companies, which is covered by the R.J. Reynolds Tobacco Company (RJRT) indemnity referred to in note 30, Reynolds American Inc. (RAI) group companies are named in litigation which does not involve Group companies. While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, it is not impossible that the results of operations or cash flows of RAI, in particular quarterly or annual periods, could be materially affected by this and by the final outcome of any particular litigation. However, having regard to the contingent liability disclosures on litigation made by RAI in its public financial reports, the Directors are satisfied with the carrying value included above for RAI.

The Group's share of the RAI results for the year to 31 December 2008 includes £22 million (2007: £18 million) in respect of external legal fees and other external product liability defence costs.

Additional information on associates as well as principal subsidiary undertakings is provided in the Principal subsidiary undertakings and Principal associate undertakings sections to the Annual Report.

12 Retirement benefit schemes

The Group's subsidiary undertakings operate around 150 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 3 years.

The principal pension schemes are in the UK, Germany, Canada, the Netherlands and Switzerland. Together these schemes account for over 86 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 health care. The liabilities in respect of these benefits are also assessed by qualified independent actuaries, applying the projected unit credit method.

As explained in note 1, the Group has changed the accounting policy for the recognition of actuarial gains and losses under IAS19 and adopted IFRIC14. The comparative figures have been restated accordingly for the following changes:

	Credit/(charge) £m	Credit/(charge) £m
Equity as at 1 January 2007		(104)
Statement of recognised income and expense		
Differences on exchange		8
Actuarial gains/(losses)	108	
– amounts previously recognised in income	(13)	
		95
Change in surplus recognition	(5)	
– amounts previously recognised in income	14	
		9
Associates actuarial gains/(losses)		17
Tax on items recognised directly in equity	(33)	
– amounts previously recognised in income	(1)	
		(34)
Equity as at 31 December 2007		(9)

Notes on the accounts continued

12 Retirement benefit schemes continued

	£m
Balance sheet as at 31 December 2007	
Investment in associates and joint ventures (<i>note 11</i>)	47
Retirement benefits assets	(13)
Deferred tax assets (<i>note 13</i>)	2
Total assets	36
Total equity (<i>note 20</i>)	(9)
Retirement benefit liabilities	3
Deferred tax liabilities (<i>note 13</i>)	42
Total equity and liabilities	36

For the year ended 31 December 2007, the profit from operations and taxation were both reduced by £1 million and therefore the profit for the year was unchanged from that previously reported.

The impact of the accounting changes was to reduce the Group's total equity at 31 December 2008 by £817 million and increase the profit for the year by £4 million.

The total accumulated net actuarial losses taken through the Statement of recognised income and expense at 31 December 2008 were £591 million (2007: £44 million) for subsidiaries and £357 million loss (2007: £39 million gain) for associates and joint ventures.

The amounts recognised in the balance sheet are determined as follows:

	Pension schemes		Health care schemes		Total	
	2008	2007 restated	2008	2007 restated	2008	2007 restated
	£m	£m	£m	£m	£m	£m
Present value of funded scheme liabilities	(4,623)	(4,248)	(24)	(17)	(4,647)	(4,265)
Fair value of funded scheme assets	4,169	4,209	13	14	4,182	4,223
	(454)	(39)	(11)	(3)	(465)	(42)
Unrecognised funded scheme surpluses	(61)	(50)			(61)	(50)
	(515)	(89)	(11)	(3)	(526)	(92)
Present value of unfunded scheme liabilities	(129)	(111)	(119)	(121)	(248)	(232)
Unrecognised past service cost	1	1			1	1
	(643)	(199)	(130)	(124)	(773)	(323)

The above net liability is recognised in the balance sheet as follows

– retirement benefit scheme liabilities	(718)	(236)	(130)	(124)	(848)	(360)
– retirement benefit scheme assets	75	37			75	37
	(643)	(199)	(130)	(124)	(773)	(323)

In Jamaica, the pension scheme holds shares in Carreras Group Ltd (a Group subsidiary) with a fair value of £4 million (2007: £7 million). In Switzerland, a pension scheme owns a property with a fair value of £19 million (2007: £11 million), part of which is occupied by British American Tobacco Switzerland SA.

12 Retirement benefit schemes continued

The amounts recognised in the income statement are as follows:

	Pension schemes		Health care schemes		Total	
	2008 £m	2007 restated £m	2008 £m	2007 restated £m	2008 £m	2007 restated £m
Defined benefit schemes						
– current service cost	67	73	1	1	68	74
– interest cost	251	216	8	7	259	223
– expected return on scheme assets	(292)	(264)	(1)	(1)	(293)	(265)
– past service cost	12	9			12	9
– settlements and curtailments		1				1
	38	35	8	7	46	42
Defined contribution schemes	25	19			25	19
	63	54	8	7	71	61

The above charges are recognised within employee benefit costs in 2008 and 2007 in note 3(a) and include £2 million in 2008 in respect of pension schemes reported as part of the restructuring costs charged in arriving at the profit from operations (note 3(e)).

The movements in scheme liabilities are as follows:

	Pension schemes		Health care schemes		Total	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Present value at 1 January	4,359	4,296	138	125	4,497	4,421
Exchange differences	607	230	17	15	624	245
Current service cost	75	75	1	1	76	76
Interest cost	273	225	8	7	281	232
Past service costs – vested	14	9			14	9
Contributions by scheme members	4	4			4	4
Benefits paid	(302)	(281)	(10)	(9)	(312)	(290)
Settlements and curtailments	(1)	(5)			(1)	(5)
Acquisition of subsidiaries	25				25	
Disposals of subsidiaries		(5)				(5)
Scheme changes	(3)	(1)			(3)	(1)
Actuarial (gains)/losses	(299)	(188)	(11)	(1)	(310)	(189)
Present value at 31 December	4,752	4,359	143	138	4,895	4,497
Funded schemes	4,623	4,248	24	17	4,647	4,265
Unfunded schemes	129	111	119	121	248	232
	4,752	4,359	143	138	4,895	4,497

The actuarial gains in both years principally relate to increases in discount rates.

Notes on the accounts continued

12 Retirement benefit schemes continued

The movements in funded scheme assets are as follows:

	Pension schemes		Health care schemes		Total	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Fair value of scheme assets at 1 January	4,209	3,938	14	12	4,223	3,950
Exchange differences	615	224	(1)	(1)	614	223
Expected return on scheme assets	321	275	1	1	322	276
Company contributions	145	138	6	7	151	145
Contributions by scheme members	5	4			5	4
Benefits paid	(290)	(272)	(7)	(7)	(297)	(279)
Acquisition of subsidiaries	23				23	
Disposals of subsidiaries		(4)				(4)
Scheme changes	(2)	2			(2)	2
Actuarial (losses)/gains	(857)	(96)		2	(857)	(94)
Fair value of scheme assets at 31 December	4,169	4,209	13	14	4,182	4,223

The actuarial losses in both years principally relate to the decline in market value of scheme assets.

Contributions to defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes, taking into account regulatory requirements. Contributions in 2009 are expected to be £180 million for pension schemes and £9 million for health care schemes, compared to £145 million and £6 million respectively, in 2008.

	Pension schemes		Health care schemes		Total	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Actual return on scheme assets	(536)	179	1	3	(535)	182

The movements in the unrecognised funded scheme surpluses are as follows:

	Pension schemes		Health care schemes		Total	
	2008 £m	2007 restated £m	2008 £m	2007 restated £m	2008 £m	2007 restated £m
Unrecognised funded scheme surpluses at 1 January	(50)	(61)			(50)	(61)
Exchange differences	(10)	1			(10)	1
Movement in year	(1)	10			(1)	10
Unrecognised funded scheme surpluses at 31 December	(61)	(50)			(61)	(50)

Movements in unrecognised scheme surpluses are recognised in the Statement of recognised income and expense.

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.

12 Retirement benefit schemes continued

The principal actuarial assumptions (weighted to reflect individual scheme differences) used in the following principal countries are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2008					
Rate of increase in salaries	4.4	3.0	4.0	3.0	1.6
Rate of increase in pensions in payment	2.9	2.0	Nil	1.9	Nil
Rate of increase in deferred pensions	2.9	Nil	Nil	1.9	
Discount rate	6.0	6.0	5.8	5.9	3.3
General inflation	2.9	2.0	3.0	1.9	1.0

For health care inflation in Canada, the assumption is 10 per cent reducing to 5 per cent by 2018.

For the remaining pension schemes, typical assumptions are that real salary increases will be from 0 per cent to 4 per cent per annum and discount rates will be from 1 per cent to 5 per cent above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

	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 health care 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 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, 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, Switzerland and the Netherlands the same tables were used for both years. In the UK, for post-retirement mortality assumptions at 31 December 2008 the PXA92 (year of birth) table rated up 3 years for active and deferred members and PXA92 (year of birth) table rated up 2 years for current pensioners, with a 1.2 per cent underpin on future improvements, all with the medium cohort effect, have been used. At 31 December 2007, the PXA92 (B=1965) and PXA92 (B=1935) tables were used, along with the medium cohort effect, however, active and deferred members were rated up by 1 year and current pensioners were rated up by 3 years. In Canada UP94 tables, in Germany Heubeck tables 2005G, in Switzerland EVK 2000 mortality tables and in the Netherlands GBM/V 2005-2050 tables have been used.

Notes on the accounts *continued*

12 Retirement benefit schemes continued

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 2008										
Member age 65 (current life expectancy)	19.4	22.2	18.0	22.2	19.4	22.0	18.0	21.0	17.8	20.6
Member age 45 (life expectancy at age 65)	23.1	26.5	20.8	24.8	21.0	22.8	19.7	21.8	20.6	23.3
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

The expected rates of return on scheme assets in the following principal countries are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2008					
Equities	6.9	8.0	8.5	7.4	7.5
Bonds	5.3	5.5	5.5	4.3	3.0
Property	6.9	5.0		6.1	4.9
Other assets	6.9		Nil	4.4	4.0

For the remaining pension schemes, typical expected long-term real rates of return ranged from 1 per cent to 8 per cent.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2007					
Equities	7.5	8.0	8.8	8.4	7.3
Bonds	5.2	5.5	5.5	4.6	3.5
Property	7.5	4.5		7.3	4.4
Other assets	8.0		Nil	3.6	5.2

For the remaining pension schemes, typical expected long-term real rates of return ranged from 2 per cent to 8 per cent.

	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.

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.

12 Retirement benefit schemes continued

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 2008							
Equities	50.0	24.5	42.7	19.9	25.8	17.7	34.6
Bonds	39.6	37.1	50.6	64.6	47.9	49.0	45.8
Property	4.2	38.4		8.5	16.1	1.4	10.5
Other assets	6.2		6.7	7.0	10.2	31.9	9.1
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

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 2008 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	111	(112)		
Rate of inflation				
– (decrease)/increase in profit before taxation			(9)	8
– increase/(decrease) of scheme liabilities			98	(91)
Discount rate				
– increase/(decrease) in profit before taxation			3	(3)
– (decrease)/increase of scheme liabilities			(119)	123
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			5	(5)
– increase/(decrease) of scheme assets			83	(83)

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 2009. The effect on scheme assets and liabilities is as at 31 December 2008.

Notes on the accounts continued

12 Retirement benefit schemes continued

A 1 percentage point change in health care inflation would have the following effects, which were similar in 2007:

	1 percentage point increase £m	1 percentage point decrease £m
31 December 2008		
Effect on total of current service cost and interest cost	1	(1)
Effect on health care scheme liabilities	19	(16)

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:

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Historical information					
Scheme liabilities	4,895	4,497	4,421	4,630	3,852
Scheme assets	4,182	4,223	3,950	3,836	3,339
Scheme net deficits	(713)	(274)	(471)	(794)	(519)
Experience losses/(gains) on scheme liabilities	156	6	35	(6)	68
Experience losses/(gains) on scheme assets	857	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 restated £m	Fair value losses £m	Other temporary differences £m	Total restated £m
At 1 January 2008 as restated	35	8	22	102		204	371
Exchange differences	4	1	3	16		35	59
(Charged)/credited to the income statement	(10)	44	36	(18)		(31)	21
Credited to SORIE				45	16	43	104
Subsidiaries acquired						4	4
Other		3	3	(1)	1	(10)	(4)
At 31 December 2008	29	56	64	144	17	245	555
At 1 January 2007	43	13	32	112		188	388
Exchange differences	4	(1)	3	12		10	28
(Charged)/credited to the income statement	(13)		(20)	(22)		9	(46)
(Charged) to SORIE				(1)			(1)
Other	1	(4)	7	1		(3)	2
At 31 December 2007	35	8	22	102		204	371

13 Deferred tax continued

Deferred tax liabilities comprise:

	Stock relief £m	Excess of capital allowances over depreciation £m	Undistributed earnings of associates and subsidiaries £m	Retirement benefits restated £m	Fair value gains/(losses) £m	Other temporary differences £m	Total restated £m
At 1 January 2008 as restated	14	139	109	141		40	443
Exchange differences	4	26	16	33		10	89
(Credited)/charged to the income statement	(7)	34	39	46	1	(2)	111
(Credited)/charged to SORIE			(2)	(57)		7	(52)
Subsidiaries acquired		23				150	173
Other	2	(15)	(2)	(1)		14	(2)
At 31 December 2008	13	207	160	162	1	219	762
At 1 January 2007 as previously reported	27	140	87	114	8	35	411
Change in accounting policy (note 12)				9			9
	27	140	87	123	8	35	420
Exchange differences	2	3	1	11		1	18
(Credited)/charged to the income statement	(15)		20	(25)		1	(19)
Charged/(credited) to SORIE				33	(6)		27
Other		(4)	1	(1)	(2)	3	(3)
At 31 December 2007	14	139	109	141		40	443
						2008	2007
						£m	restated
Net deferred tax liabilities						207	72

The restatement of 2007 reflects the change in the Group's accounting policy for recognition of actuarial gains and losses together with the adoption of IFRIC14 as explained in note 1 and note 12.

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.

	2008 £m	2007 restated £m
Deferred tax assets	(392)	(264)
Deferred tax liabilities	599	336
	207	72
Deferred tax expected to be recovered within 12 months:		
	2008 £m	2007 restated £m
Deferred tax assets	(117)	(116)
Deferred tax liabilities	197	132
	80	16

Notes on the accounts continued

13 Deferred tax continued

At the balance sheet date, the Group has unused tax losses of £926 million (2007: £375 million) which have no expiry date and unused tax losses of £526 million (2007: £403 million) which expire after 5 years. No amount of deferred tax has been recognised in respect of these unused losses.

At the balance sheet date, the Group has not recognised a deferred tax asset in respect of deductible temporary differences of £839 million (2007: £575 million). These unrecognised deductible temporary differences have no expiry date.

At the balance sheet date, the Group has unused tax credits of £199 million (2007: £206 million) which have no expiry date. No amount of deferred tax has been recognised in respect of these unused tax credits.

At the balance sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was £7 billion (2007: £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

	2008 £m	2007 £m
Trade receivables	1,789	1,272
Loans and other receivables	560	498
Prepayments and accrued income	239	198
	2,588	1,968
Current	2,395	1,845
Non-current	193	123
	2,588	1,968

Prepayments and accrued income include £72 million (2007: £53 million) in respect of dividends from associates and £9 million (2007: £11 million) in respect of interest.

Trade and other receivables have been reported in the balance sheet net of allowances as follows:

	2008 £m	2007 £m
Gross trade and other receivables	2,662	2,019
Allowance account	(74)	(51)
Net trade and other receivables per balance sheet	2,588	1,968

The movements in the allowance account are as follows:

	2008 £m	2007 £m
1 January	51	43
Differences on exchange	12	5
Provided in the year	33	22
Amounts reversed during the year	(3)	(3)
Amounts in respect of receivables written off	(19)	(16)
31 December	74	51

Impairment of trade receivables charged during the year is included as part of other operating expenses. For 2008, the net impairment charged was £31 million (2007: £37 million) of which £30 million (2007: £19 million) is reflected in the above table.

14 Trade and other receivables continued

As at 31 December 2008, trade and other receivables of £67 million (2007: £63 million) were past due their contractual payment date but not impaired. These relate to a number of external parties where there is no expectation of default. The age analysis of these trade receivables is as follows:

	2008 £m	2007 £m
Less than 3 months	57	38
Between 3 and 6 months	4	5
Between 6 months and 1 year	3	11
Greater than 1 year	3	9

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:

	2008 £m	2007 £m
US dollar	155	144
UK sterling	71	12
Euro	41	25
Other currencies	55	33

Trade and other receivables also include certain interest-bearing amounts and their effective interest rates are as follows:

	2008 £m	2007 £m	2008 %	2007 %
US dollar	8	13	1.5	5.5
Euro	1	1	4.0	4.0
Other currencies	24	21	17.8	12.0

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.

