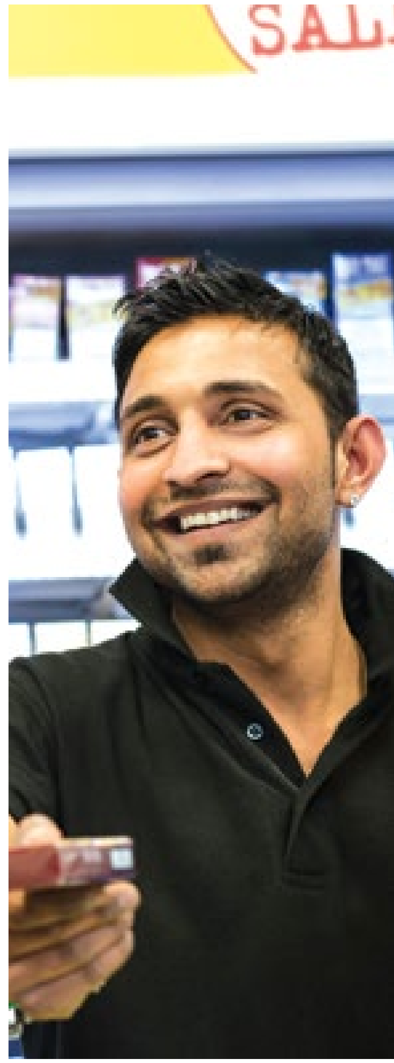
British American Tobacco

Annual Report 2012



Read the online Annual Report at www.bat.com/ar2012

Proud history, bright future

Who we are

British American Tobacco is a leading tobacco group, with brands sold in around 180 markets. We employ more than 55,000 people and, with over 200 brands in our portfolio, we make the cigarette chosen by one in eight of the world's one billion adult smokers.

Founded in 1902, our Group of companies traded through the turbulence of the 20th century, including wars, revolutions and nationalisations. The Group was first listed in 1912, and today we are one of the top 10 companies listed on the London Stock Exchange and feature in the Fortune 500. We have also had a secondary listing on the JSE Limited in South Africa since 2008.

We hold robust market positions in each of our four regions – Americas; Asia-Pacific; Eastern Europe, Middle East and Africa; and Western Europe – and we are leaders in more than 60 markets. Our approach to marketing is second to none in our industry, in brand building, innovation and responsibility. Our companies adhere strictly to the high standards of our voluntary marketing principles.

In 2012, our subsidiaries enabled governments worldwide to gather more than £30 billion in duty, excise and sales taxes on our products, more than seven times the Group's profit after tax.

We play a significant role in local communities around the world. In many countries we are a top employer and the company of choice for people in all areas of our business. We have 44 cigarette factories in 39 countries. In addition to cigarettes, we make cigarillos, roll your own and pipe tobacco.

We are also proud of our Research & Development facilities, where our people are striving to reduce the harm associated with tobacco products.

With our geographic diversity, strong brands, talented people and proven strategy, the Group is well placed to achieve further success. In particular, we are confident that our investments in both innovative cigarette products and next-generation nicotine and tobacco products will help us drive growth and build shareholder value in the years ahead.

Our leading brands

Our four leading brands are Dunhill, Kent, Lucky Strike and Pall Mall – our Global Drive Brands (GDBs).

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

Since its establishment in 1952, Kent has stood for a modern, progressive cigarette. Relaunched in 1997, it has grown very quickly in popularity, backed by innovative product offers.

Based on its rich legacy dating back to 1871, Lucky Strike is the true American original, now a popular choice throughout the world with a presence in more than 80 countries.

Pall Mall is the third biggest cigarette brand in the world, sold in over 110 markets. For more than 110 years its core proposition has been centred on rewarding smokers globally with real, high quality value offers.

We have many other famous international and local brands, including Rothmans, Vogue, Viceroy, Kool, Peter Stuyvesant and Benson & Hedges.

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

Contents

Directors' report

Financial statements and other information

British American Tobacco p.l.c. (No. 3407696) Annual Report 2012
This is the Annual Report of British American Tobacco p.l.c. (the Company) and the British American Tobacco Group, comprising the Directors' report and the audited financial statements, for the year ended 31 December 2012. It has been drawn up and is presented in accordance with, and reliance upon, applicable English company law. The liabilities of the Directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

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

Specific local mailing and/or notification requirements will apply to shareholders on the South African branch register.

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

From the Chairman

Dear Shareholder

Let me welcome you to the Annual Report for 2012. This has been a good year for your Company notwithstanding the challenging economic environment and the adverse impact of exchange rates.

Since the Group was first listed in 1912, the business has developed and grown significantly, becoming recognised as one of the UK's leading companies. Today we are among the top 10 companies listed on the London Stock Exchange.

Strong performance

British American Tobacco delivered strong profit growth in 2012, achieved through good pricing and an outstanding improvement in operating margin, partially offset by adverse exchange rate movements. To grow underlying market share and operating profit, while investing for the long term, is a strong sign of the efficacy of our strategy. Difficult trading conditions persist in parts of the world, particularly southern Europe, but these results demonstrate the Company is in excellent shape and we remain confident that our strategy will continue to deliver superior shareholder returns.

Delivering shareholder value

Our financial highlights indicate how the business is delivering superior returns. You can read a full summary of our successful year on the following pages.

This success is reflected in adjusted diluted earnings per share for 2012 rising to 207.5p, an increase of 7% on last year.

The Board has recommended a final dividend of 92.7p per share, which will be paid on 8 May 2013 to shareholders on the register at 15 March 2013. This takes the total dividend for the year to 134.9p, an increase of 7% on last year, and maintains our target of paying out 65% of sustainable earnings in dividends.

The Board also approved the continuation of our share buy-back programme in 2012. Between the beginning of March and the end of December 2012, almost 39 million shares were repurchased at a value of £1.25 billion, excluding transaction costs.

The Board has agreed a £1.5 billion share buy-back programme for 2013.

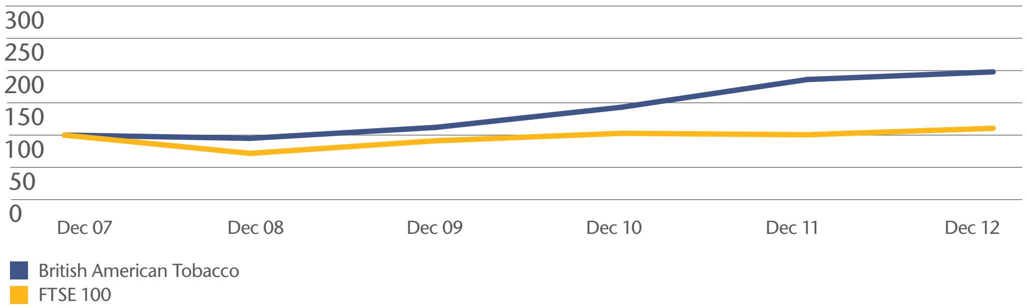
Governance

We are a leading international business, with products sold in 180 countries around the world. And, of course, we operate in a highly regulated sector that many regard as controversial. Acting responsibly makes good business sense and we set high standards for ourselves, our suppliers and our trade customers.

Our values, a key component of our culture, are clearly embraced by our people and we take great care to ensure that they are embedded throughout the business. This needs good governance and, for us, this is not simply an exercise in compliance, it is a key element underpinning the sustainable, long-term growth of our business. A full report on our corporate governance is set out on pages 46 to 57.

Historical total shareholder return

Growth in the value of a hypothetical £100 holding in British American Tobacco over five years – FTSE comparison is based on spot daily values.



Over the five-year period our compound growth rate, based on adjusted diluted earnings per share, has been 13.9%.

Sustainability

British American Tobacco was the first tobacco company to publish a social report and I am proud to say that more than a decade later we maintain our strong reputation for corporate social responsibility and sustainability. We were selected for the 11th successive year in the 2012 Dow Jones Sustainability Indexes, which recognise economic, social and environmental performance. We were also ranked in the top quartile of companies in a study on "Transparency in Corporate Reporting: Assessing the World's Largest Companies" carried out by Transparency International, a leading anti-corruption organisation.

You will see that some of the progress we have made in 2012 against our sustainability agenda is discussed in this Annual Report, in particular within our strategic review and our corporate governance statement. We have also published a separate Sustainability Summary report – "Sustainability: why it matters" – alongside our Annual Report. This outlines our progress and explains how we are developing an ambitious new sustainability agenda that will better measure and address the impact our business has on its environment and stakeholders. You can download this summary report from our corporate website at www.bat.com/sustainability.

On track for further success

Reflecting on the success of 2012, let me express my thanks and appreciation to my fellow Directors on the Board, to our Chief Executive, Nicandro Durante, to management, and to all our colleagues around the world.

In particular, I record our appreciation to Sir Nicholas Scheele and Robert Lerwill, both of whom will be standing down as Non-Executive Directors at the end of this year's Annual General Meeting, each having served eight years on your Board.

I am delighted to welcome Brigadier General (retired) Dr Richard Tubb, a US citizen, who joined your Board on 28 January 2013. Richard is a prominent and well respected expert in the field of tobacco harm reduction and his appointment further demonstrates our commitment to putting science at the heart of our business.

Looking forward, I am confident that we have the strategy, people and resources to continue to deliver high single figure earnings per share growth in the years ahead.

Richard Burrows
Chairman

2012 highlights

- **Adjusted diluted earnings per share improved by 7% to 207.5p**
- **Recommended total dividend for the year of 134.9p, up 7% on 2011**
- **Selected for the Dow Jones Sustainability Indexes for the 11th successive year**
- **Share buy-back programme set at £1.5 billion for 2013**

Our year in numbers

Group cigarette volumes, excluding associates (billion)
694 -1.6%

Profit from operations[1] (£million)
5,412 +15%

Basic earnings per share (pence)
198.1 +26%

Revenue at constant exchange rates[2] (£million)
15,999 +4%

Adjusted profit from operations[1] at constant exchange rates[2] (£million)
5,970 +8%

Adjusted diluted earnings per share[1] (pence)
207.5 +7%

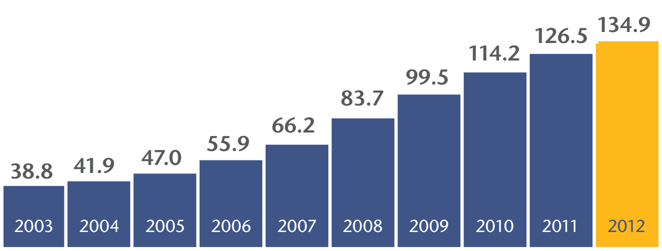
Revenue (£million)
15,190 -1%

Free cash flow (£million)
3,259 -2%

Dividends per share (pence)
134.9 +7%

10 year dividend per share (pence)

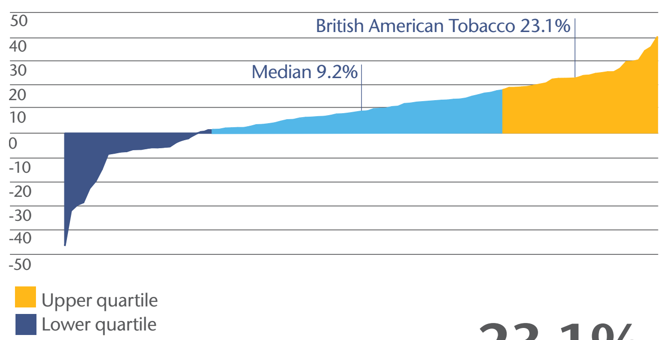
1 January 2003 to
31 December 2012



134.9 +7%

Total shareholder return (annual %)

FTSE 100 – 1 January 2010 to 31 December 2012
The FTSE 100 comparison is based on three months' average values



23.1%

Notes:

1 Adjusted profit from operations is derived after excluding the adjusting items from the profit from operations. These adjusting items include restructuring and integration costs, amortisation and impairment of trademarks and similar intangibles, goodwill impairment and the Fox River provision.

2 Constant currency provides the information based on a re-translation, at prior year exchange rates, of the current year information.

An overview of our performance

We have a wide range of measures and indicators by which the Board assesses performance. To ensure management's focus is aligned with the interests of our shareholders, our KPIs (key performance indicators – shaded in the table below) are reflected in our management incentive schemes. Although our other business measures listed here are not directly included in these incentives, we believe they improve the quality of our business and contribute to shareholder value, particularly over the long term. We review our business measures periodically and update them to ensure they remain relevant and reflect the needs and priorities of the business.

	2012 performance	Further information
Total shareholder return (TSR) – annual % *We measure our TSR against the FTSE 100 Index and our fast moving consumer goods peer group.*	**23.1%**	Page 11
Adjusted diluted earnings per share (EPS) *Our target is to grow adjusted diluted EPS at the rate of high single figures per annum.*	**207.5p** +7%	Page 11
Group's share of key subsidiary markets (increase in % share) *Growth in the Group's retail market share in our Top 40 markets, as adjusted.*	**+0.1%**	Page 15
Global Drive Brand (GDB) volumes *Volumes of our GDBs – Dunhill, Kent, Lucky Strike and Pall Mall – sold by our subsidiaries.*	**+3%**	Page 15
Total cigarette volumes *Volumes of all cigarettes sold by our subsidiaries.*	**694bn** -1.6%	Page 15
Adjusted profit from operations at constant exchange rates *Figure is derived after excluding the adjusting items (see note 1 opposite).*	**£5,970m** +8%	Page 17
Cash generated from operations *The free cash flow excluding restructuring costs and dividends and other appropriations from associates, per the alternative cash flow.*	**£2,739m** Target exceeded	Page 17
Operating margin *This is the percentage of adjusted profit from operations divided by revenue.*	**37.4%** (2011: 35.8%)	Page 17
Free cash flow as a percentage of adjusted earnings *This measures our free cash flow as a ratio of the adjusted earnings. Our target is to maintain a percentage figure of over 80%.*	**81%** (2011: 86%)	Page 17
Employee engagement index *Our aim is to achieve a more positive score than the norm for the FMCG companies in our comparator benchmark group.*	**72%** (2011: 68%)	Page 18
Carbon dioxide equivalent (CO_2e) – tonnes per million cigarettes equivalent *Our objective is to reduce Group CO_2e by 50% by 2030 from our 2000 baseline and by 80% by 2050.*	**0.81** (2000: 1.38)	Page 20
Group energy use – gigajoules per million cigarettes equivalent *Our objective is to reduce energy use by 17% by 2017 from our 2007 baseline.*	**10.31** (2007: 11.82)	Page 20
Water use – cubic metres per million cigarettes equivalent *Our objective is to reduce water use by 26% by 2017 from our 2007 baseline.*	**3.77** (2007: 4.85)	Page 21
Waste to landfill – tonnes per million cigarettes equivalent *Our objective is to sustain waste sent to landfill at no more than 0.016 tonnes per million cigarettes equivalent produced.*	**0.012** (2007: 0.025)	Page 21
Recycling – percentage of waste re-used or recycled against waste generated *Our objective is to re-use or recycle more than 85% of waste generated in each year.*	**92.5%** (2011: 85.4%)	Page 21
Lost Workday Case Incident Rate (LWCIR) *The local objective set for all of our companies is zero accidents, and we have a zero accidents ambition for the whole group.*	**0.23** (2011: 0.26)	Page 21

Chief Executive's review

Very good business performance
We exceeded all of our financial objectives in 2012. We delivered organic revenue growth on a constant currency basis of 4% and adjusted profit from operations of 8% at constant rates of exchange. Despite the adverse exchange rates, once again we delivered excellent returns to shareholders, with adjusted diluted earnings per share up by 7% on last year, with an increase of 12% at constant exchange rates.

We grew our underlying market share in 2012, with good share momentum in the second half of the year. Pricing remains strong and, while our cigarette volumes were down slightly, this was mainly due to industry declines in some of our major markets.

Outstanding operating margin improvements
We achieved a substantial improvement in operating margin of 160 basis points, exceeding our target of increasing operating margin by 50 to 100 basis points each year. In addition to a strong price mix of 6%, we have continued to focus on productivity improvements, addressing our cost base through factory rationalisation, systems standardisation and productivity savings.