Notes on the accounts continued

15 Available-for-sale investments

	2008 £m	2007 £m
1 January	97	152
Differences on exchange	9	9
Additions and advances	237	99
Revaluations	1	1
Disposals and repayments	(238)	(164)
31 December	106	97
Current	79	75
Non-current	27	22
	106	97

Investments have the following maturities:

	As per balance sheet		Contractual gross maturities	
	2008 £m	2007 £m	2008 £m	2007 £m
Equity investments	29	24	29	24
Non-equity investments				
– within 1 year	73	67	73	67
– beyond 1 year and within 2 years	4	3	4	3
– beyond 2 years and within 3 years		1		1
– beyond 3 years and within 4 years		1		1
– beyond 4 years and within 5 years				
– beyond 5 years		1		1
	106	97	106	97

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:

	2008 £m	2007 £m
Functional currencies	101	91
US dollar	2	3
Other currencies	3	3
	106	97

Non-equity investments are denominated in the following currencies:

	2008 £m	2007 £m
US dollar		1
UK sterling	77	72
	77	73

Effective interest rates applicable to non-equity investments are as follows:

	2008 %	2007 %
On US dollar		4.6
On UK sterling	6.2	6.1

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 £24 million (2007: £18 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.

	2008		2007	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedges				
– interest rate swaps	92		14	14
– cross-currency swaps	53	111	85	31
Cash flow hedges				
– cross-currency swaps	230		29	
– forward foreign currency contracts	34	31	6	6
Net investment hedges				
– cross-currency swaps		135	57	
– forward foreign currency contracts	27	354	5	50
Trading				
– interest rate swaps	13			
– cross-currency swaps				53
– forward foreign currency contracts	106	386	7	85
– others	41	46	32	35
	596	1,063	235	274
Current	420	864	82	225
Non-current	176	199	153	49
	596	1,063	235	274
Current assets and liabilities include				
– trading derivatives that mature beyond 1 year	3	23	1	10
Derivatives				
– in respect of net debt	436	554	188	179
– other	160	509	47	95
	596	1,063	235	274

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:

	2008		2007	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within 1 year	417	841	81	215
Between 1 and 2 years	4	24	81	3
Between 2 and 3 years	83	83		
Between 3 and 4 years	5		5	
Between 4 and 5 years	40	7	64	
Beyond 5 years	47	108	4	56
	596	1,063	235	274

Notes on the accounts continued

16 Derivative financial instruments continued

For cash flow hedges, the timing of expected cash flows is as follows:

	2008		2007	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within 1 year	187	31	3	6
Between 1 and 2 years	1		32	
Between 2 and 3 years	76			
	264	31	35	6

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:

	2008				2007			
	Assets		Liabilities		Assets		Liabilities	
	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m
Within 1 year								
– forward contracts	1,953	(1,746)	6,573	(7,388)	1,108	(1,095)	4,266	(4,394)
– cross currency swaps	678	(492)	404	(454)	66	(70)	249	(310)
– other	1,650	(1,598)	1,553	(1,604)	1,450	(1,396)	1,395	(1,451)
Between 1 and 2 years								
– forward contracts	89	(85)	373	(394)	62	(61)	70	(73)
– cross currency swaps	27	(25)	43	(44)	876	(774)	18	(18)
Between 2 and 3 years								
– cross currency swaps	485	(389)	407	(494)	21	(22)	21	(22)
Between 3 and 4 years								
– cross currency swaps	1	(1)	18	(21)	21	(24)	18	(18)
Between 4 and 5 years								
– cross currency swaps	1	(1)	18	(21)	572	(468)	18	(19)
Beyond 5 years								
– cross currency swaps	25	(16)	395	(538)	19	(15)	397	(421)
	4,909	(4,353)	9,784	(10,958)	4,195	(3,925)	6,452	(6,726)

16 Derivative financial instruments continued

The maturity dates of net settled derivative financial instruments are as follows:

	2008		2007	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within 1 year	36	2	(4)	6
Between 1 and 2 years	26	2	14	3
Between 2 and 3 years	13	2	1	3
Between 3 and 4 years	22	2	6	4
Between 4 and 5 years	14	2		3
Beyond 5 years	21		11	3
	132	10	28	22

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:

	2008		2007	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Interest rate swaps	105		14	14
Cross-currency swaps	283	246	171	84
Forward foreign currency contracts	167	771	18	141
Others	41	46	32	35
	596	1,063	235	274

(a) Interest rate swaps

	Maturity date	Principal currency	m	£m	Interest rate %		2008	
					Original	Swapped	Assets £m	Liabilities £m
Fixed to floating	2009	EUR	550	532	4.9	note (a)	10	
	2009	EUR	250	242	4.1	note (a)	3	
	2012	EUR	750	725	3.6	note (a)	8	
	2013	EUR	400	387	5.1	note (a)	24	
	2013	GBP	350	350	5.8	note (a)	20	
	2019	GBP	250	250	6.4	note (a)	40	
							105	
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

Note (a): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between nil and 137 basis points in both years.

The fixed to floating swaps have been used to manage the interest rate profile of external borrowings and are reflected in the repricing table in note 21. The floating to fixed swaps have been used to manage the interest rate profile of both internal and external financing arrangements, and those relating to external borrowings are also reflected in the repricing table in note 21.

Notes on the accounts continued

16 Derivative financial instruments continued

(b) Cross-currency swaps

										2008	
	Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	Assets £m	Liabilities £m
Fixed to fixed	2009	EUR	4.9	500	483	USD	6.5	564	392	151	51
	2011	EUR	5.9	465	450	DKK	6.2	3,468	450	79	85
Fixed to floating	2009	EUR	4.9	150	145	GBP note (b)		104	104	45	
	2016	GBP	5.5	325	325	EUR note (b)		473	457		108
	2019	EUR	4.6	20	19	USD note (b)		22	15	8	2
										283	246

										2007	
	Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	Assets £m	Liabilities £m
Fixed to 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

Note (b): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 78 and 83 basis points (2007: 66 and 127 basis points).

(c) Forward foreign currency contracts

Forward foreign currency contracts are denominated in the following currencies:

Fair values of assets

	2008											2007										
	Currencies purchased forward											Currencies purchased forward										
	GBP £m	USD £m	EUR £m	CHF £m	ZAR £m	DKK £m	CAD £m	SGD £m	NOK £m	PLN £m	Total £m	GBP £m	USD £m	EUR £m	CHF £m	ZAR £m	DKK £m	CAD £m	SGD £m	NOK £m	PLN £m	Total £m
Currencies sold forward																						
AUD		10									10	1										1
CAD		2									2											
CHF														1								1
COP		1									1											
CZK	1		2								3											
DKK		1									1											
EUR	1	22									23											
GBP		5	24	15	3	1	1		1		50			2	2						1	5
HUF			2								2											
KRW		4	5								9			2								2
JPY													4									4
NOK			22								22											
PLN		1									1											
RUR	1	11	19								31			1								1
SEK			7								7											
USD			2								2	3							1			4
ZAR		1	2								3											
	3	58	85	15	3	1	1		1		167	4	4	6	2				1		1	18

16 Derivative financial instruments continued

Fair values of liabilities

	2008									2007								
	Currencies purchased forward									Currencies purchased forward								
	GBP £m	USD £m	EUR £m	CHF £m	AUD £m	SGD £m	NOK £m	PLN £m	Total £m	GBP £m	USD £m	EUR £m	CHF £m	AUD £m	SGD £m	NOK £m	PLN £m	Total £m
Currencies sold forward																		
AUD	81								81	17								17
CAD	27								27	25	1							26
CHF	97		5						102	14								14
DKK	5	1	1				1		8	1								1
EUR	184	6						2	192	43	5							48
CZK										1								1
HKD	13								13	6								6
HUF	7								7	1								1
JPY		51							51		4							4
MUR	3								3									
NOK	1								1									
NZD					1				1									
PLN	2						1		3	2								2
SAR	16								16									
SGD	12								12	1								1
USD	222		3		1	1			227	11		1						12
RUR		1							1		2							2
ZAR	26								26	6								6
	696	59	9		2	1	2	2	771	128	12	1						141

Forward foreign currency contracts have been used to hedge both internal and external forecast transactions as well as the hedging of internal and external assets and liabilities. Certain contracts were used to manage the currency profile of external borrowings and are reflected in the currency table in note 21, and their nominal values are as follows:

	2008		2007	
	£m	£m	£m	£m
Forward contracts to purchase GBP, sell CHF	(142)	182	(115)	122
Forward contracts to purchase GBP, sell CAD	(377)	394	(338)	356
Forward contracts to purchase GBP, sell AUD	(761)	824	(569)	579
Forward contracts to purchase EUR, sell DKK	(451)	452		
Forward contracts to purchase EUR, sell SEK	(189)	181		
Forward contracts to purchase EUR, sell NOK	(360)	339		

Notes on the accounts continued

16 Derivative financial instruments continued

(d) Others

	2008		2007	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Others: Bund forwards (<i>note i</i>)	36	38	27	28
Interest derivative (<i>note ii</i>)		8		7
Sinking fund policy (<i>note iii</i>)	5		5	
	41	46	32	35

Notes:

(i) Forward contracts to purchase and sell German government securities with a nominal value of €1.60 billion (2007: €1.91 billion) taken out to manage internal financing arrangements and maturing within 1 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 ZAR68 million (2007: ZAR73 million).

17 Inventories

	2008 £m	2007 £m
Raw materials and consumables	1,495	1,103
Finished goods and work in progress	1,475	707
Goods purchased for resale	207	175
	3,177	1,985

Inventories pledged as security for liabilities amount to £5 million (2007: £8 million). Write-offs taken to other operating expenses in the income statement comprise £25 million (2007: £46 million), including amounts relating to restructuring costs.

18 Income tax receivable and payable

Income tax balances shown on the Group balance sheet as current assets and current liabilities, while subject to some uncertainty as to the extent and timing of cash flows, are largely expected to be received or paid within 12 months at the balance sheet date for both 2008 and 2007.

19 Cash and cash equivalents

	2008 £m	2007 £m
Cash and bank balances	1,050	651
Cash equivalents	1,259	607
	2,309	1,258

Cash equivalents mainly comprise short-term deposits with an original maturity of 3 months or less. The carrying value of cash and cash equivalents approximates their fair value.

19 Cash and cash equivalents continued

Cash and cash equivalents are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	2008 £m	2007 £m
Functional currency	1,824	968
US dollar	173	159
UK sterling	4	5
Euro	253	104
Other currencies	55	22
	2,309	1,258

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	
	2008 £m	2007 £m	2008 %	2007 %
US dollar	195	231	1.8	3.6
UK sterling	219	146	2.4	5.1
Euro	313	158	2.7	3.2
Canadian dollar	106	32	1.4	4.2
Australian dollar	49	10	4.2	6.3
Other currencies	1,427	681	9.2	6.8
	2,309	1,258		

At 31 December 2008, cash and cash equivalents of £19 million (2007: £nil) were pledged as collateral principally in respect of excise creditors.

In the Group cash flow statement, net cash and cash equivalents are shown after deducting bank overdrafts and accrued interest, as follows:

	2008 £m	2007 £m
Cash and cash equivalents as above	2,309	1,258
Less		
– accrued interest	(3)	
– overdrafts	(86)	(78)
Net cash and cash equivalents	2,220	1,180

Cash and cash equivalents include restricted amounts of £173 million (2007: £54 million).

Notes on the accounts continued

20 Capital and reserves – reconciliation of movement in total equity

	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Shareholders' funds £m	Minority interests £m	Total equity £m
1 January 2008 as restated	506	3,902	658	1,805	6,871	218	7,089
Recognised income and expense							
Differences on exchange			914		914	23	937
Difference on exchange reclassified and reported in profit for the year			(22)		(22)		(22)
Cash flow hedges							
– net fair value gains			180		180		180
– reclassified and reported in profit for the year			(173)		(173)		(173)
– reclassified and reported in net assets			1		1		1
Available-for-sale investments							
– net fair value gains			1		1		1
– reclassified and reported in profit for the year			(6)		(6)		(6)
Net investment hedges							
– net fair value losses			(672)		(672)		(672)
– differences on exchange on borrowings			(178)		(178)		(178)
Revaluation of existing business (<i>note 26</i>)			179		179		179
Retirement benefit schemes							
– actuarial losses in respect of subsidiaries (<i>note 12</i>)				(547)	(547)		(547)
– actuarial losses in respect of associates				(396)	(396)		(396)
Tax on items recognised directly in SORIE (<i>note 6(d)</i>)			73	102	175	9	184
Profit for the year				2,457	2,457	202	2,659
Other movements in equity							
Employee share options							
– value of employee services				51	51		51
– proceeds from shares issued		3		7	10		10
Dividends and other appropriations							
– ordinary shares				(1,393)	(1,393)		(1,393)
– to minority interests						(176)	(176)
Purchase of own shares							
– held in employee share ownership trusts				(116)	(116)		(116)
– share buy-back programme				(400)	(400)		(400)
Acquisition of minority interests						(5)	(5)
Other movements				8	8		8
31 December 2008	506	3,905	955	1,578	6,944	271	7,215

20 Capital and reserves – reconciliation of movement in total equity continued

	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves restated £m	Retained earnings restated £m	Shareholders' funds restated £m	Minority interests restated £m	Total equity restated £m
1 January 2007 as previously reported	517	3,886	419	1,639	6,461	227	6,688
Change in accounting policy (<i>note 12</i>)			13	(117)	(104)		(104)
1 January 2007 as restated	517	3,886	432	1,522	6,357	227	6,584
Recognised income and expense							
Differences on exchange			300		300	20	320
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)
Retirement benefit schemes							
– actuarial gains in respect of subsidiaries				95	95		95
– surplus recognition in respect of subsidiaries				9	9		9
– actuarial gains in respect of associates				17	17		17
Tax on items recognised directly in SORIE (<i>note 6(d)</i>)			(15)	(34)	(49)	(4)	(53)
Profit for the year				2,130	2,130	157	2,287
Other movements in equity							
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	658	1,805	6,871	218	7,089

Details relating to the authorised and allotted share capital, and movements therein, are included in note 4 of the Parent Company financial statements.

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 2007	48	90	3,748	3,886
31 December 2007	53	101	3,748	3,902
31 December 2008	56	101	3,748	3,905

Notes on the accounts continued

20 Capital and reserves – reconciliation of movement in total equity continued

The share premium account includes the difference between the value of shares issued and their nominal value. The increase of £3 million (2007: £5 million) relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration report.

On the purchase of own shares as part of the share buy-back programme for shares which are cancelled, a transfer is made from retained earnings to the capital redemption reserve equivalent to the nominal value of shares purchased. Purchased shares which are not cancelled are classified as treasury shares and presented as a deduction from total equity.

Shareholders' funds are stated after deducting the cost of treasury shares which include £523 million (2007: £123 million) for shares repurchased and not cancelled and £222 million (2007: £173 million) in respect of the cost of own shares held in the employee share ownership trusts.

Transaction costs deducted from equity for the year ended 31 December 2008 were £3 million (2007: £5 million).

In 1999, shares were issued for the acquisition of the Rothmans International B.V. Group, and the difference between the fair value of shares issued and their nominal value was credited to merger reserves.

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	Revaluation reserve £m	Other reserves £m	Total other reserves £m	Retained earnings	
							Treasury shares £m	Other £m
1 January 2008 as restated	80	(11)	16		573	658	(296)	2,101
Recognised income and expense								
Differences on exchange	914					914		
Differences on exchange reclassified and reported in profit for the year	(22)					(22)		
Cash flow hedges								
– net fair value gains		180				180		
– reclassified and reported in profit for the year		(173)				(173)		
– reclassified and reported in net assets		1				1		
Available-for-sale investments								
– net fair value gains			1			1		
– reclassified and reported in profit for the year			(6)			(6)		
Net investment hedges								
– net fair value losses	(672)					(672)		
– differences on exchange on borrowings	(178)					(178)		
Revaluation of existing business (note 26)				179		179		
Retirement benefit schemes								
– actuarial losses in respect of subsidiaries (note 12)								(547)
– actuarial losses in respect of associates								(396)
Tax on items recognised directly in SORIE (note 6(d))	66	7				73		102
Profit for the year								2,457
Other movements in equity								
Employee share options								
– value of employee services								51
– proceeds from shares issued							7	
Dividends and other appropriations								
– ordinary shares								(1,393)
Purchase of own shares								
– held in employee share ownership trusts							(116)	
– share buy-back programme							(400)	
Other movements							60	(52)
31 December 2008	188	4	11	179	573	955	(745)	2,323

The revaluation reserve relates to the acquisition of the cigarette and snus businesses of ST as explained in note 26(a).