Innovations driving growth
Our Global Drive Brands (GDBs) – Dunhill, Lucky Strike, Kent and Pall Mall – continued to perform well, driven by our innovations, recording both volume and share growth. We saw outstanding volume growth of 11% for Lucky Strike in 2012. Dunhill volumes grew by 2%, Kent by 1% (or 4% adjusting for the one-off comparator in Japan) and Pall Mall by 3%. Collectively, our four GDBs achieved volume growth of 3% (or 4% excluding the impact of Japan) and now account for over one-third of our total volumes. GDBs grew market share by 30 basis points.

Fine Cut tobacco, a category that includes roll-your-own and make-your-own, grew volume by 8% in Western Europe and increased market share. This was driven by Pall Mall, by far the largest brand in this category.

Consumer focus
Improving the execution of our strategy starts and ends with our focus on the consumer. Marketing products that satisfy a wide range of consumer needs has been key to our recent success and will become ever more important in the future.

This consumer focus also extends to our efforts to improve productivity through a flexible and efficient supply organisation. This will enable us to release funds to invest in our brands and innovations, helping us grow market share and deliver higher returns for shareholders.

Next-generation products
Alongside the innovations in the cigarette market, we are developing next-generation products. Nicoventures, a company we set up in 2011, is aiming to launch nicotine-based products and, in December 2012, we acquired CN Creative, a UK-based company specialising in the development of electronic cigarette technologies.

Great people
Our continuing success is only possible thanks to our talented people, excellent teams and great leaders driving our organisation. I was very pleased to see that, in our latest employee opinion survey in 2012, the percentage of our people who are extremely satisfied with British American Tobacco as a place to work was significantly higher than in our peer group.

Sustainability at the heart of our business
We continue to raise standards within our supply chain, market our products in a responsible way and strive to reduce the impact of tobacco use on public health. For me, this is a simple point. To grow our business we must operate sustainably – creating shared value for our shareholders and society in a challenging and changing landscape.

Our efforts in these areas have received positive recognition externally, but there is more we can do. In the year ahead, we will be working with stakeholders to develop a new sustainability agenda that increases our ambition and better measures the impacts of our business.

Trafficking tobacco and regulation
We support regulation backed by robust evidence showing that it will help achieve the objective of reducing the impact of tobacco use on public health. Measures such as excessive excise increases, retail display bans and plain packaging do more to disrupt orderly markets and little to further their intended aims. In fact they play into the hands of criminals by creating ideal conditions for the counterfeiters and smugglers to thrive.

The illegal trade in counterfeit and smuggled goods accounts for around 12% of the global marketplace. This is a competitor that has no regard for playing by the rules, no incentive for maintaining quality and no qualms about selling tobacco products to the underaged.

Where possible, we are in the front line in the battle against tobacco trafficking – working alongside law enforcers, customs officials and international organisations, as well as making our packs easier to trace and harder to counterfeit.

Management Board changes
Ricardo Oberlander joined the Management Board at the start of 2013 as Regional Director, Americas, replacing Jack Bowles, who moved to our Asia-Pacific region. At the same time, Naresh Sethi was appointed Regional Director, Western Europe.

On 1 March 2013, Alan Davy was appointed to the position of Group Operations Director, replacing Des Naughton, who took on the new role of 'Managing Director – Next-Generation Products', encompassing Nicoventures and CN Creative.

I would like to congratulate Ricardo, Jack, Naresh, Alan and Des on their new roles on our Management Board.

Challenges and opportunities ahead

Our geographic diversity, powerful brands, investment in innovations and strong positions in emerging markets remain key strengths and we are confident in the future of the tobacco business. We also believe that building a portfolio of next-generation products alongside our main tobacco business will provide us with significant new opportunities in the years ahead.

We ended 2012 with share growth in the majority of our markets. Pricing remains good and our GDBs get stronger every year. While we cannot underestimate the challenges ahead in 2013, I am confident that we have robust plans in place and the resources to succeed. We have the momentum, proven capabilities and passionate people to deliver another year of good growth and I look forward to 2013 with optimism.

Nicandro Durante
Chief Executive

2012 highlights

- Our underlying overall market share grew
- Global Drive Brand volumes grew by 3%
- Innovations continue to drive growth
- Outstanding increase in operating margin by 160 basis points
- We have taken important steps forward in our plans to develop next-generation products
- Excellent overall financial performance

Global Drive Brands 2012 performance

	Dunhill	Kent	Lucky Strike	Pall Mall
Cigarettes sold (billion)	49	67	33	83
Volume growth	+2%	+1%	+11%	+3%
Number of markets	130+	90+	80+	110+

Global market overview

Global marketplace

The value of the global tobacco market has been estimated at around £450 billion and the industry produces around 5.5 trillion cigarettes a year. While cigarette sales in developed countries continue to decline year-on-year, sustained volume growth is widely predicted in emerging markets, driven by population growth and increasing disposable income. As a result, the overall value of the tobacco market continues to grow.

The biggest single tobacco market is China, where the industry is state-owned, with some 350 million smokers who account for more than 40% of global consumption.

The four biggest international tobacco companies – British American Tobacco, Imperial Tobacco, Japan Tobacco and Philip Morris International – account for some 45% of the global market, or around three-quarters of the market outside China.

Widely cultivated non-food crop

Tobacco is one of the world's most widely cultivated crops, grown in more than 120 countries. The farmers who choose to grow it – many in developing countries – do so because it is hardy, grows well in poorer soils and volatile weather, and is known for fetching stable prices. Farmers can earn good yields from very small plots of tobacco and are able to grow other crops, such as food, often using the same land at different times of the year. The techniques used for growing quality tobacco can also be applied to growing these other crops.

Less than 1% of the world's agricultural land is given over to tobacco farming and only for part of the year, yet it is an important contributor to the agricultural economy in many countries.

Tobacco's economic contribution

The global tobacco industry contributes substantially to the economies of more than 100 countries, and millions of people worldwide depend on it for employment. Few industries are as wide-ranging and, for most countries, tobacco forms an important part of their economy and society.

Even in countries that do not have tobacco manufacturing, tobacco retail and distribution is an important source of economic activity. And, of course, tobacco taxes are a major source of revenue for almost every government in the world – for example, the UK government alone raised around £12 billion in excise and VAT on tobacco products in 2012. It is estimated that governments worldwide collect in the region of US$250 billion in excise on the sale of tobacco products each year.

Next-generation products

Increasing prices and higher rates of excise make it ever more important that consumers are offered real value by the tobacco products they buy. Quality and innovation will both play an increasing role in delivering market share, as tobacco companies operate in a highly competitive marketplace.

These innovations will include next-generation products: new-style tobacco and nicotine products that employ a range of new technologies. Substantial investments have been made in developing cigarette alternatives, including nicotine inhalation products, electronic cigarettes, aerosol nicotine-delivery systems and products that heat tobacco rather than burn it.

The scientific community widely agrees that it is the toxicants in tobacco and tobacco smoke, not the nicotine, that causes the majority of tobacco-related diseases. Conventional cigarettes carry the most risks to health, while some forms of low-toxicant smokeless tobacco products, such as Swedish-style snus, although not risk-free, are much less risky. Regulatory-approved nicotine products that contain no tobacco or smoke toxicants are almost risk-free.

The UK's Royal College of Physicians has said "if nicotine could be provided in a form that is acceptable and effective as a cigarette substitute, millions of lives could be saved."

We encourage tobacco companies, scientists and regulators to work together to ensure a science-based approach is used to assess new products that potentially pose less risk. This will provide consumers with the assurance that the product information they receive is based on sound science and allows them to make an informed choice based on the risk profile of different products.

Raising the debate on Twitter

British American Tobacco's Twitter account is @BATPress. Although we don't communicate about our brands and products, we do make our views known on a series of topical industry issues. We use Twitter to reach key stakeholders, such as journalists, opinion formers and members of the tobacco control community, on the topics that matter to us and our consumers.

Follow us @BATPress

Regulating the market

Sound regulation is important in the tobacco industry and, where it is developed with all stakeholders involved, it can help to ensure an orderly marketplace that serves the interests of both consumers and governments.

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

Measures such as retail display bans and sudden increases in excise rates can distort competition among tobacco companies and, in some cases, may result in consumers switching to cheaper illegally trafficked products.

Legislation enacted in 2012 to introduce plain packaging for tobacco products in Australia could affect the livelihoods of small retailers and make counterfeit products easier to produce and sell. It could also set a precedent for other consumer goods manufacturers and countries, as international trademarks are appropriated by local laws. This is why the Australian government's legislation has been challenged by member states of the World Trade Organization (WTO). The complaint, raised by three separate countries, will be considered by the WTO in 2013 and a ruling is expected in 2014.

Trafficking of tobacco products

Cigarettes are still among the most commonly trafficked products on the black market due to high profit margins, the relative ease of production and movement, along with low detection rates and penalties. It is a widespread problem that is made worse by excessive regulatory policies in some countries.

Tobacco trafficking accounts for around 600 billion cigarettes sold every year. This trade has a negative impact on consumers, retailers, governments and tobacco companies. For consumers, counterfeit cigarettes mean no quality controls and no health warnings, while smuggled genuine products may carry health warnings that do not meet local government regulations.

It is estimated that governments worldwide lose up to US$40 billion a year in excise and other taxes due to the trafficking of tobacco products. Meanwhile the profits end up in the hands of criminals who don't pay tax and sell their products to anyone, including children.

This illegal trade can only be tackled effectively if the industry, regulators and enforcement authorities work together, supported by appropriate excise policies, sound regulation and effective enforcement.

Tobacco farming – a choice for millions of farmers

British American Tobacco produced a short film in 2012 about tobacco farming and made it available on its corporate website and YouTube.

Tobacco can grow in poorer soils and most climates and can easily be grown in rotation with food and other cash crops, helping farmers sustain a diversified income. The film explains how our local experts work with farmers, promoting stable livelihoods as well as helping to ensure social and environmental sustainability.

You can view the film at www.bat.com/leaf or at www.youtube.com/WelcomeToBat.

Our strategy to deliver shareholder value

Our strategy

Our vision

Our Group vision is to lead the global tobacco industry. We don't just measure that in volume and value, we also aim to be the world's best at meeting consumer needs.

Growth

We are consumer-led, providing high quality, relevant tobacco and next-generation products that meet consumer needs. We do this by being brand focused and excelling at bringing superior, differentiated offers to market.

Read more in our strategic review on page 14

Productivity

By effectively deploying our resources we can increase profits, improve our operating margin and invest in our business, helping us to grow market share and achieve higher returns for shareholders. We do this through our consumer-centric, flexible supply organisation and the implementation of a new global operating model with common systems and processes.

Read more in our strategic review on page 16

Winning organisation

British American Tobacco is a great place to work. We have great people and great teams. Our aim is to maintain a high performing organisation that can attract, develop and retain the next generation of leaders. We do this by being entrepreneurial and creating a culture of personal ownership.

Read more in our strategic review on page 18

Responsibility

Our people are required to act ethically at all times and, as a business, we seek to reduce our environmental footprint and the harm caused by our products. To ensure we have a sustainable business, we engage with society through active, honest and open dialogue, while promoting a science-based approach to regulation that meets the needs of consumers.

Read more in our strategic review on page 19

Key performance indicators

Adjusted diluted earnings per share

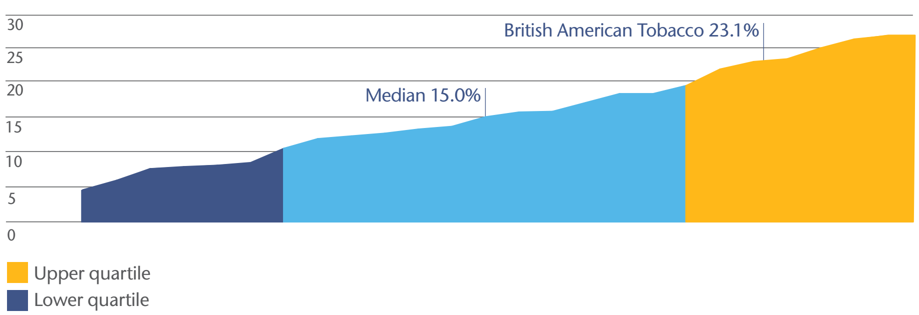
Adjusted diluted earnings per share (pence)

This is our adjusted diluted earnings per share (EPS) – the detail of the calculation and the adjustments made are explained in note 7 on the financial statements.

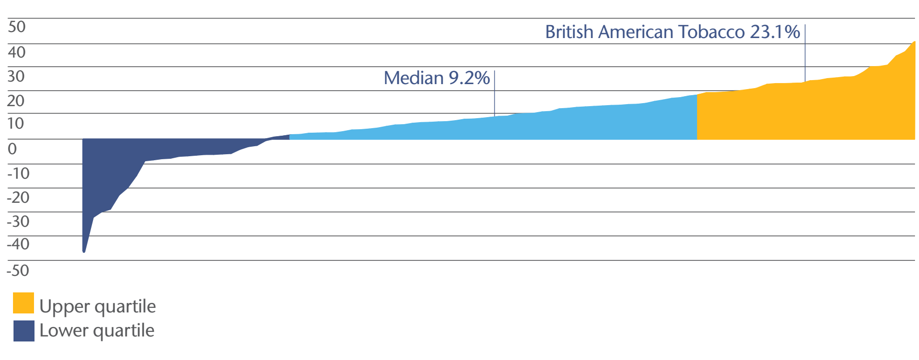
Target
Our target is to grow adjusted diluted EPS at the rate of high single figures per annum, on average, over the medium to long term.

Total shareholder return – annual %

FMCG group – 1 January 2010 to 31 December 2012
The FMCG group comparison is based on three months' average values (annual %)



FTSE 100 – 1 January 2010 to 31 December 2012
The FTSE 100 comparison is based on three months' average values (annual %)



The Group is focused on increasing shareholder value, which is measured using total shareholder return (TSR) compared to the FTSE 100 Index and also to a Fast Moving Consumer Goods (FMCG) peer group. The FMCG comparator group is reviewed annually to ensure that it remains both relevant and representative.

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

Our business model

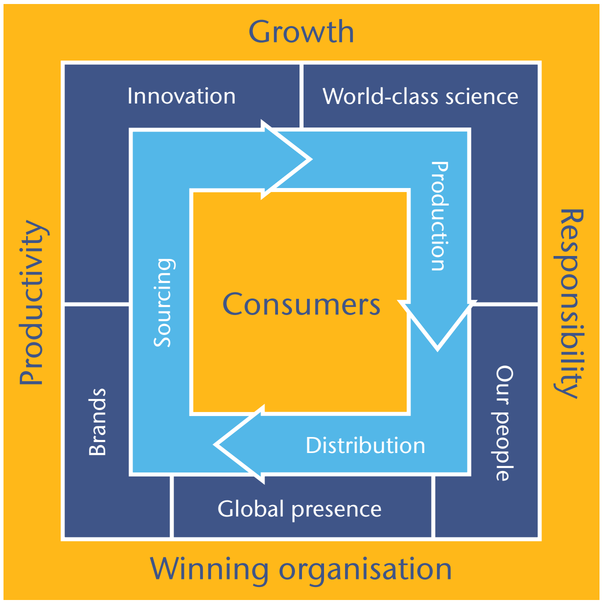
Our business model is designed to deliver sustainable growth in earnings for our shareholders. It is built around consumers and is supported by our consistent strategy, with growth and productivity driven by a winning organisation acting responsibly at all times.

How our strategy and business model work together

Our strategy and business model drive our global operations, supported by a strong commitment to good corporate governance. We have world-class science, well-established brands and a range of product innovations that will deliver relevant benefits to consumers now and in future. All this contributes to a shareholder value proposition that continues to evolve but has a formidable track record of success in recent years.

Our business model delivering value

Our consumer-centric approach to sourcing, production and distribution helps us to create value for a wider group of stakeholders throughout our products' lifecycles. These include farmers and their communities, other suppliers, trade partners, governments and regulators. The quality of our people is a crucial factor in delivering this and our global presence enables us to leverage the value they create on a worldwide scale.