20 Capital and reserves – reconciliation of movement in total equity continued

	Translation reserve restated £m	Hedging reserve £m	Available- for-sale reserve £m	Other reserves £m	Total other reserves restated £m	Retained earnings	
						Treasury shares £m	Other restated £m
1 January 2007 as previously reported	(177)	10	13	573	419	(197)	1,836
Change in accounting policy (<i>note 12</i>)	13				13		(117)
1 January 2007 as restated	(164)	10	13	573	432	(197)	1,719
Recognised income and expense							
Differences on exchange	300				300		
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)		
Retirement benefit schemes							
– actuarial gains in respect of subsidiaries							95
– surplus recognition in respect of subsidiaries							9
– actuarial gains in respect of associates							17
Tax on items recognised directly in SORIE (<i>note 6(d)</i>)	(21)	6			(15)		(34)
Profit for the year							2,130
Other movements in equity							
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	80	(11)	16	573	658	(296)	2,101

The translation reserve is as explained in the accounting policy on foreign currencies in note 1.

The hedging reserve and the available-for-sale reserve are as explained in the accounting policy on financial instruments in note 1.

Of the amounts released from the hedging reserve during the year, losses of £3 million (2007: £5 million gain) and losses of £25 million (2007: £9 million gain) were reported within revenue and raw materials and consumables respectively, together with £nil (2007: £2 million gain) reported in other operating expenses and a gain of £201 million (2007: £26 million gain) reported within net finance costs.

Other reserves comprise:

(a) £483 million which arose in 1998 from merger accounting in a Scheme of Arrangement and Reconstruction whereby British American Tobacco p.l.c. acquired the entire share capital of B.A.T Industries p.l.c. and the share capital of that company's principal financial services subsidiaries were distributed, so effectively demerging them; and

(b) In the Rothmans transaction, convertible redeemable preference shares were issued as part of the consideration. The discount on these shares was amortised by crediting other reserves and charging retained earnings. The £90 million balance in other reserves comprises the accumulated balance in respect of the preference shares converted during 2004.

Notes on the accounts continued

21 Borrowings

	Currency	Maturity dates	Interest rates	2008 £m	2007 £m
Eurobonds	Euro	2009 to 2019	3.6% to 5.9%	6,778	3,920
	UK sterling	2008 to 2019	5.5% to 7.3%	1,754	1,376
Bonds issued pursuant to Rule 144A and RegS under the US Securities Act (as amended)	US dollar	2013 to 2018	8.1% to 9.5%	694	
Floating rate notes	Euro	2010	floating rate	510	388
Other notes	Malaysian ringgit	2008 to 2012	3.7% to 5.0%	132	115
	US dollar	2008	6.9%		173
	Other currencies			27	97
Syndicated bank loans	US dollar	2012	floating rate	469	346
	Euro	2009	floating rate	1,116	
Bank loans				514	352
Other loans				3	13
Finance leases				78	65
Overdrafts				86	78
				12,161	6,923

The floating rate interest rates are based on EURIBOR or US LIBOR plus a margin ranging between 36 and 350 basis points.

	2008 £m	2007 £m
Current	2,724	861
Non-current	9,437	6,062
	12,161	6,923

Current borrowings include interest payable of £270 million at 31 December 2008 (2007: £136 million). Included within non-current borrowings are £2,957 million (2007: £2,466 million) of borrowings subject to fair value hedges where this amortised cost has been decreased by £116 million (2007: decreased £49 million) in the table above.

The fair value of borrowings is estimated to be £11,792 million (2007: £6,862 million) and has been determined using quoted market prices or discounted cash flow analysis.

	2008 £m	2007 £m
Amounts secured on Group assets	97	81

Amounts secured include finance leases of £78 million (2007: £65 million) and the remaining amounts are secured on certain property and inventory of the Group (note 10 and note 17).

Borrowings are repayable as follows:

	Per balance sheet		Contractual gross maturities	
	2008 £m	2007 £m	2008 £m	2007 £m
Within 1 year	2,724	861	2,852	1,029
Between 1 and 2 years	575	765	1,026	1,047
Between 2 and 3 years	1,151	397	1,607	636
Between 3 and 4 years	1,288	898	1,690	1,134
Between 4 and 5 years	1,584	927	1,908	1,151
Beyond 5 years	4,839	3,075	6,198	3,749
	12,161	6,923	15,281	8,746

The contractual gross maturities in each year include the borrowings maturing in that year together with forecast interest payments on all borrowings which are outstanding for all or part of that year.

21 Borrowings continued

Borrowings are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	Functional currency £m	US dollar £m	UK sterling £m	Euro £m	Canadian dollar £m	Australian dollar £m	Other currencies £m	Total £m
31 December 2008								
Total borrowings	4,317	1,181	328	6,335				12,161
Effect of derivative financial instruments								
– cross-currency swaps		407	(221)	(640)			450	(4)
– forward foreign currency contracts	(1,280)			(1,000)	394	824	1,154	92
	3,037	1,588	107	4,695	394	824	1,604	12,249
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

Details of the derivative financial instruments included in these tables are given in note 16.

The exposure to interest rate changes when borrowings are repriced is as follows:

	Within 1 year £m	Between 1-2 years £m	Between 2-3 years £m	Between 3-4 years £m	Between 4-5 years £m	Beyond 5 years £m	Total £m
31 December 2008							
Total borrowings	3,699	141	1,080	819	1,584	4,838	12,161
Effect of derivative financial instruments							
– interest rate swaps	1,712			(725)	(737)	(250)	
– cross-currency swaps	472					(344)	128
	5,883	141	1,080	94	847	4,244	12,289
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

Details of the derivative financial instruments included in these tables are given in note 16.

Effective interest rates are as follows:

	2008 £m	2007 £m	2008 %	2007 %
US dollar	1,249	653	6.5	6.8
UK sterling	1,761	1,393	6.6	6.1
Euro	8,421	4,305	4.8	4.5
Canadian dollar	12	22	5.8	5.8
Other currencies	718	550	5.8	6.0
	12,161	6,923		

The values and rates shown above do not reflect the effect of the interest rate and cross-currency swaps detailed in note 16.

Notes on the accounts continued

21 Borrowings continued

Finance lease liabilities per the balance sheet and on a contractual gross maturity basis are payable as follows:

	2008			2007		
	Principal £m	Interest £m	Total £m	Principal £m	Interest £m	Total £m
Within 1 year	38	3	41	24	3	27
Between 1 and 2 years	22	2	24	20	2	22
Between 2 and 3 years	10	1	11	12	1	13
Between 3 and 4 years	5		5	5		5
Between 4 and 5 years	2		2	2		2
Beyond 5 years	1		1	2		2
	78	6	84	65	6	71

Borrowings facilities

	2008 £m	2007 £m
Undrawn committed facilities expiring		
– within 1 year	144	1,416
– between 2 and 3 years	99	
– between 3 and 4 years	1,651	99
– between 4 and 5 years		1,651
	1,894	3,166

The facilities include undrawn amounts in respect of the Group's central banking facility of £1.75 billion (2007: £1.75 billion). In March 2007, a 1-year option was exercised with final maturity dates between March 2011 and March 2012.

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 2 euro facilities, 1 of €420 million and 1 of €860 million. These facilities expire on 31 October 2009. There was a net draw-down on these revolving credit facilities of €1.15 billion during the year to 31 December 2008 (2007: €nil). The period of availability for draw-down on these facilities lapsed in August 2008.

The Group defines net debt as follows:

	2008 £m	2007 £m
Borrowing (note 21)	12,161	6,923
Derivatives in respect of net debt:		
– assets (note 16)	(436)	(188)
– liabilities (note 16)	554	179
Cash and cash equivalent (note 19)	(2,309)	(1,258)
Current available-for-sale investments (note 15)	(79)	(75)
	9,891	5,581

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 2008	182	23	20	203	428
Differences on exchange	44	5	2	28	79
Provided in respect of the year	65	9	15	62	151
Utilised during the year	(108)	(15)	(4)	(50)	(177)
Other movements	(3)	1	2		
31 December 2008	180	23	35	243	481
Analysed on the balance sheet as					
– current	104	15	9	167	295
– non-current	76	8	26	76	186
	180	23	35	243	481
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

The restructuring provisions relate to the restructuring and integration costs incurred and reported as adjusting items in the income statement. The principal restructurings in 2008 and 2007 are as described 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 2010 and approximately 80 per cent within 5 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 to a subsidiary in 2000 and the reorganisation of the Italian business acquired in 2003. While some elements of the non-current provisions of £8 million will unwind over several years, it is estimated that around 50 per cent will unwind within 5 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 45 per cent of the non-current provisions of £26 million will unwind within 5 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 £20 million (2007: £10 million) for restructuring of existing businesses, £6 million (2007: £3 million) for acquired businesses, £nil (2007: £nil) for employee related benefits and £15 million (2007: £24 million) for other provisions.

Notes on the accounts continued

23 Trade and other payables

	2008 £m	2007 £m
Trade payables	808	633
Duty, excise and other taxes	2,859	1,605
Accrued charges and deferred income	800	610
Social security and other taxation	27	24
Sundry payables	390	253
	4,884	3,125
Current	4,718	2,976
Non-current	166	149
	4,884	3,125

Accrued charges and deferred income include £2 million (2007: £4 million) in respect of interest payable.

There is no material difference between the above amounts for trade and other payables and their fair value, due to the short term duration of the majority of trade and other payables.

Trade and other payables are predominantly denominated in the functional currencies of subsidiary undertakings with less than 5 per cent (2007: 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.

The Group defines capital as net debt (see note 21) and equity (see note 20). The only externally imposed capital requirement for the Group is interest cover as described under interest rate risk below. The Group assesses its financial capacity by reference to cash flow and interest cover. Group policies include a set of financing principles, including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital base is managed and, in particular, the policies on dividends (as a percentage of long-term sustainable earnings) and share buy-back are decided.

The Group manages its financial risks in line with the classification of its financial assets and liabilities in the Group's balance sheet and related notes.

The Group's management of specific risks is dealt with as follows:

Liquidity risk

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group has a target average centrally managed debt maturity of 5 years with no more than 20 per cent of centrally managed debt maturing in a single year. As at 31 December 2008, the average centrally managed debt maturity was 5.1 years (2007: 5.4 years) and the highest proportion of centrally managed debt maturing in a single year was 18.3 per cent (2007: 16.7 per cent). It is Group policy that short-term sources of funds (including drawings under the US dollar commercial paper programme) are backed by undrawn committed lines of credit and cash.

24 Financial instruments continued

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

On 13 February 2008, the Group entered into an acquisition credit facility whereby lenders agreed to make available an amount of US\$2 billion. On 1 May 2008, this facility was syndicated in the market and was redenominated into 2 euro facilities, 1 of €420 million and 1 of €860 million. These facilities expire on 31 October 2009. There was a net draw down on these credit facilities of €1.15 billion during the year ended 31 December 2008 (2007: €nil).

During the year, the Group also issued US\$300 million and US\$700 million bonds, maturing in 2013 and 2018 respectively, pursuant to Rule 144A and RegS under the US Securities Act. The Group also repaid US\$330 million and £217 million bonds upon maturity in May and November respectively.

In addition, the Group repurchased its Mexican 2011 MXN1,055 million UDI bond and refinanced it with a floating rate borrowing of MXN1,444 million.

In 2007, €800 million of €1.7 billion bonds with a maturity of February 2009 were replaced by €1 billion bonds with a maturity of 2017. In March 2007, the Group's central banking facility of £1.75 billion was extended on existing terms under a 1 year extension option with final maturity dates between March 2011 and March 2012, and was undrawn as at 31 December 2008.

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 2008, the ratings from Moody's and S&P were Baa1/BBB+ (end 2007: Baa1/BBB+). The strength of the ratings has underpinned the debt issuance during 2007 and 2008 and, despite the impact of the turbulence in financial markets, the Group is confident of its ability to successfully access the debt capital markets, as demonstrated with the issue of US\$1 billion bonds in the US bond market towards the end of 2008, following issues in the euro and sterling markets earlier in the year.

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 are 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 2008, the currency profile of the Group's gross debt, after taking into account derivative contracts, was 14 per cent (2007: 20 per cent) US dollar, 55 per cent (2007: 53 per cent) euro, 3 per cent (2007: 5 per cent) Canadian dollar, 2 per cent (2007: nil per cent) sterling, 7 per cent (2007: 12 per cent) Australian dollar and 19 per cent (2007: 10 per cent) other currencies.

Notes on the accounts continued

24 Financial instruments continued

The Group faces currency exposures arising from the translation of profits earned in foreign currency subsidiaries and associates; these exposures are not normally hedged. Exposures also arise from:

(i) foreign currency denominated trading transactions undertaken by subsidiaries. These exposures comprise committed and highly probable forecast sales and purchases, which are offset wherever possible. The remaining exposures are hedged within the Treasury policies and procedures with forward foreign exchange contracts and options, which are designated as hedges of the foreign exchange risk of the identified future transactions; and

(ii) forecast dividend flows from subsidiaries to the centre. To ensure cash flow certainty, the Group hedges such flows using forward foreign exchange contracts designated as net investment hedges of the foreign exchange risk arising from the investments in these subsidiaries.

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% 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 £187 million higher (2007: £21 million higher) and items recognised directly in equity being £427 million higher (2007: £211 million higher). A 10 per cent weakening of functional currencies against non-functional currencies would result in pre-tax profit being £216 million lower (2007: £21 million lower) and items recognised directly in equity being £519 million lower (2007: £243 million lower).

The exchange sensitivities on items recognised directly in equity relates to hedging of certain net asset currency positions in the Group, but does not include sensitivities in respect of exchange on non-financial assets, as well as on cash flow hedges in respect of future transactions debt.

Interest rate risk

The objectives of the Group's interest rate risk management policy are to lessen the impact of adverse interest rate movements on the earnings, cash flow and economic value of the Group, and to safeguard against any possible breach of its financial covenants. Additional objectives are to minimise the cost of hedging and the associated counterparty risk.

The Group targets gross interest cover to be between 5 times and 9 times and for 2008 it is 8.5 times (2007: 9.4 times). The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of 4.5 times.

In order to manage its interest rate risk, the Group maintains both floating rate and fixed rate debt. The Group sets targets (within overall guidelines) for the desired ratio of floating to fixed rate debt on both a gross (50:50 +/- 10) and net (at least 50 per cent fixed in the short to the medium term) basis as a result of regular reviews of market conditions and strategy by Treasury and the board of the main central finance company. At 31 December 2008, the relevant ratios of floating to fixed rate borrowings were 45:55 (2007: 53:47) on a gross basis and 25:75 (2007: 33:67) 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.

24 Financial instruments continued

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 £52 million lower (2007: £28 million lower) and items recognised directly in equity being £1 million higher (2007: £1 million higher). A 100 basis point decrease in interest rates would result in pre-tax profit being £52 million higher (2007: £28 million higher) and items recognised directly in equity being £1 million lower (2007: £1 million lower).

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 1 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 £66 million (2007: £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.

Notes on the accounts continued

24 Financial instruments continued

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 1 year are assumed to approximate to their book values. For financial assets and liabilities with maturities of more than 1 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

	2008 £m	2007 restated £m
Profit from operations	3,572	2,904
Adjustments for		
– amortisation of trademarks	24	
– gains on disposal of businesses and trademarks	(141)	(75)
– depreciation and impairment of property, plant and equipment	350	293
– amortisation and write-off of intangible assets	56	43
– (increase)/decrease in inventories	(367)	170
– decrease/(increase) in trade and other receivables	19	(83)
– increase in trade and other payables	746	61
– decrease in net retirement benefit liabilities	(99)	(119)
– decrease in provisions for liabilities and charges	(31)	(16)
– other non-cash items	27	3
Cash generated from operations	4,156	3,181

The restatement of 2007 reflects the change in the Group's accounting policy for recognition of actuarial gains and losses as explained in note 1 and note 12.