World-class science

For over 50 years, we have had an extensive scientific research programme. More recently, we have been focusing research on innovative low-toxicant smokeless tobacco and nicotine-based products for adult smokers who want a safer alternative to cigarettes. Our work with scientists and public health professionals aims to secure widespread support for tobacco harm reduction, including the regulatory changes needed to support bringing reduced-risk products to market.

Brands

We have a successful brand marketing strategy based on our insights of the consumer. Our portfolio of more than 200 global, regional and local brands is designed to meet key consumer preferences, wherever they are in the world. Our Global Drive Brands – Dunhill, Kent, Lucky Strike and Pall Mall – have enjoyed considerable success and today account for one in three of the cigarettes we sell. Our aim is to offer a tailored brand solution for every relevant consumer segment.

Innovation

We make significant investment in research and development to deliver innovations that satisfy or anticipate consumer needs and generate growth for the business. This involves innovations such as capsule products, 'all natural' products and Reloc, our resealable pack technology. We also look outside the traditional cigarette market and research, develop and test new products to meet changing consumer needs. We continue to review potential acquisitions that will complement our in-house research or increase our speed to market.

Our people

We employ more than 55,000 people worldwide – from securing our leaf supply through production and distribution to our efforts to develop reduced-risk products. Our workforce is strongly multi-cultural and we have a devolved structure, with each local company having responsibility for its operations. We encourage a culture of personal ownership and value our employees' talents. Their diverse perspectives help us to succeed and we recognise their critical role in achieving the goals we set for our business.

Consumers

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

Global presence

Our business was born international and, with 110 years of operating globally behind us, today we are one of the world's leading tobacco groups. Our brands are sold in around 180 markets and our geographic diversity and strong positions in emerging markets are key strengths. We hold robust market positions in each of our regions and have leadership in more than 60 markets. With over 200 brands in our portfolio, we make the cigarette chosen by one in eight of the world's one billion adult smokers.

Sourcing

We have a significant interest in tobacco growing and we provide agronomy support to over 100,000 directly contracted farmers. We manage our whole supply chain responsibly, both leaf and other materials used across our business, and work with suppliers to create a shared understanding of our social, environmental and economic impacts. This enables us and our suppliers to manage risks better, while ensuring that we are agile and flexible, using our resources as effectively as possible.

Production

Manufacturing tobacco products is a large-scale operation and we have state-of-the-art manufacturing facilities all over the world. We work to ensure that our costs are globally competitive and that we use our resources as effectively as possible. Our companies have consolidated their production facilities in recent years to ensure that we can meet the needs of an agile and flexible supply chain – rationalising our machinery and technology to establish a more cost-effective and world-class operational base for the future.

Distribution

Our well-developed distribution channels are critical enablers of our growth strategy, allowing us to roll out innovations on a global scale. We continuously review our route to market to ensure we remain competitive. This includes our relationships with wholesalers, distributors and logistics providers, as well as our direct to store sales operation. Almost half of our global volume is now sold through retailers supplied through our direct distribution capability or exclusive distributors.

Strategic review

Growth

We continued to achieve sustainable, profitable growth in 2012, driven by continued pricing momentum despite a difficult economic environment. This was underpinned by a strong brand portfolio, innovative launches and good pricing.

Strong growth driven by GDBs

Overall GDB volume grew by 3% in 2012 (or by 4% excluding the impact of Japan), driven by the expansion of GDBs into new and established markets, as well as the roll-out of consumer-relevant innovations. The GDB share of global volumes has increased from 18% to 33% since 2005, driven by our innovations. In 2012 we remained the market leader for capsule products, with a segment share of over 50% in our key markets.

Dunhill, our most prestigious brand, delivered organic growth in 2012 across most of our key markets, including Indonesia, Malaysia, the Gulf Cooperation Council (GCC), South Africa, Taiwan and Romania, driven primarily by innovation. Despite the difficult competitive environment in South Korea, total Dunhill volume increased by 2% in 2012 to reach 49 billion cigarettes.

Dunhill continued to deploy the Reloc seal across its ranges, with 62% of all Dunhill cigarettes now sold in this innovative packaging. Dunhill also grew across Indonesia, South Africa, Hungary, Romania and Malaysia, helping the brand to reach record volumes in 2012.

Kent continued its strong growth in eastern Europe and the Middle East in 2012. Global volume grew by 1% to 67 billion cigarettes; 4% excluding the impact of Japan. This robust performance was achieved through share gains in key markets such as Ukraine, Vietnam and other eastern European and Middle East markets.

Kent Convertibles, the innovative range of capsule products launched in 2010, is now available in 26 markets. An upgrade in both product and packaging design in 2012 resulted in an increase in volume of over 30% for this range. The further development of Kent's HD range also delivered strong volume performance in Russia.

Lucky Strike had another outstanding year with double-digit growth of 11%. A record volume of 33 billion cigarettes was sold in 2012 due to strong performances in Argentina, Chile, France and Germany. This level of growth was achieved despite the general market decline in the key Lucky Strike markets of Spain and Italy.

Lucky Strike's growth continued to come from both capsule technology and the new 'all natural' offer. There were almost twice as many capsule cigarettes sold compared to last year and the 'all natural' offer more than tripled sales within the same period. These two products accounted for more than 22% of all Lucky Strike cigarettes sold.

Pall Mall, our number one volume brand, delivered growth of 3% in 2012. Significant growth came from Pakistan, Germany, Canada, Romania, Russia and the UK.

Across our GDBs, Fine Cut roll-your-own and make-your-own tobacco volumes grew in Western Europe by nearly 30% in 2012. Pall Mall posted impressive results with increased volumes of 18% and a strong performance throughout the region. Lucky Strike more than doubled its volumes, driven by new launches.

Strong performance of international brands

In addition to our GDBs we have a strong portfolio of international brands such as Rothmans, Peter Stuyvesant, Craven A and John Player Gold Leaf.

Rothmans had a very good year on the back of a new launch in Russia and grew 4% globally. This was despite reduced volumes in Egypt due to increased illicit trade, and the brand continued to grow in the Middle East, Nigeria, North Africa, Italy and the UK.

Viceroy volumes were down in 2012 due mainly to a decline in Turkey. Vogue volumes also fell in 2012 driven by a decline in Russia, however the brand grew in key Western Europe markets such as Romania and Germany.

John Player Gold Leaf, our key regional brand in Asia-Pacific and the Middle East, posted good growth with improved performance in its key markets of Pakistan, Bangladesh and the GCC.

Benson & Hedges saw good growth in many markets, but overall the brand was adversely impacted by market declines in Australia and Nigeria.

Craven A, our regional brand in Asia-Pacific and Eastern Europe, Middle East and Africa (EEMEA), had a great year with double-digit growth of 11% and an improved performance in all of its key markets.

Underlying performance of Kool was good, although the brand declined due to the high comparator caused by the impact of the out-of-stocks in Japan in 2011.

Peter Stuyvesant delivered higher volumes in 2012 mainly due to a stable performance in South Africa and growth in other EEMEA markets.

Trade marketing and distribution

We have around 10,000 Trade Marketing & Distribution (TM&D) employees responsible for the selling and delivery of our products, the presence and activation of our brands at the point of sale and the development of mutually beneficial partnerships with our customers. This includes engagement in the prevention of youth smoking and illicit trade.

Developing the field force

To successfully support our brands and innovations in a fast-paced and rapidly changing environment, Positive, a new ambitious programme to train and develop our people is being rolled out globally. The programme provides our people with a competitive edge and ensures we continue to meet the demands of customers and consumers.

Route to market

Our route to market is critical to meet consumer demand at the point of sale and allows us to roll out brand initiatives and innovations quickly and on a global scale.

Where appropriate, we believe that direct-to-store sales (DSS) are an effective way of serving retailers and building sustainable business partnerships. DSS gives us visibility and control over the sales and distribution process, allowing us access to both the market and consumer information. It also provides a direct commercial link to our most strategic retail accounts. In 2012 we further enhanced our capabilities with investments in a number of markets including Indonesia and South Africa.