25 Cash flow continued

Profit from operations includes charges in respect of Group restructuring and integration costs referred to in note 3(e). These are also reflected in the movements in depreciation, amortisation, inventories, receivables, payables and provisions above, and in the proceeds on disposal of subsidiaries as well as on disposal of property, plant and equipment shown in the Group cash flow statement. The cash outflow in respect of the Group's restructuring costs was £151 million (2007: £170 million), of which £210 million (2007: £190 million) is included in cash generated from operations above.

Cash generated from operations includes an outflow of £102 million (2007: £nil) relating to the Canadian settlement explained in note 3(f).

Cash flows from investing activities

(a) Proceeds on disposals of intangibles

In 2008, the £17 million cash inflow on disposal of intangibles comprises the cash received on the termination of a licence agreement in South Africa in 2007, while in 2007, the £16 million cash inflow reflects the sale of pipe tobacco trademarks (see note (3h)).

(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 £8 million (2007: £65 million inflow) and £1 million sales proceeds from non-current investments (2007: £6 million).

(c) Proceeds from associates' share buy-backs

In 2008, the cash inflow reflects cash received of £41 million in respect of the Group's participation in the share buy-back programme conducted by Reynolds American Inc, as well as proceeds of £1 million from the repurchase of shares by Procesadora Unitab (see note 29).

(d) Purchase of Tekel cigarette business assets and ST cigarette and snus businesses

In 2008, the cash outflow of £873 million on the purchase of Tekel assets comprises the purchase price and the acquisition costs as shown in note 26(b). In 2008, the cash outflow of £1,243 million on the purchase of the ST cigarette and snus businesses comprises the purchase price less acquired net cash and cash equivalents and overdrafts as shown in note 26(a).

(e) Purchases of other subsidiaries and minority interests

The purchase of other subsidiaries and minority interests in 2008 arises from the acquisition of minority interests in the Group's subsidiaries in Africa and Middle East and Europe, while in 2007, it reflects the acquisition of minority interests in the Group's subsidiaries in Africa and Middle East, Europe and Asia-Pacific.

(f) Proceeds on disposal of subsidiaries

In 2008, the cash inflow reflects the net proceeds on disposal of a non-core business in the Asia-Pacific region, while for the year ended 31 December 2007, the cash inflow principally reflected the proceeds from sale of the Belgian cigar factory and associated trademarks.

Notes on the accounts continued

25 Cash flow continued

Cash flows from financing activities

(a) In 2008, the increase in borrowings principally reflects the issue of €1.25 billion and £500 million bonds maturing in 2015 and 2024 respectively. The bonds replace the €1.8 billion revolving credit facility arranged in December last year and cancelled in 2008. In addition, the Group increased its €1 billion 5.375 per cent bond by an additional €250 million, bringing the total size of the bond to €1.25 billion.

On 13 February 2008, the Group entered into 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 2 euro facilities, 1 of €420 million and 1 of €860 million. These facilities expire on 31 October 2009. There was a net draw-down on these revolving credit facilities of €1.15 billion during the year to 31 December 2008 (2007: €nil). The period of availability for further draw-down of these facilities lapsed in August 2008.

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

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 2007, €800 million of €1.7 billion bonds with a maturity of 2009 were replaced by €1 billion bonds with a maturity of 2017.

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

26 Business combinations and disposals

(a) Skandinavisk Tobakskompagni (ST)

On 27 February 2008, the Group agreed to acquire 100 per cent of ST's cigarette and snus businesses in exchange for its existing 32.35 per cent holding in ST and payment of DKK11,582 million (£1,237 million) in cash, following 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 trademarks, primarily in Norway. The transaction was completed on 2 July 2008.

Until the date of the transaction the results of ST were equity accounted as an associated undertaking and following the transaction, the results of the acquired businesses have been consolidated.

The estimated fair value of the ST group at 2 July 2008 was £2,754 million, comprising £2,128 million for the cigarette and snus businesses and £626 million for the other operations. The Group has exchanged its 32.35 per cent existing interest in ST (estimated fair value of £891 million) and cash of £1,237 million for a 100 per cent interest in the cigarette and snus businesses (estimated fair value of £2,128 million). The transaction has been accounted for as an acquisition of 67.65 per cent of the cigarette and snus businesses' net assets of ST and a disposal of the Group's existing 32.35 per cent interest in the non-cigarette and snus businesses of ST.

26 Business combinations and disposals continued

The goodwill of £923 million on the acquisition of the cigarette and snus businesses at 2 July 2008, stated at the exchange rates ruling at the date of the transaction, arises as follows:

	Book value £m	Fair value adjustments £m	Fair value £m
Goodwill	45	(45)	
Other intangible assets	8	471	479
Property, plant and equipment	83	88	171
Inventories	211	6	217
Trade and other receivables	237		237
Available-for-sale investments	5	(5)	
Cash and cash equivalents	78		78
Overdrafts	(82)		(82)
Retirement benefit liabilities	(3)		(3)
Deferred tax liabilities		(139)	(139)
Other provisions for liabilities and charges	(7)		(7)
Trade and other payables	(364)		(364)
Assets classified as held-for-sale		182	182
Net assets of cigarette and snus businesses	211	558	769
Less: fair value of 32.35% existing interest in cigarette and snus businesses			(248)
Fair value of net assets acquired			521
Goodwill			923
Total consideration			1,444

The total consideration comprises:

	£m
Cash	1,237
Fair value of the existing 32.35% interest in ST not retained by the Group	203
Acquisition costs	4
Total consideration	1,444

The transaction also results in a revaluation of the 32.35% existing interest in the cigarette and snus businesses:

	£m
Fair value of the Group's existing interest as above	248
Carrying value under equity accounting prior to the transaction	(69)
Revaluation	179

The disposal of the Group's 32.35 per cent interest in the non-cigarette and snus businesses of ST gave rise to a non-taxable gain of £139 million, after costs of £3 million as follows:

	£m
Cash	(1,237)
Book value, including goodwill, of existing 32.35% interest in ST not retained by the Group	(80)
Costs allocated to disposal	(3)
Fair value of cigarette and snus businesses acquired	1,440
Exchange differences recycled from equity	19
Gain on disposal of non-cigarette and snus businesses	139

Notes on the accounts continued

26 Business combinations and disposals continued

Included within the cigarette and snus businesses acquired from ST are £182 million of local trademarks, primarily in Norway, that are being actively marketed for sale as a condition of the regulatory approval being granted. These assets are expected to be sold within a period of 1 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 revaluation of land and buildings, recognition of cigarette trademarks and the related impact of deferred taxation.

In addition to the fair value adjustments above, goodwill carried in the local books has been reversed.

The goodwill of £923 million arising on the acquisition of the cigarette and snus businesses of ST represents a strategic premium to acquire cigarette market leadership in Denmark and Norway and significant cigarette market positions in Sweden and Poland, together with a stronger snus business as a result of acquiring in-house manufacturing and additional expertise, along with anticipated synergies that will arise post-acquisition. The goodwill in respect of ST on the balance sheet comprises the £923 million as a result of this transaction, together with £64 million from earlier transactions which relates to the cigarette and snus businesses.

In the period from 2 July 2008 to 31 December 2008 the acquired businesses contributed revenue of £275 million and profit from operations of £60 million after charging £19 million for amortisation of acquired trademarks and £13 million in respect of restructuring and integration costs. If the acquisition had occurred on 1 January 2008, before accounting for anticipated synergy and restructuring benefits, it is estimated that Group revenue would have been £12,411 million and Group profit from operations would have been £3,644 million for the year to 31 December 2008. These amounts have been estimated based on the ST 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 £19 million for amortisation of acquired trademarks for the period to 2 July 2008.

(b) Tekel

On 22 February 2008, the Group announced that it had won the public tender to acquire the cigarette business assets of Tekel, the Turkish state-owned tobacco company, with a bid of US\$1,720 million. The acquisition only relates to the cigarette business assets of Tekel, which principally comprise trademarks, factories and tobacco leaf stocks. The acquisition did not include employees and the Group had directly employed the required workforce by the effective date of the transaction. Completion of this transaction was subject to regulatory approval which was subsequently received and on 24 June 2008 the Group completed the transaction subject to finalisation of completion accounts. The goodwill of £566 million on the cigarette business assets of Tekel, stated at the exchange rates ruling on the date of the transaction, arises as follows:

Provisional values

	Book value £m	Fair value adjustments £m	Fair value £m
Intangible assets		127	127
Property, plant and equipment	77	(40)	37
Deferred tax assets		1	1
Inventories	154	(24)	130
Trade and other receivables		1	1
Other provisions for liabilities and charges		(4)	(4)
Assets classified as held-for-sale	6	9	15
Net assets acquired	237	70	307
Goodwill			566
Total consideration			873
Consideration comprises:			
Cash			866
Acquisition costs			7
Total consideration			873

26 Business combinations and disposals continued

Included within the cigarette business assets acquired from Tekel are certain items of property, plant and equipment that are being actively marketed for sale. These assets, amounting to £15 million, are expected to be sold within a period of 1 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 downwards revaluation of land and buildings, reduction in inventory to net realisable value and the recognition of cigarette trademarks.

The goodwill of £566 million arising on the acquisition of the cigarette business 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.

Finalisation of part of the transaction is still ongoing and, in addition, work in respect of identifying the appropriate fair value to be assigned to the acquired cigarette business assets has been ongoing since the published results for the 6 months to 30 June 2008. This further work has led to the goodwill increasing by £90 million compared to the provisional amount included in the 6 months results. This has arisen due to more detailed on-site inspections and a review by the external valuers in determining the most appropriate fair values for property, plant and equipment and the assets disclosed as held for sale.

In the period from 24 June 2008 to 31 December 2008 the acquired Tekel cigarette business assets contributed revenue of £135 million and a loss from operations of £16 million after charging £5 million for amortisation of acquired intangibles and £41 million in respect of restructuring and integration costs.

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 £12,232 million and Group profit from operations would have been £3,576 million for the year ended 31 December 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 period to 24 June 2008.

(c) As described in note 3(h), the Group agreed to sell its pipe tobacco trademarks on 20 February 2007; sold its Belgian cigar factory and associated trademarks 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.

(d) At 31 December 2008, held-for-sale assets reflect the ST trademarks of £182 million which the Group is required to divest as a condition for regulatory approval of the acquisition of the cigarette and snus businesses of ST, £16 million of property, plant and equipment acquired from Tekel being actively marketed for sale and £18 million of property, plant and equipment in Bologna, Italy which is expected to be sold in 2009. The remainder comprises non-core assets in various locations being actively marketed for sale comprising plant, property and equipment of £9 million (2007: £30 million), inventories of £nil (2007: £3 million) and other assets of £nil (2007: £3 million). These assets are expected to be sold in 2009. In 2007, trade and other payables of £2 million have been shown as liabilities directly associated with assets held-for-sale.

Notes on the accounts continued

27 Share-based payments

During the period ended 31 December 2008, the following material share-based payment arrangements existed, which are described below:

	Long-term incentive plan	Deferred share bonus scheme	Sharesave schemes	Share option scheme	Share reward scheme
Timing of grant	March and May	Annually in March	Annually in November	See note (a)	Annually in April
Number of options/ shares granted in 2008	March – 1,973,421 May – 755,187	1,739,960	3 year – 143,280 5 year – 165,859	n/a	155,643
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
Fair value per share for 2008 grant	March – £12.80 May – £13.47	£17.03	3 year – £3.73 5 year – £3.95	n/a	£19.22
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
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 3 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 2 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 3 years from date of grant and may be subject to forfeit if participant leaves employment before the end of the 3 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 3 year or 5 year savings contract. Participants are not entitled to dividends prior to the exercise of the options.
- Options exercisable 3 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 3 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 5 year holding period.

Further details on the operation of share-based payment arrangements can be found in the Remuneration report.

27 Share-based payments continued

Share option schemes

Details of the movements for equity-settled share option schemes during the years ended 31 December 2008 and 31 December 2007 covering the Share option and Sharesave schemes were as follows:

	2008		2007	
	Number of options	Weighted average exercise price per share £	Number of options	Weighted average exercise price per share £
Outstanding at start of year	4,596,010	7.32	8,449,681	6.86
Granted during the period	309,139	13.60	250,862	14.35
Exercised during the period	(1,507,887)	6.17	(3,806,566)	6.73
Forfeited during the period	(107,315)	10.25	(297,967)	7.85
Outstanding at end of year	3,289,947	8.34	4,596,010	7.32
Exercisable at end of year	2,209,370	6.78	3,440,746	6.44

In addition to the above options, the movement in nil-cost equity-settled options from the Long-term incentive plan was as follows:

	2008 Number of options	2007 Number of options
Outstanding at start of year	7,322,045	8,108,255
Granted during the period	2,363,555	2,324,409
Exercised during the period	(2,544,530)	(2,439,044)
Forfeited during the period	(423,591)	(316,591)
Changed to cash-settled share-based payment arrangement*	(5,282)	(354,984)
Outstanding at end of year	6,712,197	7,322,045
Exercisable at end of year	1,036,291	921,841

*During 2008, equity-settled awards in respect of 5,282 (2007: 300,107) options were modified to a cash-settled basis, while a further nil (2007: 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 £18.77 (2007: £16.03). A detailed breakdown of the range of exercise prices for options outstanding for the years ended 31 December 2008 and 31 December 2007 is shown in the table below:

	2008			2007		
Range of exercise prices	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £
Nil-cost	6,712,197	7.8	n/a	7,322,045	7.8	n/a
£2.53 to £4.99	107,256	1.2	2.54	287,606	2.0	3.16
£5.00 to £6.99	1,185,185	3.1	5.98	1,960,056	3.6	5.84
£7.00 to £8.99	1,016,553	4.4	7.77	1,588,218	5.0	7.72
£9.00 to £12.49	445,619	2.0	10.60	509,268	3.0	10.61
£12.50 to £14.49	535,334	4.2	13.92	250,862	4.6	14.35
	10,002,144	6.1	2.74	11,918,055	6.2	2.82

The weighted average fair value of equity-settled share option schemes' shares granted during 2008 was £11.96 (2007: £9.94).

Notes on the accounts continued

27 Share-based payments continued

Assumptions used in the Black-Scholes models to determine the fair value of share options at grant date were as follows:

	2008		2007	
	Long-term incentive plan*	Sharesave schemes**	Long-term incentive plan*	Sharesave schemes**
Share price at date of grant (£)	19.03/20.01	17.00	15.41/15.69	17.94
Exercise price (£)	nil-cost	13.60	nil-cost	14.35
Volatility (%)	18	23	21/20	18
Average expected term to exercise (years)	3.50	3.2/5.2	3.5	3.2/5.2
Risk-free rate (%)	3.9/4.5	2.72/3.15	5.1/5.5	4.4/4.5
Expected dividend yield (%)	3.7/3.5	4.1	4.1/4.0	3.5

*Where 2 figures have been quoted for the Long-term incentive plan, the first number represents the March award and the second number the May award.

**Where 2 figures have been quoted for the Sharesave Schemes, the first number represents the assumptions for the 3-year savings contract and the second number for the 5-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:

	2008	2007
Average share price volatility FTSE 100 comparator group	26	28
Average share price volatility FMCG comparator group	19	21
Average correlation FTSE 100 comparator group*	31	27/28
Average correlation FMCG comparator group*	18/17	18

*Where 2 figures have been quoted for the Long-term incentive plan, the first number represents the March award and the second number the May award.

The expected British American Tobacco p.l.c. share price volatility was determined taking account of the daily share price movements over a 5 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 2 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.

27 Share-based payments continued

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 2008 and 31 December 2007, covering the Deferred share bonus and Share reward schemes, were as follows:

	2008 Number of shares	2007 Number of shares
Outstanding at start of year	5,613,160	5,833,871
Granted during the period	1,616,662	2,302,001
Exercised during the period	(2,102,905)	(2,162,432)
Forfeited during the period	(56,929)	(68,004)
Changed to cash-settled share-based payment arrangement*	(905)	(292,276)
Outstanding at end of year	5,069,083	5,613,160
Exercisable at end of year	307,244	437,703

*Equity-settled awards in respect of 905 (2007: 235,819) shares were modified to a cash-settled basis, while a further nil (2007: 56,457) shares were replaced by cash-settled awards.

The shares outstanding for the year ended 31 December 2008 had a weighted average contractual life of 1.1 years (2007: 1.2 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:

	2008		2007	
	Deferred share bonus scheme	Share reward scheme	Deferred share bonus scheme	Share reward scheme
Grant price (£)	19.03	19.22	15.41	15.76
Expected volatility (%)	18	18	21	21
Average expected term to exercise (years)	3.0	5.0	3.0	5.0
Risk-free rate (%)	3.9	4.0	5.1	5.0
Expected dividend yield (%)	3.7	3.7	4.1	4.0

The weighted average fair value of other equity share-based payment arrangements granted during 2008 was £17.24 (2007: £14.02).

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 2008 of £23.1 million (2007: £28.0 million) of which £5.0 million (2007: £6.3 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 £12.4 million in 2008 (2007: £23.9 million).

Notes on the accounts continued

27 Share-based payments continued

Details of movements for cash-settled arrangements in respect of the Share option scheme during the years ended 31 December 2008 and 31 December 2007, were as follows:

	2008		2007	
	Number of options	Weighted average exercise price per share £	Number of options	Weighted average exercise price per share £
Outstanding at start of year	295,331	6.63	431,280	6.69
Granted during the period	n/a	n/a	n/a	n/a
Exercised during the period	(82,142)	6.92	(129,317)	6.86
Forfeited during the period			(6,632)	6.39
Outstanding at end of year	213,189	6.51	295,331	6.63
Exercisable at end of year	213,189	6.51	295,331	6.63

In addition to the above, the movement in other nil-cost cash-settled arrangements during the years ended 31 December 2008 and 31 December 2007, covering the Long-term incentive plan and Deferred share bonus scheme, were as follows:

	2008 Number of shares	2007 Number of shares
Outstanding at start of year	2,278,828	1,614,706
Granted during the period	643,994	711,173
Exercised during the period	(849,468)	(591,471)
Forfeited during the period	(63,770)	(102,840)
Changed from equity-settled share-based arrangement*	6,187	647,260
Outstanding at end of year	2,015,771	2,278,828
Exercisable at end of year	143,742	125,406

*As explained in the sections for Share option schemes and Other equity share-based payment arrangements, 6,187 (2007: 647,260) awards in respect of shares were changed from an equity-settled to a cash-settled basis.

Assumptions used to determine the fair value of cash-settled share-based payment arrangements at date of grant, can be found in the sections relating to share option schemes and other equity share-based payment arrangements.

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 £18.86 (2007: £16.37). A detailed breakdown of the range of exercise prices for cash-settled share-based payment arrangements outstanding for the years ended 31 December 2008 and 31 December 2007 are shown in the table below:

	2008			2007		
Range of exercise prices	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £
Nil-cost	2,015,771	5.5	n/a	2,278,828	5.6	n/a
£5.60 to £5.98	96,859	4.0	5.96	120,844	5.0	5.96
£6.39 to £8.09	116,330	3.9	6.98	174,487	5.0	7.09
	2,228,960	5.4	0.62	2,574,159	5.5	0.76

27 Share-based payments continued

Share-based payment expense

The amounts recognised in the income statement in respect of share-based payments were as follows:

	2008 £m	2007 £m
Equity-settled share-based payments	51	37
Cash-settled share-based payments	12	24
Total amount recognised in the income statement (<i>note 3(a)</i>)	63	61

As explained in the sections for Share option schemes and Other equity share-based payment arrangements, 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 £83,410 (2007: £3.2 million), which was reflected in a £121,923 (2007: £6.4 million) increase in the expense for cash-settled payments and a £38,513 (2007: £3.2 million) decrease in the expense for equity-settled payments.

28 Group employees

The average number of persons employed by the Group and its associates during the year, including Directors, was 96,381 (2007: 97,696).

	2008 Number	2007 Number
Europe	20,891	18,913
Asia-Pacific	10,283	10,334
Latin America	15,411	15,009
Africa and Middle East	7,876	7,807
America-Pacific	1,709	1,844
Subsidiary undertakings	56,170	53,907
Associates	40,211	43,789
	96,381	97,696

Details of Directors' remuneration, share options and retirement benefits are given in the Remuneration report.

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.

Notes on the accounts continued

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.

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 £72 million (2007: £53 million). The Group's share of dividends from associates included in other net income in the table below, was £326 million (2007: £290 million). Legal fees recovered from Reynolds American Inc. included in other net income amounted to £1 million (2007: £1 million).

Proceeds of £41 million were received from the Group's participation in the Reynolds American Inc. share buy-back programme and a further £1 million from the repurchase of shares by Procesadora Unitab (note 25).

	2008 £m	2007 £m
Transactions		
– revenue	29	32
– purchases	(298)	(275)
– other net income	325	292
Amounts receivable at 31 December	79	67
Amounts payable at 31 December	(59)	(37)

As discussed in notes 3(h), and 26, in 2008 the Group realised a gain of £139 million on the disposal of its 32.35 per cent holding in the non-cigarette and snus businesses of ST, and in 2007 the Group also completed the sale of its Belgium cigar factory and associated trademarks to the cigars division of ST. The gains on disposal are not included in the above table for either year.

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.

	2008 £m	2007 £m
The total compensation for key management personnel, including Directors, was:		
– salaries and other short-term employee benefits	18	14
– post-employment benefits	3	4
– share-based payments	7	7
	28	25

There were no other long-term benefits applicable in respect of key personnel other than those disclosed in the Remuneration report in the Annual Report. The above table includes termination benefits paid during the year of £nil (2007: £1.2 million).

In 2007, other than in their capacity as shareholders, there have been no material transactions with Compagnie Financière Richemont SA and Remgro Limited, who together indirectly owned 29.95 per cent of the ordinary share capital of British American Tobacco p.l.c. at 31 December 2007.

In November 2008, the controlling companies of R&R Holdings S.A., Richemont and Remgro, distributed the 30 per cent of the shares of British American Tobacco p.l.c. that they indirectly held to their shareholders. A new subsidiary of Richemont and Remgro, Reinet Investments S.C.A, now owns 4 per cent of the shares of British American Tobacco p.l.c., while the rest are owned by non-related individuals and institutions.

30 Contingent liabilities and financial commitments

The Group is subject to contingencies pursuant to requirements that it complies with relevant laws, regulations and standards. Failure to comply could result in restrictions in operations, damages, fines, increased tax, increased cost of compliance, reputational damage, or other sanctions. These matters are inherently difficult to quantify.

In cases where the Group has an obligation as a result of a past event existing at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and the amount of the obligation can be reliably estimated, a provision would be recognised based on best estimates and management judgment.

There are, however, contingent liabilities in respect of litigation, taxes in some countries and guarantees for which no provisions were made.

The Group has exposures in respect of the payment or recovery of a number of taxes. The Group is and has been subject to a number of tax audits covering amongst others, excise tax, value added taxes, sales taxes, corporate taxes, withholding taxes and payroll taxes.

The estimated costs of known tax obligations have been provided in these accounts in accordance with the Group's accounting policies. In some countries, tax law requires that full or part payment of disputed tax assessments be made pending resolution of the dispute. To the extent that such payments exceed the estimated obligation, they would not be recognised as an expense. In some cases disputes are proceeding to litigation.

While the amounts that may be payable or receivable could be material to the results or cash flows of the Group in the period in which they are recognised, the Board does not expect these amounts to have a material effect on the Group's financial condition.

Product liability litigation

Group companies, notably Brown & Williamson Holdings, Inc. (formerly Brown & Williamson Tobacco Corporation) (B&W) as well as other leading cigarette manufacturers, are defendants, principally in the United States, in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

Indemnity

In 2004, B&W completed the combination of the assets, liabilities and operations of its US tobacco business with R.J. Reynolds Tobacco Company (RJRT), a wholly-owned

subsidiary of R.J. Reynolds Tobacco Holdings, Inc., pursuant to which Reynolds American Inc. was formed (the Business Combination). As part of the Business Combination, B&W contributed to RJRT all of the assets and liabilities of its US cigarette and tobacco business, subject to specified exceptions, in exchange for a 42 per cent equity ownership interest in Reynolds American. As a result of the Business Combination:

- B&W discontinued the active conduct of any tobacco business in the United States;
- B&W contributed to RJRT all of its assets other than the capital stock of certain subsidiaries engaged in non-US businesses and other limited categories of assets;
- RJRT assumed all liabilities of B&W (except liabilities to the extent relating to businesses and assets not contributed by B&W to RJRT and other limited categories of liabilities) and contributed subsidiaries or otherwise to the extent related to B&W's tobacco business as conducted in the US on or prior to 30 July 2004; and
- RJRT agreed to indemnify B&W and each of its associates (other than Reynolds American and its subsidiaries) against, among other matters, all losses, liabilities, damages, expenses, judgments, attorneys' fees, etc., to the extent relating to or arising from such assumed liabilities or the assets contributed by B&W to RJRT (the RJRT Indemnification).

The scope of the RJRT Indemnification includes all expenses and contingent liabilities in connection with litigation to the extent relating to or arising from B&W's US tobacco business as conducted on or prior to 30 July 2004, including smoking and health tobacco litigation, whether the litigation is commenced before or after 30 July 2004 (the Tobacco Litigation).

Pursuant to the terms of the RJRT Indemnification, RJRT is liable for any possible judgments, the posting of appeal bonds or security, and all other expenses of and responsibility for managing the defence of the Tobacco Litigation. RJRT has assumed control of the defence of the Tobacco Litigation involving B&W, to which RJRT is also a party in most (but not all) of the same cases. Accordingly, RJRT uses or plans to use the same law firm or firms to represent both B&W and RJRT in any single or similar case (except in certain limited circumstances) as RJRT's interests are typically aligned with B&W's interests, as RJRT has substantial experience in managing recognised external legal counsel in defending the Tobacco Litigation, and external counsel have independent professional responsibilities to represent the interests of B&W. In addition, in accordance with the terms of the RJRT Indemnification, associates of B&W have retained control of the defence in certain Tobacco Litigation cases with respect to which such associates are entitled to indemnification.

Notes on the accounts continued

30 Contingent liabilities and financial commitments continued

US litigation

The total number of US product liability cases pending at 31 December 2008 involving B&W and/or other Group companies was approximately 3,251 (2007: approximately 3,323). At 31 December 2008, UK-based Group companies have been named as co-defendants in 6 of those cases (2007: 6). In 2008, no US cases were tried against B&W. No US cases involving the UK-based Group companies were tried in 2008. No product liability case in which a UK-based Group company is a defendant is currently scheduled for trial in 2009.

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 4 broad categories:

(a) Medical reimbursement cases

These civil actions seek to recover amounts spent by government entities and other third party providers on health care and welfare costs claimed to result from illnesses associated with smoking. Although B&W continues to be a defendant in health care cost recovery cases involving plaintiffs such as hospitals and Native American tribes (see below), the vast majority of such cases have been dismissed on legal grounds.

Further, on 23 November 1998, the major US cigarette manufacturers (including B&W and RJRT) and the attorneys general of 46 US states and 5 US territories executed the Master Settlement Agreement (MSA), which settled recoupment lawsuits that had been brought by these states and territories. Under the terms of the MSA, the settling cigarette manufacturers agreed, among other things, to pay approximately US\$246 billion to the settling states and territories (and to 4 states that had reached separate settlements of their recoupment actions) over 25 years, and agreed to various restrictions on US tobacco advertising and marketing. The MSA includes a credit for any amounts paid by participating tobacco manufacturers in subsequent suits brought by the states' political subdivisions.

At 31 December 2008, a reimbursement suit was pending against B&W by an Indian tribe in Indian tribal court in South Dakota, and another reimbursement case (*City of St. Louis*) was pending against B&W and a UK-based company. In *City of St. Louis*, plaintiffs consist of more than 60 public and non-profit hospitals in Missouri seeking reimbursement of past and future alleged smoking related health care costs.

Summary judgment motions are pending and discovery remains ongoing. A trial date for this case has been set for 11 January 2010.

(b) Class actions

At 31 December 2008, B&W was named as a defendant in some 10 (2007: 12) 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 US state and federal courts against individual cigarette manufacturers and their parent corporations, alleging that the use of terms such as '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 defendants' practices with respect to the marketing, advertising, promotion and sale of 'light' cigarettes, and seeks billions of dollars in economic damages. The district court granted plaintiffs' motion for class certification on 25 September 2006. On 3 April 2008, the *Schwab* class was decertified by the Second Circuit Court of Appeals. The mandate returning the case to the district court was issued 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), filed on 5 May 1994, a jury rendered a punitive damages verdict in favour of the Florida class against all defendants, with US\$17.6 billion in punitive damages assessed against B&W. After various post-trial and appellate proceedings, the Florida Supreme Court, among other things, affirmed an intermediate appellate court's decision to decertify the class, vacated the jury's punitive damages award and permitted putative *Engle* class members to file individual lawsuits against the *Engle* defendants within 1 year of the Court's decision (subsequently extended to 11 January 2008). As of 31 December 2008, B&W has been served individually in approximately 54 *Engle* progeny cases pending in Florida courts. These cases include approximately 110 plaintiffs.

In the first trial of an individual Engle class member (*Lukacs*), the jury, on 11 June 2002, awarded plaintiff US\$37.5 million in compensatory damages (B&W's share: US\$8.4 million). After post-trial proceedings, on 12 November 2008, the trial court entered judgment for plaintiff in the amount of US\$24,835,000 (plus interest), for which defendants were jointly and severally liable. Defendants filed an appeal from the judgment on 1 December 2008.

In a case filed on 24 May 1996 by a class of Louisiana smokers (*Scott*) in Louisiana state court against several US cigarette manufacturers (including B&W), the jury, on 28 July 2003, returned a verdict in defendants' favour on a medical monitoring claim, but made findings against defendants with respect to claims relating to fraud, conspiracy, marketing to minors and smoking cessation. On 21 May 2004, the jury returned a verdict in the amount of US\$591 million on the class's claim for a smoking cessation programme. On 7 February 2007, an intermediate appellate court, among other things, affirmed class certification and upheld the smoking cessation programme for certain smokers who began smoking before 1988, but reduced the US\$591 million jury award by US\$312 million and rejected any award of prejudgment interest. On 21 July 2008, the trial court entered judgment in the case, finding that defendants were jointly and severally liable for funding the cost of a court-supervised smoking cessation programme, and ordering defendants to deposit approximately US\$264 million together with interest from 30 June 2004 into a trust for the funding of the programme. On 15 December 2008, the trial court entered an order permitting defendants to take a suspensive appeal, thereby staying enforcement of the judgment pending the resolution of defendants' appeal.

A class action complaint (*Cleary*) was filed in state court in Chicago, Illinois on 3 June 1998 against several defendants, including B&W, B.A.T Industries p.l.c. (Industries) and British American Tobacco (Investments) Limited (Investments). Industries was dismissed on jurisdictional grounds by an intermediate appellate court on 17 March 2000. The second amended complaint, filed on 8 April 2005, alleges, among other things, that defendants fraudulently concealed facts regarding the addictive nature of nicotine and that certain US defendants marketed tobacco products to underage consumers, and seeks, among other remedies, disgorgement of profits. On 11 July 2006, plaintiffs filed a renewed motion for class certification, which remains pending. The case is currently in class certification discovery.

(c) Individual cases

Approximately 3,238 cases were pending against B&W at 31 December 2008 (2007: approximately 3,307) 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) 2,620 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) 54 are *Engle* progeny cases that have been served upon B&W, and (d) 74 are cases filed by other individuals.

There are 3 verdicts against B&W that remained subject to appeal in 2008:

In December 2003 and January 2004, a New York state court jury (*Frankson*) awarded an individual plaintiff compensatory and punitive damages against B&W and 2 industry organisations. After post-trial and appellate proceedings, the trial court entered judgment on 26 June 2007 in the amounts of US\$175,000 in compensatory damages and US\$5 million in punitive damages. Defendants subsequently appealed from the judgment to an intermediate appellate court. Appellate oral argument was heard on 26 January 2009. A decision remains pending.

In February 2005, a Missouri state court jury (*Smith*) awarded an individual plaintiff US\$500,000 in compensatory damages and US\$20 million in punitive damages against B&W. On 16 December 2008, an intermediate Missouri appellate court affirmed the compensatory damages award, but remanded the case for a new trial on issues relating to punitive damages. B&W filed a motion for rehearing on 31 December 2008, which was denied on 27 January 2009.