We also work with exclusive distributors to ensure our products are effectively sold and delivered to retailers, and almost half of our global volume is sold to retailers through these distributors and through our own distribution capability.

Customer management

Building partnerships with retailers is a key part of our trade marketing activities. We work closely with our retail partners to provide support and ensure that at all times they can profitably meet the expectations of adult smokers with regards to availability, pricing and brand quality. This includes the development of effective trading terms, which are a key foundation of a successful partnership.

Key performance indicators (KPIs)

Group's share of key subsidiary markets (increase in % share)*

This is our retail market share in the Group's Top 40 markets which cover around 80% of the volumes of subsidiaries. The information used in this calculation is based on publicly available information and internal company analysis.

Target
Our target is to continue to grow market share.

* Share figures are rebased annually to reflect market and segment size changes. The 2012 figure has been rebased to reflect the one-off impact of out-of-stocks in Japan in 2011.

+0.1%

Global Drive Brand (GDB) volumes

GDB volumes are calculated as the total volumes of the four GDBs – Dunhill, Kent, Lucky Strike and Pall Mall – sold by our subsidiaries.

Target
Our target is to increase our GDB share faster than the rest of our portfolio.

232bn
(+3%)

Business measures

Total cigarette volumes

Total cigarette volumes are defined as all cigarettes sold by our subsidiaries.

Objective
Our objective is to maintain or grow our total volumes.

694bn
(-1.6%)

Productivity

Productivity continues to be an important part of our strategy. It provides the capabilities and resources we need to support investment in our brands so that we can grow share in our key markets.

Our globally-integrated supply chain continues to improve efficiency and effectiveness while we are making our operations flexible, agile and truly consumer-centric. Our ability to roll out innovations with speed is evolving and we continue to leverage our scale.

Productivity savings

Cost management remains a focus across the business, and has helped to deliver an improved operating margin of 37.4%. We have also continued to improve our marketing efficiency and capital effectiveness, including reducing unnecessary complexity to save costs and using our cash and assets more effectively.

We continue to realise productivity savings from the supply chain, including indirect material procurement and overhead savings, ensuring the Group is able to invest in product enhancements and capabilities that enhance the consumer experience.

New operating model

In 2012 the Group began a medium-term programme to implement a new operating model. This includes revised organisational structures, standardised processes and shared back-office services, underpinned by a global, single instance of SAP. The new structures and processes are currently being implemented and the deployment of the new SAP system started in the third quarter of 2012. This will take around four years to fully roll out.

Optimising resource allocation

Our integrated supply chain enables the group to deliver growth. The transparency of demand and supply at a global level through sales and operational planning ensures we are able to deliver faster and better decision making to allocate resources. This has also allowed us to roll out innovations faster and implement machine technology standards – improving our sourcing flexibility, contingency planning and capital effectiveness.

Global supply chain network

In 2012 we continued to optimise our manufacturing footprint. Over the past 10 years we have reduced the number of cigarette factories from 87 to 44 in 39 countries, including acquisitions. Further closures, including at Bremen in Germany, have progressed in line with expectations, while the restructuring of Boncourt in Switzerland and Vranje in Serbia were announced during the year. Investment to support continued growth ensured manufacturing sites were optimised to deliver anticipated volumes, coordinated across our global network.

Consolidation of factories around the Group continues to be undertaken responsibly and with care for affected employees and local communities. Our key factories now generally serve multiple portfolios and markets, managed through our above-market planning capability.

We are also developing industry-wide supply chain security systems with other international tobacco companies. This will include identifiers that will allow consumers and authorities to validate a product's authenticity, and digital coding technology to help governments ensure that all taxes and duties are paid.

Our track and trace technology, which allows us to monitor the movement of our products within the supply chain, was implemented in Russia, Poland, Ukraine and Belarus by the end of 2012 and is currently being introduced in Germany and Romania.

Procurement joint venture

Agrega, our procurement joint venture with AB InBev, continues to expand its geographic reach, leverage scale and build expertise in indirect spend.

Leaf supply chain

Our leaf supply chain is the most vertically integrated in the industry and continues to provide a competitive advantage, global visibility and cost efficiencies through the quality of our leaf, our people and through our relationships with farmers. Our proven expertise in leaf gives us a strong position to address new consumer needs and the effects of product-based regulation.

We are managing our leaf footprint to ensure sustainability of supply and guaranteeing access to quality sources of leaf.

Key performance indicators (KPIs)

Adjusted profit from operations at constant exchange rates

Profit used in this assessment is the adjusted profit from operations of the Group's subsidiaries – adjusted profit from operations at constant rates for the items shown as memorandum information on the Group Income Statement.

Target
The Group's medium to long-term target is to grow adjusted profit from operations on average by 6% per annum.

£5,970m
(+8%)

Cash generated from operations

Cash flow from operations is defined as the free cash flow excluding restructuring costs and dividends and other appropriations from associates, per the alternative cash flow on page 35.

Target
A specific target is set each year for the cash flow from operations. The target for 2012 was exceeded.

£2,739m

Business measures

Operating margin

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

Objective
Our objective is to increase operating margin by 50-100 basis points per annum.

37.4%

Free cash flow as a percentage of adjusted earnings

This measures our free cash flow as a ratio of the adjusted earnings.

Objective
Our objective is to maintain a percentage figure over 80%.

81%

Winning organisation

Diversity

We pride ourselves on having a diverse workforce who meet the needs of our diverse consumers, customers, suppliers and other stakeholders. We have 64 nationalities working at our global headquarters in the UK.

We are committed to improving the diversity of our senior management teams, including by gender and by nationality. Local staff account for an average of 62% of employees on top teams around the world, an increase from 57% last year. We are also supporting the career development of female managers to increase the number of women in senior roles. In 2012, the number of women in management roles remained steady at 32% and we had 25% female Board representation.

We are dedicated to providing equal opportunities to each employee. We do not discriminate when making decisions on hiring, promotion or retirement and we are committed to providing training and development for employees with disabilities.

Employee opinion survey

'Your Voice' is our employee opinion survey that we carry out every two years to measure employee satisfaction and engagement. In 2012 we updated the survey to better meet our business needs and priorities, and 42,932 employees completed the survey, which was translated into 48 languages.

The results help us to understand how our employees view us and any issues they have. In this latest survey, 80% said they were extremely satisfied with British American Tobacco as a place to work, well above the benchmark of 71% in the fast moving consumer goods (FMCG) sector. Our functions, regions and local companies are turning the detailed feedback from the survey into plans to address areas for improvement.

The survey also allows us to determine our overall employee engagement index score. Broadly, this score combines employee satisfaction with our employees' attitudes towards recommending British American Tobacco as a place to work, their desire to stay with the organisation and their pride in working for us. Our employee engagement index score of 72% in 2012 met our objective of scoring more favourably than the FMCG norm (68%).

Employee engagement

British American Tobacco is committed to employee engagement throughout the business and this includes acting on areas identified as needing improvement in our employee survey.

Employees are kept well informed of the strategy, performance and objectives of the Group through communication cascades at key points in the year, which involve video broadcasts from the Chief Executive, face-to-face presentations and Q&A discussions. Global, regional and local intranets, web-based meetings and presentations, and electronic employee magazines also provide important information, while feedback is encouraged through open forums and Q&A sessions.

Our Sharesave Scheme, our Partnership Share Scheme and our Share Reward Scheme are open to all UK employees. We also operate several similar schemes for senior management in our end markets.

Business measures

Employee engagement index

Our 'Your Voice' employee opinion survey was updated in 2012 to better meet our business priorities. This has enabled us to change the business measure and focus it more specifically on our engagement index – a measure that reflects employee satisfaction, advocacy and pride in the organisation.

Objective

Our objective is to achieve a more positive score than the norm for the fast moving consumer goods companies in our comparator benchmark group. In 2012, our engagement index score was 72%, compared to a norm of 68% for our comparator group.

72%

Responsibility

In our industry it is particularly important that we act responsibly, demonstrate openness and build trust. We do this by managing the impact of our operations and products responsibly. This is backed up by transparent and independently assured reporting, regular stakeholder engagement and sound governance procedures.