On 18 March 2005, a New York state court jury (*Rose*) awarded an individual plaintiff US\$1.7 million in compensatory damages against B&W. On 10 April 2008, an intermediate state appellate court reversed the judgment and ordered that the case be dismissed. On 16 December 2008, the New York Court of Appeals affirmed the intermediate appellate court's ruling. Plaintiff filed a motion to reargue to the Court of Appeals on 14 January 2009, and defendants filed a response on 9 February 2009. A decision on this motion remains pending.

Notes on the accounts continued

30 Contingent liabilities and financial commitments continued

(d) Other claims

The Flintkote Company (Flintkote), a US asbestos production and sales company, was included in the acquisition of Genstar Corporation by Imasco Limited in 1986 and became a Group subsidiary following the restructuring of Imasco Limited (now Imperial Tobacco Canada Limited (Imperial), the Group's operating company in Canada) in 2000. Soon after this acquisition, and as part of the acquisition plan, Genstar began to sell most of its assets, including the non-asbestos related operations and subsidiaries of Flintkote. The liquidation of Flintkote assets produced cash proceeds and, having obtained advice from the law firm of Sullivan & Cromwell LLP and other advice that sufficient assets would remain to satisfy liabilities, Flintkote and Imasco authorised the payment of a dividend of US\$170.2 million in 1986 and a further dividend of US\$355 million in 1987. In 2003, Imperial divested Flintkote and then, in 2004, Flintkote filed for bankruptcy in the United States Bankruptcy Court for the District of Delaware. In 2006, Flintkote, representatives of both the present and future asbestos 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.

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 US\$600 million. Among the PRPs are NCR Corporation (NCR) and Appleton Papers Inc. (Appleton) who may be liable for a proportion of the clean up costs. In 1978, Industries purchased what was then NCR's Appleton Papers Division from NCR. In 1978, Industries also incorporated a US entity by the name of BATUS, Inc. (BATUS), which in 1980 became the holding company for all of Industries' US subsidiaries, including Appleton. As the holding company, BATUS obtained insurance policies for itself and its subsidiaries that included coverage for certain environmental liabilities. Industries/BATUS spun off the Appleton business in 1990 to Wiggins Teape Appleton p.l.c. and Wiggins Teape Appleton (Holdings) p.l.c., now known as Arjo Wiggins Appleton Ltd. and Arjo Wiggins US Holdings Ltd. (collectively,

the AWA Entities), obtaining full indemnities from AWA Entities for past and future environmental claims. Disputes between NCR, Appleton, the AWA Entities, and Industries as to the indemnities given and received under the purchase agreement in 1978 have been the subject of arbitrations in 1998 and 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 that which 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, which preserves the parties' rights to litigate the issue even though the limitation period has expired. 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.

UK-based Group companies

At 31 December 2008, Industries was a defendant in the US in 1 class action, the Schwab case mentioned previously. In that case, Industries was substituted for British American Tobacco p.l.c. as a defendant. Investments had been served in 1 reimbursement case (*City of St. Louis*), the Department of Justice case (see below), 1 anti-trust case (*Daric Smith*, see below), 2 class actions (*Cleary* and *Schwab*) and 2 individual actions (*Eiser* and *Perry*).

Conduct-based claims

On 22 September 1999, the US Department of Justice brought an action in the US District Court for the District of Columbia against various industry members, including B&W, Industries and Investments. Industries was dismissed for lack of personal jurisdiction on 28 September 2000. The Government sought, among other relief, the disgorgement of US\$280 billion in past profits pursuant to the federal Racketeer Influenced and Corrupt Organisations Act (RICO) statute. On 4 February 2005, the DC Circuit Court of Appeals ruled that the Government could not claim disgorgement of profits under RICO. On 17 August 2006, the district court

issued its final judgment in favour of the Government, and against certain defendants, including B&W and Investments. The court also ordered a wide array of injunctive relief, including a ban on the use of 'lights' and other similar descriptors. Investments' compliance with the court-ordered remedies may result in potentially significant financial exposure. Defendants, including B&W and Investments, filed notices of appeal to the DC Circuit Court of Appeals on 11 September 2006, and thereafter obtained a stay of the district court's judgment. Appellate briefing has been completed and oral argument took place on 14 October 2008. A decision remains pending.

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 defendants participated in a conspiracy to fix or maintain the price of cigarettes sold in the US, including the State of Kansas, in violation of the Kansas Restraint of Trade Act. Discovery is continuing.

Product liability outside the United States

At 31 December 2008, active claims against the Group's companies existed in 18 (2007: 18) markets outside the US but the only markets with more than 5 active claims were Argentina, Brazil, Canada, Chile, Italy, Nigeria, and the Republic of Ireland. There has been new litigation in Bulgaria and Israel, where class actions have been filed, and in Russia where the Ministry of Health commenced a consumer protection claim. In 2008, judgments in favour of the defence were rendered in individual smoking and health cases in Finland, the Netherlands and Chile. The following is a description of the major developments since the last report in cases pending outside the United States that fall into 4 broad categories:

(a) Medical reimbursement cases

Argentina

ATLA (Argentine Tort Law Association) in June 2007 instigated a lawsuit stating damages and medical recoupment claims as against Nobleza-Piccardo S.A.I.C.y F. (Nobleza Piccardo). ATLA sought to have certain public entities joined as plaintiffs. On 23 December 2008, the court allowed intervention by the national government and declined to accept in full certain defences asserting legal invalidity of the claims. Nobleza Piccardo will appeal this ruling.

Brazil

The São Paulo State Public Prosecutor instigated a lawsuit in July 2007 comprising product liability, ETS and medical recoupment claims. On 7 October 2008, Souza Cruz S.A. (Souza Cruz) filed an objection to a motion to intervene as

an additional plaintiff by ACTbr, a private anti-tobacco group. On 17 October 2008, the court issued an order to plaintiffs to respond to certain of defendants' procedural requests, as well as certain defences and objections.

Canada

The government of the Province of British Columbia brought a claim pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2000 (the Recovery Act) against domestic and foreign manufacturers seeking to recover plaintiff's costs of health care benefits. Investments, Industries, Imperial and certain former Rothmans Group companies are named as defendants. The constitutionality of the Recovery Act was challenged by certain defendants. Ultimately, in September 2005, the Supreme Court of Canada declared the Recovery Act to be constitutionally valid. The defendants joined the federal Government of Canada as a defendant and the federal Government, in turn, filed a motion to strike the claim. The Supreme Court of British Columbia found in favour of the federal Government, dismissing it from the action. Defendants' subsequent appeal of that order has been consolidated with a similar appeal in the Knight case (see below). The appeals are scheduled to be heard in the week of 1 June 2009. Non-Canadian defendants, including Investments and Industries, sought to dismiss the action on the ground that the British Columbia court lacked personal jurisdiction over them. These motions were subsequently denied, and defendants' appeal of these decisions was ultimately unsuccessful. The claim is now set down for trial in September 2011.

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, Imperial and certain former Rothmans Group companies 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.

Colombia

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 2 Colombian citizens alleging that the defendant violated numerous 'collective' interests and rights of the Colombian population. In addition to equitable and injunctive relief, plaintiffs are seeking 25 per cent of smoking-related health care costs since the time that the Group has been operating in Colombia.

Notes on the accounts continued

30 Contingent liabilities and financial commitments continued

Israel

Clalit, 1 of the main health care providers in Israel, filed a recoupment claim on 28 September 1998 in the Tel Aviv District Court against several local and international tobacco companies. Clalit seeks NIS7.6 billion (approximately US\$1.9 billion) in damages and injunctive relief. Following a series of procedural negotiations between the parties, the Group companies currently named as defendants in the action are Industries, B&W, B.A.T (U.K. and Export) Limited (BATUKE) and Investments. In 2003, the Group company defendants except for Industries, and others, filed motions to strike the Statement of Claim on the ground that Clalit's claims are remote and derivative, and therefore cannot be brought as direct claims. On 16 February 2004, the District Court judge issued a consolidated decision denying defendants' motions. Defendants have appealed this decision to the Supreme Court. The outcome of the Supreme Court ruling on defendants' appeals is still awaited. Additionally, in 2002, Industries filed a motion to set aside service as improper due to its lack of contacts with the jurisdiction. That motion was denied in or about November 2005, and Industries subsequently filed a motion seeking leave to appeal that decision to the Supreme Court. A decision on Industries' motion is stayed pending a ruling on the other defendants' motions to strike.

Nigeria

In 2007, 4 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. In 2008, a health care recoupment claim was also filed in Akwa Ibom state. The Company and British American Tobacco (Nigeria) Limited have been served with notices in that action. A health care recoupment claim has reportedly also been filed in Ogun state. No Group companies have been served with that claim.

On 21 February 2008, the initial Lagos action was voluntarily discontinued by plaintiffs and replaced on 13 March 2008 with a substantially similar action. British American Tobacco (Nigeria) Limited, the Company and Investments have all been served in the new action and have filed preliminary

objections. On 8 July 2008, the High Court of Gombe State ruled on the preliminary objections filed by the Company, Investments and other defendants in the case, setting aside service on all defendants and striking out the claim. Plaintiff has since filed a renewed action and the court has granted plaintiff's application for leave to issue and serve a writ of summons outside the jurisdiction. In Kano and Oyo States, proceedings are currently concerned with determining the parties' preliminary objections to jurisdiction. Matters in the Akwa Ibom and Federal claims stand adjourned for reports on service.

Saudi Arabia

There are reports that the Saudi Ministry of Health is pursuing a health care recoupment action in the Riyadh General Court against a number of tobacco distributors and agents. At 31 December 2008, no Group company had been served with process. The Ministry of Health is reportedly seeking damages of at least 127 billion Saudi Riyals. 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 December 2008, no Group company had been served with process.

Spain

The Junta de Andalucía, together with the Health Service of Andalucía (hereinafter 'Junta') filed, on 20 September 2007, a recoupment action against the Spanish State and 6 tobacco companies, including British American Tobacco España, S.A. (BAT España). The Junta seeks the reimbursement of €1,769,964 allegedly spent in health care costs for treating patients with smoking-related diseases. The Court upheld the State's preliminary objections to the claim and dismissed the claim on 14 November 2007. On 4 March 2008, the Junta filed a notice of its intention to appeal that decision. The Junta's appeal remains pending. On 23 July 2008, BAT España was served with notice of a new claim by the Junta asserting essentially the same claims as in the prior action.

(b) Class actions

Brazil

In 1995, a class action was filed by the Association for the Defence of the Health of Smokers (ADESF) against Souza Cruz and other tobacco manufacturers in the São Paulo Lower Civil Court alleging that defendants are liable to a class of smokers and former smokers for failing to warn of cigarette addiction. Plaintiffs seek monetary damages and injunctive relief. The case was stayed in 2004 pending defendants' appeal from a decision issued by the lower civil court on 7 April 2004. On 12 November 2008, the São Paulo Court of Appeals

overturned the lower court's unfavourable decision of 2004, finding that the lower court had failed to provide defendants with an opportunity to produce evidence. The case now returns to the lower court for production of evidence and a new judgment.

The Brazilian Association for the Defence of Consumers' Health (Saudecon) filed a class action against Souza Cruz in the City of Porto Alegre, Brazil on 3 November 2008. Plaintiff purports to represent all Brazilian smokers whom, it alleges, are unable to quit smoking and lack access to cessation treatments. Plaintiff is seeking an order requiring the named defendants to fund, according to their market share, the purchase of cessation treatments for these smokers over a minimum period of 2 years. Souza Cruz filed its Statement of Defence on 26 January 2009.

A consumer association known as ACODE (Association of Exploited Consumers of the Federal District) instigated an action in essence seeking a court order to stop Souza Cruz from marketing cigarettes in Brazil. In December 2006, the 4th Chamber of the Federal District Court of Appeals confirmed a lower court decision that ruled the claim groundless and unlawful. Plaintiff filed an appeal before the Superior Court of Justice which has been pending final review since May 2007.

The State of Sergipe instigated in 2004 a class action seeking compensation for smokers in Sergipe State who purportedly sought to quit smoking. The lower court denied plaintiffs' request for early relief and determined that all Brazilian tobacco companies and ANVISA be ordered to join the case as co-defendants. Since then all the parties involved have yet to be served process.

Bulgaria

In March 2008, a collective claim was filed in the Sofia City Court of Bulgaria against 21 defendants, including British-American Tobacco Polska S.A., British-American Tobacco (Romania) Trading SRL, and House of Prince A/S. Plaintiff seeks recovery of roughly 17,000 Leva (approximately US\$12,000) in damages per class member and injunctive relief. The claim was dismissed twice on procedural deficiencies, but re-instated both times on appeal. On 2 December 2008, the Sofia City Court dismissed the youth advertising claim and required plaintiff to meet various evidentiary and procedural conditions in order to proceed with the claim.

Canada

In the *Knight* class action in Canada, the Supreme Court of British Columbia certified a class of all consumers of cigarettes bearing 'light' or 'mild' descriptors since 1974 manufactured in British Columbia by Imperial. The British Columbia Court of Appeal affirmed the certification of the class but has limited any potential financial liability to the period from 1997. This is a 'lights' class action in which plaintiff alleges that the marketing of light and mild cigarettes is deceptive because it conveys a false and misleading message that those cigarettes are less harmful than regular cigarettes. Plaintiff seeks compensation for amounts spent on 'light and mild' products and a disgorgement of profits from Imperial. Imperial joined the federal Government of Canada as a defendant and the federal Government, in turn, filed a motion to strike the claim. The court subsequently dismissed the federal Government from the action. Imperial appealed that order, and its appeal has been consolidated with a similar appeal in the British Columbia recoupment litigation (see above). Hearings are scheduled for the week of 1 June 2009.

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. Certification was denied on 29 December 2008 and Imperial subsequently received plaintiffs' notice for leave to appeal.

There are currently 2 class actions in Quebec. On 21 February 2005, the Quebec Superior Court granted certification. The court certified 2 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. Plaintiffs have served a Statement of Claim.

On 12 May 2008, the Ontario Court of Appeal dismissed 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 2008 decision. In summary, the court decided that there was no rational relationship between the class definition and the proposed common issues and that a class action was not a preferable procedure.

Notes on the accounts *continued*

30 Contingent liabilities and financial commitments *continued*

Israel

In May 2008, 9 smokers of low yield cigarettes filed a class action in Israel, known as *Numberg*, before the Tel Aviv District Court against various defendants including the Group's Israeli distributor, Globbrands Agencies 2007 Limited. Plaintiffs allege that since December 2004, defendants have fraudulently marketed and sold low yield cigarettes in Israel, in contravention of what they interpret to be an express ban on the sale of such products following the prohibition on the use of 'lights' descriptors, by using methods such as marking cigarette packages in a special colour, using descriptors such as 'slim' or 'super slim', and displaying text that describes the amount of tar and nicotine yields. In addition to injunctive and declaratory relief, plaintiffs seek NIS78.5 billion (approximately US\$20.3 billion) in monetary damages.

Venezuela

FEVACU (Venezuelan Federation of Associations of Users and Consumers) instigated a purported class action that was admitted by the court on 22 October 2008 seeking, among other relief, that defendant be required to fund a trust for the treatment of alleged smoking-related diseases. On 19 January 2009, C.A. Cigarrera Bigott Sucs. appeared as a third party whose rights may be affected by the proceedings, as provided under the procedural law.

(c) Individual cases

Brazil

As of 31 December 2008, there were approximately 310 individual cases that remain pending in Brazil against Souza Cruz in which it is contended that the smokers' diseases or deaths were caused by cigarette smoking. Since 1995, approximately 530 individual cases have been filed in Brazil against Souza Cruz. Approximately 10 of these cases have resulted in court decisions favourable to plaintiffs in either the civil court or court of appeal, all of which remain on appeal.

Canada

3 individual smoking and health cases have been filed in Canada. Of these, 2 (*Battaglia* and *Landry*) have been in abeyance since 2004 and 2003 respectively. The 3rd (*Spasic*) is active and currently at a preliminary stage. 1 smoking and health case (*Stright*) has been filed in Nova Scotia but has been in abeyance since 2005.

Chile

On 16 December 2008, the Civil Court of Santiago dismissed an individual smoking and health action filed by Mr Andres Javier Rada Meza against Compania Chilena de Tabacos S.A. (Chiletabacos) and other tobacco manufacturers in 2006.

Plaintiff can challenge this decision before the Court of Appeal with 10 days of being notified of the decision. In addition to Rada, there are 8 smoking and health claims pending against Chiletabacos that have not been decided yet.

Finland

On 10 October 2008, following a consolidated trial, the Helsinki District Court dismissed 3 individual smoking and health actions that were brought against British American Tobacco Nordic Oy (BAT Nordic), amongst others, and ordered each plaintiff to pay BAT Nordic costs of €125,000. In December 2008, plaintiffs appealed the District Court's decisions in their entirety but 1 plaintiff, Lindroos, has subsequently withdrawn her appeal. Briefing of the substantive appeals is ongoing.

Ireland

Fifteen individual smoking and health cases are ongoing in the Republic of Ireland, in which plaintiffs seek compensation for various alleged tobacco-related injuries. The Group defendants involved in these claims are PJ Carroll & Co. Ltd and Rothmans of Pall Mall (Ireland) Ltd, although both Group companies are not named in every action. 1 case, *McCormack*, was dismissed by judgment perfected on 17 July 2008 but plaintiff has filed a notice of appeal. Dismissal motions in 13 other cases are pending the decision of the Supreme Court in *McCormack*. The fifteenth case is currently dormant.

Italy

As of 31 December 2008, there were approximately 1,672 (2007: 3,478) individual 'lights' cases in Italy pending against British American Tobacco Italia S.p.A. Almost all of the individual 'lights' cases filed in Italy are pending before lower level (Justices of the Peace) courts. Because of the type of court involved, the maximum possible recovery in damages is €1,033. In 2007, 2,230 'lights' cases were filed by a single plaintiffs' counsel in the jurisdiction of Pescopagano. In 2008, all of these claims were withdrawn. As of 31 December 2008, 1,026 (2007: 950) cases (not including the Pescopagano cases) have been suspended or dismissed. There are 38 (2007: 33) individual smoking and health cases pending before Italian Civil Courts, in which it is contended that the smokers' diseases or deaths were caused by cigarette smoking. There are 3 (2007: 2) labour cases for alleged occupational exposure.

Netherlands

On 17 December 2008, the District Court of Amsterdam dismissed an individual smoking and health action filed in June 2005 by Peter Josef Romer against British American Tobacco The Netherlands B.V. and British American Tobacco Manufacturing B.V. Plaintiff has until 18 March 2009 to appeal the dismissal.

(d) Consumer protection litigation

Russia

On 8 September 2008, a consumer fraud action was filed in the Savelovsky District Court of Moscow by the Ministry of Health and Social Development in Russia against OJSC British American Tobacco – Yava (Yava) and its retail distributor, CJSC International Tobacco Marketing Services. The claim seeks a declaration from the court that the use of the words ‘light, superlight, and 1mg light’ on cigarette packets of Yava’s low tar cigarettes are misleading and unlawful, and further seeks the removal of these descriptors. In November 2008, the action was dismissed for lack of jurisdiction, but the dismissal was reversed on appeal. Grounds are awaited to determine whether a further appeal can be launched. In the meantime, the case file has been returned to the court of first instance where a hearing on the merits will be scheduled.

Other litigation outside the US

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 Can\$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 Can\$50 million in 2008 and a percentage of Imperial’s annual net sales revenue going forward for fifteen years up to a maximum of Can\$350 million.

Conclusion

While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, the Group believes that the defences of the Group’s companies to all these various claims are meritorious on both the law and the facts, and a vigorous defence is being made everywhere. If an adverse judgment is entered against any of the Group’s companies, an appeal will be made. Such appeals could require the appellants to post appeal bonds or substitute security in amounts which could in some cases equal or exceed the amount of the judgment. In any event, with regard to US litigation, the Group has the benefit of the RJRT Indemnification. At least in the aggregate, and despite the quality of defences available to the Group, it is not impossible that the Group’s results of operations or cash flows in particular quarterly or annual periods could be materially affected by the final outcome of any particular litigation.

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

Guarantees

Performance guarantees given to third parties in respect of Group companies were £1 million (2007: £1 million).

Operating leases

Total future minimum lease payments under non-cancellable operating leases comprise leases where payments fall due:

	2008 £m	2007 £m
Property		
Within 1 year	77	55
Between 1 and 5 years	150	100
Beyond 5 years	160	147
	387	302
Plant and equipment		
Within 1 year	32	21
Between 1 and 5 years	38	29
	70	50

5 year summary

	2008 £m	2007 restated £m	2006 restated £m	2005 restated £m	2004 restated £m
For the years ended 31 December					
Income statement					
Gross turnover (including duty, excise and other taxes)	33,921	27,104	25,503	24,082	31,934
Revenue (after deducting duty, excise and other taxes)	12,122	10,018	9,762	9,325	10,768
Profit from operations*	3,572	2,904	2,632	2,426	3,763
Profit before taxation	3,684	3,077	2,774	2,590	3,640
Profit for the year (before minority interest)	2,659	2,287	2,057	1,898	2,966
*after (charging)/crediting					
– restructuring and integration costs	(160)	(173)	(216)	(271)	(206)
– Canadian settlement	(102)				
– amortisation of trademarks	(24)				
– gains on disposal of businesses and trademarks	141	75	41	72	1,427
– investment costs written off					(50)
	2008 pence	2007 restated pence	2006 restated pence	2005 restated pence	2004 restated pence
Earnings per share					
– basic unadjusted	123.28	105.19	92.57	84.48	133.81
– diluted unadjusted	122.54	104.46	91.81	83.80	131.50
– diluted adjusted	128.78	108.53	98.60	89.48	76.67
Dividends declared per share	83.70	66.20	55.90	47.00	41.90
	2008 £m	2007 restated £m	2006 restated £m	2005 restated £m	2004 restated £m
At 31 December					
Balance sheet					
Non-current assets	18,809	13,398	12,401	13,093	12,095
Current assets	8,742	5,366	5,391	5,904	5,680
Total assets	27,551	18,764	17,792	18,997	17,775
Shareholders' funds	6,944	6,871	6,357	6,264	5,878
Minority interests	271	218	227	247	198
Total equity	7,215	7,089	6,584	6,511	6,076
Non-current liabilities	11,435	7,121	6,755	6,650	7,259
Current liabilities	8,901	4,554	4,453	5,836	4,440
Total liabilities	20,336	11,675	11,208	12,486	11,699
Total equity and liabilities	27,551	18,764	17,792	18,997	17,775

The restatement of prior years principally reflects the change in Group accounting policy for actuarial gains and losses together with the adoption of IFRIC14 as explained in note 1 and note 12.

Certain reclassifications have been made in respect of gross turnover in 2008; as a result historical information has been re-presented.

Quarterly analyses of profit

The figures shown below have been produced using average rates of exchange on a quarterly basis since the beginning of the year. Thus the discrete quarters have not been restated for subsequent movements in foreign exchange rates during the year, which are reflected in the results for subsequent quarters.

	31 Mar 2008 £m	30 Jun 2008 £m	30 Sept 2008 £m	3 months to 31 Dec 2008 £m	Year to 31 Dec 2008 £m
Profit from operations	807	917	990	858	3,572
after (charging)/crediting					
– restructuring and integration costs	(10)	(23)	(34)	(93)	(160)
– Canadian settlement			(101)	(1)	(102)
– amortisation of trademarks			(12)	(12)	(24)
– gains on disposal of businesses and trademarks			139	2	141
Net finance costs	(95)	(84)	(91)	(121)	(391)
Share of post-tax results of associates and joint ventures	159	134	93	117	503
after (charging)/crediting					
– trademark impairments				(20)	(20)
– additional ST income		13			13
– termination of joint venture	45		1	(1)	45
– restructuring costs			(12)		(12)
Profit before taxation	871	967	992	854	3,684
Earnings per share					
Basic	29.92p	32.56p	33.01p	27.79p	123.28p
Adjusted diluted	28.44p	33.58p	33.95p	32.81p	128.78p

	31 Mar 2007 £m	30 Jun 2007 £m	30 Sept 2007 £m	3 months to 31 Dec 2007 restated £m	Year to 31 Dec 2007 restated £m
Profit from operations	684	808	812	600	2,904
after (charging)/crediting					
– restructuring costs	(8)	(32)	(10)	(123)	(173)
– gains on disposal of businesses and trademarks		11	45	19	75
Net finance costs	(58)	(68)	(78)	(65)	(269)
Share of post-tax results of associates and joint ventures	111	111	113	107	442
after (charging)					
– trademark impairments				(7)	(7)
Profit before taxation	737	851	847	642	3,077
Earnings per share					
Basic	24.24p	28.70p	29.73p	22.52p	105.19p
Adjusted diluted	24.31p	29.20p	28.49p	26.53p	108.53p

The restatement of the 2007 results reflects the change in the Group's accounting policy for recognition of actuarial gains and losses together with the adoption of IFRIC14 as explained in note 1.

Principal subsidiary undertakings

	% equity shares held		% equity shares held
Europe			
Great Britain			
B.A.T Industries p.l.c.	100	Romania	
B.A.T (U.K. and Export) Ltd.	100	British-American Tobacco (Romania) Trading SRL	100
B.A.T. International Finance p.l.c.	100*	Russia	
BATMark Ltd.	100*	OJSC British American Tobacco – STF	99
British-American Tobacco (Holdings) Ltd.	100	OJSC British American Tobacco – Yava	99†
British American Tobacco International (Holdings) B.V. (incorporated in the Netherlands)	100	CJSC British American Tobacco – SPb	100†
British American Tobacco (1998) Ltd.	100*	CJSC 'International Tobacco Marketing Services'	100
British American Tobacco (Brands) Ltd.	100	Serbia	
British American Tobacco (Investments) Ltd.	100	Duvanska Industrija 'Vranje' A.D.	88
British American Tobacco (Supply Chain WE) Ltd.	100	Spain	
British American Tobacco UK Ltd.	100	British American Tobacco España, S.A.	100
Tobacco Insurance Company Ltd.	100	Sweden	
Weston Investment Company Ltd.	100	British American Tobacco Sweden AB	100
		Fiedler & Lundgren AB	100
Belgium		Switzerland	
British American Tobacco Belgium S.A.	100	British American Tobacco International Ltd.	100
Cyprus		British American Tobacco Switzerland S.A.	100
B.A.T (Cyprus) Ltd.	100	Ukraine	
Czech Republic		A/T B.A.T. – Prilucky Tobacco Co.	99
British American Tobacco (Czech Republic), s.r.o.	100	Uzbekistan	
Denmark		UZBAT A.O.	97
House of Prince A/S	100	America-Pacific	
Finland		Canada	
British American Tobacco Finland Oy	100	Imperial Tobacco Canada Ltd.	100
France		Japan	
British American Tobacco France SAS	100	British American Tobacco Japan, Ltd.	100
Germany		United States of America	
British-American Tobacco (Germany) GmbH	100	B.A.T Capital Corporation	100*
British American Tobacco (Industrie) GmbH ●	100	BATUS Japan, Inc	100
Greece		Brown & Williamson Holdings, Inc.	100
British American Tobacco Hellas S.A.	100	British American Tobacco (Brands) Inc.	100
Hungary		Asia-Pacific	
BAT Pécsi Dohánygyár Kft.	100	Australia	
Italy		British American Tobacco Australia Ltd.	100
British American Tobacco Italia S.p.A.	100	Bangladesh	
Netherlands		British American Tobacco Bangladesh Company Ltd.	65
British American Tobacco The Netherlands B.V.	100	Cambodia	
British American Tobacco Holdings (The Netherlands) B.V.	100	British American Tobacco (Cambodia) Ltd.	71
Norway		China	
British American Tobacco Norway AS	100	B.A.T. China Ltd. (incorporated in Great Britain)	100
Poland		British-American Tobacco Company (Hong Kong) Ltd. (incorporated in Hong Kong)	100
British-American Tobacco Polska S.A.	99	Indonesia	
Scandinavian Tobacco S.A.	100	PT BAT Indonesia Tbk	78
Republic of Ireland		Malaysia	
P.J. Carroll & Company Ltd.	100	British American Tobacco (Malaysia) Berhad	50

	% equity shares held		% equity shares held
New Zealand		St Lucia	
British American Tobacco (New Zealand) Ltd.	100	CARISMA Marketing Services Ltd.	100
Pakistan		Venezuela	
Pakistan Tobacco Co. Ltd.	94	C.A. Cigarrera Bigott Sucs.	100
Papua New Guinea		Africa and Middle East	
British American Tobacco (PNG) Ltd.	100	Cameroon	
Singapore		British American Tobacco Cameroun S.A.	99
British-American Tobacco (Singapore) Pte Ltd.	100	Congo	
British-American Tobacco Marketing (Singapore) Pte Ltd.	100	British American Tobacco Congo SARL	100
South Korea		Egypt	
British American Tobacco Korea Ltd.	100	British American Tobacco Egypt LLC	100
British American Tobacco Korea Manufacturing Ltd.	100	Ghana	
Sri Lanka		British American Tobacco Ghana Ltd.	97
Ceylon Tobacco Company Ltd.	84	Kenya	
Vietnam		British American Tobacco Kenya Ltd.	60
B.A.T Vietnam Ltd. (incorporated in Great Britain)	100	La Reunion	
British American Tobacco-Vinataba (JV) Ltd.	70	B.A.T. La Reunion SAS	100
Latin America		Malawi	
Argentina		British American Tobacco (Malawi) Ltd.	100
Nobleza-Piccardo S.A.I.C.y F.	96	Mauritius	
Brazil		British-American Tobacco (Mauritius) p.l.c. (incorporated in Great Britain)	100
Souza Cruz S.A.	75	Mozambique	
Chile		Sociedade Agricola de Tabacos Lda.	95
Compania Chilena de Tabacos S.A.	96	Nigeria	
Guyana		British American Tobacco (Nigeria) Ltd.	100
Demerara Tobacco Company Ltd.	70	South Africa	
Honduras		British American Tobacco Holdings South Africa (Pty) Ltd.	100
Tabacalera Hondureña S.A.	80	Turkey	
Jamaica		British American Tobacco Sigara ve Tütünçülük Sanayi ve Ticaret A.S.	100
Carreras Group Ltd. ▲	50	British American Tobacco Tütün Mamulleri Sanayi ve Ticaret A.S.	100
Mexico		Uganda	
British American Tobacco Mexico, S.A. de C.V.	100	British American Tobacco Uganda Ltd.	90
Panama		Zambia	
British American Tobacco Central America S.A.	78	British American Tobacco (Zambia) plc	78
Tabacalera Istmeña S.A.	100		
Peru			
Tabacalera Nacional S.A.A.	96^		
Trinidad & Tobago			
The West Indian Tobacco Company Ltd.	50		

Subsidiary undertakings held directly by British American Tobacco p.l.c. are indicated thus *; all others are held by sub-holding companies. Unless otherwise stated, the country of incorporation and operation is that under which the company is listed. All subsidiary undertakings are involved in activities related to the manufacture, distribution or sale of tobacco products. All companies' shares are ordinary shares or common stock except for those indicated thus †, which include preference shares, and that indicated thus ^, which include investment stock (non-voting).

● Financial year end is 30 November. ▲ Financial year end is 31 March.

A complete list of subsidiary and associated undertakings will be attached to the next British American Tobacco p.l.c. annual return to the Registrar of Companies.

The Company has taken advantage of the exemption under Section 410(2) of the Companies Act 2006 by providing information only in relation to subsidiary undertakings whose results or financial position, in the opinion of the Directors, principally affected the financial statements.

Principal associate undertakings

		Latest published information	Total issued capital £m	% shares held
America-Pacific				
United States of America				
Reynolds American Inc.	▼ Common Stock	31 Dec 2008	*	42
<i>tobacco</i>	▼ Preferred Stock		**	
Asia-Pacific				
India				
ITC Ltd.	▼ Ordinary	31 Dec 2008	54	32
<i>tobacco</i>				
<i>paper and packaging</i>				
<i>hotels</i>				

▼ Listed overseas.

* As at 31 December 2008, Reynolds American Inc. had issued 291,450,762 shares (US\$0.0001 Common Stock), of which the Group held 122,518,429.

** As at 31 December 2008, Reynolds American Inc. had issued 1,000,000 shares (US\$0.01 Preferred Stock), in which the Group held no interest.

Report of the independent auditors

to the members of British American Tobacco p.l.c.

We have audited the Parent Company financial statements of British American Tobacco p.l.c. for the year ended 31 December 2008 which comprise the Balance sheet and the related notes. These Parent Company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Remuneration report that is described as having been audited.

We have reported separately on the Group financial statements of British American Tobacco p.l.c. for the year ended 31 December 2008.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report, including the Remuneration report and the Parent Company financial statements, in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Directors' responsibilities in relation to the financial statements, included in the Responsibility of Directors.