We continue to address our social, environmental and economic impacts to build value for the business, for our shareholders and for all the wider stakeholders affected by our business. To help us do this, we will be redefining our sustainability agenda; there is more information about this in our sustainability overview on page 22.

Our Business Principles and our Standards of Business Conduct set out what we require of our companies and our employees in terms of responsible corporate behaviour and personal integrity. And we support regulation that maintains a balance between consumer preferences and the interests of society, while also enabling our business to continue to compete commercially.

Research & development

Our Group Research & Development (R&D) activities are focused on our harm reduction efforts but also encompass the exploration of new products and innovative technologies. Group R&D also provides guidance on the use of ingredients to ensure our products comply with national legislative requirements and our own Group standards.

Our principal R&D facilities are located in Southampton and Cambridge in the UK and at Cachoeirinha in Brazil. In 2012, total investment in Group R&D, including marketing innovations and Nicoventures, was £171 million, compared to £166 million in 2011.

In 2012 we gave presentations at a number of scientific conferences, including the American Association for the Advancement of Science, and submitted 29 research papers for publication in peer-reviewed journals. To increase the transparency of our science we make our research publicly available on our dedicated science website www.bat-science.com.

As part of our research into tobacco harm reduction we are exploring a range of reduced-risk tobacco and nicotine products. In 2012, we completed the clinical phase of a study to measure biomarkers of biological effect that could indicate changes in the body relating to disease processes.

Regulatory-approved nicotine products, as an alternative to conventional cigarettes, offer significantly reduced health risks. Our subsidiary Nicoventures is preparing to launch a nicotine inhalation product that, subject to regulatory approval, could provide smokers with a safer alternative to cigarettes.

In addition, in 2012 we acquired CN Creative, a UK-based company that specialises in the development of electronic cigarette (e-cigarette) technologies intended to offer smokers less risky alternatives to cigarettes. This is a natural extension of our long-term commitment to tobacco harm reduction.

Responsible marketing

Wherever we do business around the world, our companies' marketing is governed by our International Marketing Principles. They were launched at the end of 2012 and provide a consistent and responsible approach to marketing across the Group, replacing our International Marketing Standards which were launched in 2001 and updated in 2007.

The updated International Marketing Principles reflect developments in marketing, technology, regulation and stakeholder expectations and are available at www.bat.com/imp.

We are committed to 100% compliance to our International Marketing Principles, and immediate action is taken in response to any reported breaches.

Environmental performance

We are working to address both our immediate environmental impacts and the likely environmental pressures on the business in the future. This involves risk assessments, performance management and making our operations more efficient.

Our key focus is on minimising energy consumption, reducing our carbon footprint and securing the resources we need for the long term. To assess our environmental efficiency, we set targets relative to the volume of cigarettes we produce.

To measure and manage our future environmental performance, in 2012 we developed new five-year targets for CO_2e, energy and water use, as well as year-on-year targets for waste. You can read more about our new targets for 2013 and beyond online at www.bat.com/sustainability/data.

Afforestation

Our afforestation programmes encourage tree planting to provide a sustainable source of wood for farmers who require it for tobacco curing. Our aim is to reduce the use of natural forests for curing by directly contracted farmers to zero by 2015. In 2012, we made progress towards this target, with a fall from 7.3% to 4.0% of wood used by these farmers. Since 2007 we have planted 140 million trees.

Biodiversity

Our Biodiversity Risk and Opportunity Assessment (BROA) tool helps our companies protect and improve biodiversity in and around tobacco farms. In 2012, we rolled out an updated version of the BROA tool to all our leaf growing operations. The next round of assessments will be completed by the end of 2014.

Since 2001 we have worked with Earthwatch, Fauna & Flora International and the Tropical Biology Association in the British American Tobacco Biodiversity Partnership. The Partnership seeks to address some of the challenging issues surrounding the conservation and management of biodiversity within agricultural landscapes and the ecosystems on which we depend.

Responsibility (continued)

Human rights

We recognise that we have a role in addressing human rights issues and we use our influence with our suppliers to improve conditions in our supply chain. In 2012, we reviewed our approach, drawing on the UN Universal Declaration of Human Rights and the Organisation for Economic Cooperation and Development's (OECD's) Guidelines for Multinational Enterprises.

Human rights criteria are incorporated into our major supply chain management programmes, including our Business Enabler Survey Tool and our Social Responsibility in Tobacco Production programme. Our suppliers are required to meet criteria on issues including workers' rights and child labour, and we are incorporating human rights criteria into all our framework agreements with global suppliers. We also encourage compliance with Group policy and local laws.

Child labour is an important issue for an industry like ours with an agricultural supply chain. In 2001 we helped to establish the Eliminating Child Labour in Tobacco Growing (ECLT) Foundation and we support it actively as a founding member, helping communities understand child labour issues and improving access to education and health services for children.

Corporate social investment

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

Our global CSI expenditure in 2012 was £11.6 million (2011: £13.7 million) as defined by the statutory reporting criteria for charitable donations.

Health and safety

We are committed to providing a safe place to work for all employees and contractors. In 2012, we strengthened our accident review processes and launched 'Closing the gap to zero', our global awareness campaign. This campaign was led by our Chief Executive and Group Operations Director.

Following targeted initiatives, we saw fewer accidents than the previous year in all six most common causes of accidents. We also reduced the number of reported lost workday cases across the Group by 20%. Regrettably, we suffered an increase in serious injuries and fatalities to our employees and contractors working in some of the more challenging environments around the world.

Reported serious injuries increased from 30 to 43 and fatalities from seven to 12. The rise in fatalities was mainly due to an increase in assaults on our sales representatives and security guards and serious road traffic accidents. Detailed reviews of each incident are undertaken to learn lessons and identify actions for the future.

Business measures

Carbon dioxide equivalent (CO_2e) (tonnes CO_2 e per million cigarettes equivalent produced)

CO_2e is largely derived from energy consumption and we track this in tonnes per million cigarettes equivalent produced.

The 2012 figure includes the performance data for the business we acquired in Colombia in October 2011.

Objective
Our objective is to reduce Group CO_2e by 50% by 2030 from our 2000 baseline of 1.38 and by 80% by 2050.

0.81
(41% lower than 2000 baseline)

Group energy use (gigajoules per million cigarettes equivalent produced)

This measure tracks Group energy use in gigajoules per million cigarettes equivalent produced.

Group energy use is the energy used by the Group in its own operations, business travel and freight. We do not include energy used to produce and deliver purchased energy.

The 2012 figure includes the performance data for the business we acquired in Colombia in October 2011.

Objective
Our objective is to reduce energy use to 9.82 by 2017, 17% lower than our 2007 baseline.

10.31
(13% lower than 2007 baseline)

Business measures

Water use (cubic metres per million cigarettes equivalent produced)

This measure tracks Group water use in cubic metres per million cigarettes equivalent produced.

The 2012 figure includes the performance data for the business we acquired in Colombia in October 2011.

Objective
Our objective is to reduce water use to 3.6 by 2017, 26% lower than our 2007 baseline.

3.77
(22% lower than 2007 baseline)

Waste to landfill (tonnes per million cigarettes equivalent produced)

This measure tracks Group waste sent to landfill in tonnes per million cigarettes equivalent produced.

The 2012 figure includes the performance data for the business we acquired in Colombia in October 2011.

Objective
Our objective is to sustain waste sent to landfill at no more than 0.016 tonnes per million cigarettes equivalent produced, 36% lower than our 2007 baseline.

0.012
(52% lower than 2007 baseline)

Recycling (percentage of waste recycled)

This measure tracks the total percentage of Group waste re-used or recycled against total waste generated.

The 2012 figure includes the performance data for the business we acquired in Colombia in October 2011.

Objective
Our objective is to recycle more than 85% of waste generated in each year.

92.5%

Lost Workday Case Incident Rate (LWCIR)

The LWCIR is a standard health and safety measure that helps us measure working days lost through injury on a consistent basis year-on-year.

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

Objective
The local target set for all of our companies is zero accidents, and we have a zero accidents ambition for the whole group.