Our responsibility is to audit the Parent Company financial statements and the part of the Remuneration report to be audited 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 Parent Company financial statements give a true and fair view and whether the Parent Company financial statements and the part of the Remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether, in our opinion, the information given in the Directors' report is consistent with the Parent Company financial statements. The information given in the Directors' report includes that specific information presented in the Business review that is cross referred from the Directors' report.

In addition, we report to you if, in our opinion, the Company has not kept proper accounting records, if 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 read other information contained in the Annual Report and consider whether it is consistent with the audited Parent Company financial statements. The other information

comprises only the Business review, the Directors' report excluding the audited part of the Remuneration report, the Group 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 parent company 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 Parent Company financial statements and the part of the Remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Parent Company financial statements, and of whether the accounting policies are appropriate to the Company'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 Parent Company financial statements and the part of the Remuneration report to be audited 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 Parent Company financial statements and the part of the Remuneration report to be audited.

Opinion

In our opinion:

- the Parent Company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2008;
- the Parent Company financial statements and the part of the Remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' report is consistent with the Parent Company financial statements.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
1 Embankment Place, London

25 February 2009

Balance sheet – British American Tobacco p.l.c.

At 31 December

	Notes	2008 £m	2007 £m
Assets			
Fixed assets			
Investments in Group companies	2	4,063	4,047
		4,063	4,047
Current assets			
Debtors	3	4,240	4,110
		4,240	4,110
Total assets		8,303	8,157
Equity			
Capital and reserves			
Share capital		506	506
Share premium account		56	53
Capital redemption reserves		101	101
Other reserves		90	90
Profit and loss account		3,143	2,951
after deducting			
– cost of treasury shares		(741)	(294)
Shareholders' funds	4	3,896	3,701
Liabilities			
Creditors	5	4,407	4,456
Total equity and liabilities		8,303	8,157

The accompanying notes are an integral part of the Parent Company financial statements.

On behalf of the Board

Jan du Plessis

Chairman

25 February 2009

Notes on the accounts

1 Accounting policies

Basis of accounting

The Parent Company financial statements have been prepared on the going concern basis under the historical cost convention except as described in the accounting policy below on financial instruments and in accordance with the Companies Act 1985/2006 and UK Generally Accepted Accounting Principles.

The Company is a public limited company which is listed on the London Stock Exchange and is incorporated and domiciled in the UK.

Cash flow statement

The cash flows of the Company are included in the consolidated cash flow statement of British American Tobacco p.l.c. which is included in this Annual Report. Consequently, the Company is exempt under the terms of FRS1 (Revised) from publishing a cash flow statement.

Foreign currencies

Transactions arising in currencies other than sterling are translated at the rate of exchange ruling on the date of the transaction. Assets and liabilities expressed in currencies other than sterling are translated at rates of exchange ruling at the end of the financial year. All exchange differences are taken to the profit and loss account in the year.

Accounting for income

Income is included in the profit and loss account when all contractual or other applicable conditions for recognition have been met. Provisions are made for bad and doubtful debts, as appropriate.

Taxation

Taxation provided is that chargeable on the profits of the period, together with deferred taxation. Deferred taxation is provided in full on timing differences between the recognition of gains and losses in the financial statements and their recognition in tax computations. However, the Company does not discount deferred tax assets and liabilities.

Fixed asset investments

Fixed asset investments are stated at cost, together with subsequent capital contributions, less provisions for any impairment in value.

Dividends

Final dividend distributions to the Company's shareholders are recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders, while interim dividend distributions are recognised in the period in which the dividends are declared and paid.

Repurchase of share capital

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

Related parties

The Company has taken advantage of the exemption under paragraph 3(b) FRS8 from disclosing transactions with related parties that are part of the British American Tobacco p.l.c. Group.

Financial instruments

The financial instrument disclosures of the Company are included in the Group financial statements which are included in this Annual Report. Consequently, the Company is exempt under paragraph 3C (b) of FRS25 and 2D(b) of FRS29 from publishing these financial instrument disclosures.

Financial guarantees are recorded at fair value less accumulated amortisation.

Notes on the accounts continued

2 Investments in Group companies

The Company's directly owned subsidiaries are British American Tobacco (1998) Limited, B.A.T. International Finance p.l.c., B.A.T Capital Corporation, BATMark Limited, British American Ventures Limited and British American Tobacco QUEST Limited.

The Directors are of the opinion that the individual investments in the subsidiary undertakings have a value not less than the amount at which they are shown in the Balance sheet.

	2008 £m	2007 £m
1 January 2008	4,047	4,047
Additions	16	
31 December 2008	4,063	4,047

On 10 February 2009, the Company purchased 230,000,000 £1 shares in B.A.T. International Finance p.l.c. for a consideration of £230 million.

3 Debtors

	2008 £m	2007 £m
Amounts due from Group undertakings	4,240	4,110

Included in debtors are amounts of £69 million (2007: £95 million) falling due after 1 year.

4 Shareholders' funds

	Share capital £m	Share premium account £m	Capital redemption reserves £m	Other reserves £m	Profit and loss account £m	Total £m
1 January 2008	506	53	101	90	2,951	3,701
Increase in share capital – share options		3				3
Profit for the year					2,033	2,033
Dividends and other appropriations						
ordinary shares (<i>note 8</i>)					(1,393)	(1,393)
Purchase of own shares					(400)	(400)
Consideration paid for purchase of own shares held in employee share ownership trusts					(114)	(114)
Consideration received on the exercise of options over own shares held in employee share ownership trusts					7	7
Other movements					59	59
31 December 2008	506	56	101	90	3,143	3,896

Dividends paid are recognised in the year in which they are declared, and dividends received are recognised in the year in which they are received. The final dividend which has been declared for the year ended 31 December 2008 is shown in note 8 to the Group financial statements and will be recognised in the financial statements for the year ended 31 December 2009.

As permitted by Section 230 of the Companies Act 1985, the profit and loss of the Company has not been presented in these financial statements. The profit for the year ended 31 December 2008 was £2,033 million (2007: £3,517 million).

Details of Directors' remuneration, share options and retirement benefits are given in the Remuneration report. Details of key management compensation are included in note 29 of the Group financial statements.

Shareholders' funds are stated after deducting the cost of treasury shares which include £523 million (2007: £123 million) for shares repurchased and not cancelled and £218 million (2007: £171 million) in respect of the cost of own shares held in employee share ownership trusts.

Transaction costs deducted from equity for the year ended 31 December 2008 were £3 million (2007: £5 million).

4 Shareholders' funds continued

Share capital	Ordinary shares of 25p each Number of shares	Convertible redeemable preference shares of 25p each Number of shares	£m
Authorised			
1 January 2008 and 31 December 2008	2,858,265,349	241,734,651	775.00
Allotted, called up and fully paid			
1 January 2008	2,024,504,341		506.13
Changes during the year			
– share option schemes	526,810		0.13
31 December 2008	2,025,031,151		506.26

Share capital	Ordinary shares of 25p each Number of shares	Convertible redeemable preference shares of 25p each Number of shares	£m
Authorised			
1 January 2007 and 31 December 2007	2,858,265,349	241,734,651	775.00
Allotted, called up and fully paid			
1 January 2007	2,068,803,944		517.20
Changes during the year			
– share option schemes	1,007,692		0.25
– purchase of own shares	(45,307,295)		(11.32)
31 December 2007	2,024,504,341		506.13

Share premium

The increase of £3 million relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration report.

5 Creditors

	2008 £m	2007 £m
Amounts due to Group undertakings	610	692
Loans due to Group undertakings	3,617	3,617
Sundry creditors	180	147
	4,407	4,456

Included in creditors are amounts of £114 million (2007: £108 million) falling due after more than 1 year.

Loans due to Group undertakings are unsecured and bear interest at rates between 4.96 per cent and 7.23 per cent.

6 Audit fees

	2008	2007
Fees payable to PricewaterhouseCoopers LLP		
Audit fees	£30,000	£30,000
Fees paid for other services	£nil	£nil

7 Contingent liabilities and financial commitments

British American Tobacco p.l.c. has guaranteed borrowings by subsidiary undertakings of £11,296 million (2007: £6,383 million) and total borrowing facilities of £18,240 million (2007: £15,905 million).

Performance guarantees given to third parties in respect of Group companies were £1 million (2007: £1 million).

There are contingent liabilities in respect of litigation in various countries (note 30 to the Group financial statements).

Shareholder and contact information

Listings and shareholder services

Primary listing

London Stock Exchange (Share Code: BATS; ISIN: GB0002875804)

United Kingdom Registrar

Computershare Investor Services PLC
The Pavilions, Bridgwater Road, Bristol BS99 6ZZ, UK
tel: 0800 408 0094 (UK); +44 870 889 3159 (overseas)
e-mail enquiries: web.queries@computershare.co.uk

www.computershare.com/uk/investor/bri

Access the web-based enquiry service for shareholders operated by Computershare Investor Services in the UK; view details of your British American Tobacco shareholding and recent dividend payments and register for shareholder electronic communications to receive notification of British American Tobacco shareholder mailings by e-mail

www.computershare.com/dealing/uk

Go online or telephone 0870 703 0084 (UK) to buy or sell British American Tobacco shares traded on the London Stock Exchange. This service is only available to shareholders in countries where settlement can be made in sterling or euros

Secondary listing

(since 28 October 2008) – JSE (Share Code: BTI)

Shares are traded in electronic form only and transactions settled electronically through Strate

South Africa Registrar

Computershare Investor Services (Pty) Ltd
PO Box 61051, Marshalltown 2107, South Africa
tel: 0861 100 925 (SA); +27 11 870 8222 (overseas)
e-mail enquiries: web.queries@computershare.co.za

American Depositary Receipts

NYSE Alternext U.S. (Symbol: BTI; CUSIP No. 110448107)

British American Tobacco sponsors an American Depositary Receipt (ADR) programme in the United States. Each ADR represents 2 of the Company's ordinary shares

Enquiries regarding ADR holder accounts and payment of dividends should be directed to Citibank Shareholder Services

P.O. Box 43077, Providence, Rhode Island 02940-3077, USA
tel: 1-888 985-2055 (toll-free) or +1 781 575 4555
e-mail enquiries: citibank@shareholders-online.com
website: www.citi.com/dr

Publications

Copies of current and past Annual Reports are available on request. Copies of the Group corporate descriptive booklet About Us are also available. Highlights from these publications can be produced in alternative formats such as Braille, audio tape and large print, contact:

British American Tobacco Publications
Unit 80, London Industrial Park, Roding Road, London E6 6LS
tel: +44 (0)20 7511 7797; facsimile: +44 (0)20 7540 4326
e-mail: bat@team365.co.uk

Alternatively contact Computershare Investor Services (Pty) Ltd in South Africa using the details shown opposite

Our website – www.bat.com

Access comprehensive information about British American Tobacco and download shareholder publications at the corporate website; visit the Investor Centre for valuation and charting tools and dividend and share price data; and subscribe to the e-mail and SMS alert services for key financial events in the British American Tobacco financial calendar

Dividend Reinvestment Plan

Available to the majority of shareholders on the UK register; this is a straightforward and economic way of utilising your dividends to build up your shareholding in British American Tobacco; contact Computershare Investor Services in the UK for details

Individual Savings Accounts (ISAs)

A British American Tobacco sponsored ISA, contact:
The Share Centre
PO Box 2000, Aylesbury, Bucks HP21 8ZB
tel: 0800 800 008 (UK) +44 (0)1296 414 141
e-mail enquiries: service@share.co.uk
website: www.share.co.uk

Capital gains tax

Fact sheet for British American Tobacco historical UK capital gains tax information; contact:
the British American Tobacco Company Secretarial Department
tel: +44 (0)20 7845 1000 or access the Investor Centre at www.bat.com/investorcentre/cgt

Final dividend 2008 – dates in 2009

26 February	Dividend announced (including amount of dividend per share in both sterling and rand, applicable exchange rate and conversion date)
6 March	Last day to trade (JSE)
9-13 March	No transfers between UK main register and South African branch register, no shares may be dematerialised or rematerialised
9 March	Ex-dividend date (JSE)
11 March	Ex-dividend date (LSE)
13 March	Record date (LSE and JSE)
6 May	Payment date (sterling and rand)

Financial calendar 2009

30 April	Annual General Meeting The Mermaid Conference & Events Centre London EC4V 3DB
6 May	Interim Management Statement
30 July	Interim Results
28 October	Interim Management Statement

Analyses of shareholders

The high and low prices at which the Company's shares are recorded as having traded during the year on each of the LSE and the JSE (from 28 October 2008) are as follows:

	High	Low
LSE	2,049.0p	1,450.0p
JSE	R301.0	R240.0

At 31 December 2008 there was a total of 2,025,031,151 ordinary shares in issue held by 110,181 shareholders. These shareholdings are analysed as follows:

(a) by listing as at 31 December 2008:

Register	Total number of shares	Percentage of issued share capital	Number of holders
UK	1,780,385,102	87.92	54,813
South Africa	244,646,049	12.08	55,368

(b) by category of shareholder and size of shareholding as at 24 December 2008 being the latest practicable date for which equivalent information is available on both registers:

UK Register

Category of UK shareholder	Number of UK holders	Percentage of total UK holders	Number of UK ordinary shares	Percentage of UK ordinary share capital
Individuals	46,559	84.95	78,039,641	4.39
Financial institutions/ pension funds	249	0.45	5,243,107	0.29
Nominee companies	7,555	13.79	1,614,157,139	90.75
Other corporate holders	445	0.81	52,243,336	2.94
Treasury shares (UK)	1	<0.01	28,960,054	1.63

South African Register

Category of SA shareholder	Number of SA holders	Percentage of total SA holders	Number of SA ordinary shares	Percentage of SA ordinary share capital
Individuals	38,308	69.19	25,476,842	10.34
Financial institutions/ pension funds	3,158	5.70	175,542,699	71.24
Nominee companies	10,974	19.82	29,755,465	12.08
Other corporate holders	2,928	5.29	15,612,868	6.34

Combined registers

Category of shareholder	Number of holders	Percentage of total holders	Number of ordinary shares	Percentage of issued ordinary share capital
Individuals	84,867	77.03	103,516,483	5.11
Financial institutions/ pension funds	3,407	3.09	180,785,806	8.93
Nominee companies	18,529	16.82	1,643,912,604	81.18
Other corporate holders	3,373	3.06	67,856,204	3.35
Treasury shares (UK)	1	<0.01	28,960,054	1.43

UK Register

	Number of holders	Percentage of UK ordinary share capital
1 – 1,999	43,873	1.34
2,000 – 9,999	8,665	1.83
10,000 – 199,999	1,686	4.22
200,000 – 499,999	245	4.42
500,000 and over	339	86.56
Treasury shares (UK)	1	1.63

South African Register

	Number of holders	Percentage of South African ordinary share capital
1 – 1,999	49,566	6.43
2,000 – 9,999	4,111	6.95
10,000 – 199,999	1,532	24.54
200,000 – 499,999	99	11.87
500,000 and over	60	50.21

Combined Registers

	Number of holders	Percentage of issued ordinary share capital
1 – 1,999	93,439	1.96
2,000 – 9,999	12,776	2.45
10,000 – 199,999	3,218	6.69
200,000 – 499,999	344	5.33
500,000 and over	399	82.14
Treasury shares (UK)	1	1.43

Shareholder and contact information continued

Registered office

Globe House, 4 Temple Place, London WC2R 2PG
tel: +44 (0)20 7845 1000; facsimile: +44 (0)20 7240 0555

Incorporated in England and Wales No. 3407696

Secretary

Nicola Snook

General Counsel

Neil Withington

Investor relations

Enquiries should be directed to
Ralph Edmondson or Rachael Brierley
tel: +44 (0)20 7845 1180

Press office

Enquiries should be directed to
Fran Morrison or David Betteridge
tel: +44 (0)20 7845 2888
email: press_office@bat.com

Auditors

PricewaterhouseCoopers LLP
1 Embankment Place, London WC2N 6RH

www.bat.com/annualreport2008



The paper used for this report is Revive 50:50 silk, comprising 25% post-consumer and 25% pre-consumer waste, and 50% virgin wood fibre sourced from sustainable forests independently certified according to the rules of the Forest Stewardship Council. This document is recyclable. Designed and produced by Likemind. Photography by Matthew Ford. Printed in the UK by St Ives Westerham Press Ltd. ISO14001:2004, FSC certified and Carbon Neutral.