0.23

For more information on our environmental objectives and to access our Sustainability Data Centre, visit the Sustainability section of our website.

www.bat.com/sustainability

Sustainability overview

Our vision of a sustainable tobacco business is one that manages the impact of its operations and products responsibly today and prepares for a future in which it continues to create value for shareholders as well as being in the best interest of other stakeholders.

Our approach to sustainability

We were the first tobacco company to publish a social report and our approach to sustainability has been reviewed and refined ever since. Our sustainability agenda today focuses on the five areas of harm reduction, marketplace, supply chain, environment and people and culture – all of which we describe in this section, highlighting our key priorities and issues.

In 2012, we began work on a brand new sustainability agenda that increases our ambition and better measures our impacts. The key areas of our current sustainability agenda will continue to be important, but we want to focus more specifically on the issues that have the greatest bearing on society. We will be working with stakeholders to develop our plans and we will report on this in our Annual Report 2013.

Sustainability reporting

We are also changing the way we report this year – away from a single annual Sustainability Report towards a more integrated approach across our Annual Report and our corporate website, www.bat.com.

We are still producing a Sustainability Summary report, published at the same time as this Annual Report, outlining our 2012 performance and key issues. We will also be producing more focused sustainability communications, including two issue-specific reports later in 2013 to provide stakeholders with more in-depth information on the topics that interest them most.

You will find specific performance indicators relating to our sustainability focus areas within the main strategic review in this report. Detailed performance data for 2012 is available at www.bat.com/sustainability/data. You can also read more about our activities and view our sustainability video online at www.bat.com/sustainability.

Stakeholder engagement

Our stakeholders include investors, NGOs, regulators, suppliers, the scientific and public health communities, consumers, employees, local communities, customers (retailers and distributors) and sustainability opinion leaders. In short, anyone who is impacted by, or can impact upon, our business operations is a stakeholder of British American Tobacco.

Engaging with our stakeholders helps us to understand their concerns and therefore to respond to them appropriately. It gives us valuable feedback on our policies, procedures and ways of working, so that we can continually improve them. It provides us with opportunities to put our views across, helping our stakeholders understand our positions.

Materiality

Over the years, we have always focused our sustainability reporting on those issues of the greatest significance to our business and our stakeholders. However, in 2007, we began taking a more systematic approach to identifying those issues. Following a review of our companies' stakeholder dialogue sessions since 2001, we drew up a list of key topics and grouped them into categories to help us establish which were the most significant.

The materiality process involved internal consultation with regional teams and senior functional managers in relevant areas, as well as the Management Board and the Board CSR Committee. Finally, we discussed a refined list of key topics with sustainability opinion leaders and relevant NGOs. The end result was the identification of our current focus areas: harm reduction, marketplace, supply chain, environment and people and culture.

We continue to review our materiality process each year and, in 2013, this review will support our work in redefining our sustainability agenda.

Sustainability assurance statement from Ernst & Young

Some of the data used in the Strategic review in this Report has been reviewed by Ernst & Young LLP as part of their process for providing assurance of British American Tobacco's sustainability reporting for 2012. This includes data on pages 19-22 relating to environmental performance, health and safety, our employee opinion survey 'Your Voice' scores and diversity. You can read Ernst & Young's full assurance statement at www.bat.com/assurance.

Harm reduction

We know tobacco products pose real and serious health risks and the only way to avoid these risks is not to use them. But many adults choose to smoke, so our top priority continues to be working towards reducing these risks and making available a range of less risky tobacco and nicotine-based alternatives.

Our research and development programme is focusing on tobacco harm reduction and we are exploring a range of reduced-risk tobacco and nicotine products. This includes a nicotine inhalation product being prepared for launch in the UK by our subsidiary Nicoventures and exploring innovative electronic cigarette technologies through our recent acquisition of CN Creative.

Our work with scientists and public health professionals aims to secure widespread support for tobacco harm reduction, including the regulatory changes needed to support bringing reduced-risk products to market.

Environment

We are working to reduce our environmental impacts as we aim for stretching 2030 and 2050 carbon reduction targets.

In 2012, we also developed new five-year targets for CO_2e, energy and water use, as well as year-on-year targets for waste. These targets can be viewed online at www.bat.com/sustainability/data, where you can also find more details of our performance in 2012 against our key measures.

To help achieve our challenging new targets, we will be rolling out a number of energy and CO_2e reduction projects in 2013, and will continue to explore renewable and low carbon energy options for the longer term. We will also be conducting detailed assessments of long-term water supply and demand requirements in the 'high-risk' places we operate in.

Marketplace

We are proud of the way we do business and we aim always to be open and honest about our views and activities within the marketplace.

Like any business, we want to grow our market share. But we want to do this by encouraging existing adult smokers to choose our products over those of our competitors, not by trying to increase the number of people who smoke or how much they smoke.

Given the serious negative health impacts of tobacco products, we support balanced regulation and we expect high standards of corporate conduct among those who produce, distribute, market and sell them.

To achieve this we focus on three key areas: engaging with stakeholders on industry regulation; responsible marketing and preventing underage access; and fighting the black market in tobacco.

People and culture

Our reputation as a leading employer helps us stand out in an increasingly competitive international employment market, and our people are key to delivering our strategy.

Our focus is on: driving high performance; developing the next generation of leaders; valuing the diversity of our employees; encouraging and rewarding entrepreneurial behaviour; and creating an engaging culture where individuals and teams can be successful.

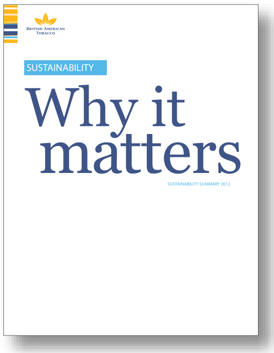
Providing a safe place to work, protecting our employees' wellbeing and listening to their views are also fundamental. We want a stretching and supportive culture founded on personal commitment and responsibility that attracts, engages and retains the most talented and diverse people.

Supply chain

We rely on a complex but critical supply chain and we need it to be fit for the future. We are using our influence to improve sustainability from crop to consumer.

We manage the impacts of our business through our own activities and those of our supply chain. Our environmental management systems meet best international standards and we developed our supply chain sustainability strategy with the help of our internal and external stakeholders.

We don't own tobacco farms, but we provide agronomy support through our extension services to over 100,000 directly contracted farmers. Our Social Responsibility in Tobacco Production programme encourages continual improvement of the social and environmental performance of the suppliers we buy tobacco leaf from.



www.bat.com/sustainability

Chief Operating Officer's review

The Group delivered a very good performance in 2012. Exchange rate movements, especially the euro, Brazilian real, South African rand and Russian rouble, had an adverse impact on reported results.

Reported revenue was 1% lower. At constant rates of exchange, revenue was 4% higher, reflecting continued good pricing momentum.

The reported profit from operations was 15% higher at £5,412 million, with a 3% increase in adjusted profit from operations. At constant rates of exchange, the adjusted profit was 8% higher.

Group volumes from subsidiaries were 694 billion, down by 11 billion or 1.6%. This was principally as a result of industry volume declines in Western Europe, Brazil and Egypt, together with volume losses in low value brands in Indonesia and Turkey. Organic volumes were down 2.0% or 1.7%, excluding the effect of the one-off comparator in Japan in 2011.

Other tobacco products performed well. Fine Cut tobacco grew by 8% to 14,494 tonnes in Western Europe, mainly in Germany, Spain, the United Kingdom, the Netherlands and Italy. Market share was up strongly and profit was higher. Pall Mall is by far the largest Fine Cut brand in Western Europe.

The four Global Drive Brands (GDB) achieved good overall volume growth of 3% and increased market share by 30 basis points, driven by the successful roll-out of innovations. GDBs now account for over one-third of total volumes. Dunhill volumes increased by 2% as strong growth in Indonesia, Malaysia, South Africa, Romania, Hungary and Chile was partially offset by a decline in South Korea. Kent was 1% higher than last year with increased volumes in Ukraine, Russia, Azerbaijan and Vietnam, offset by reduced volumes in Japan. Adjusting for the one-off comparator in Japan, Kent grew by 4%.

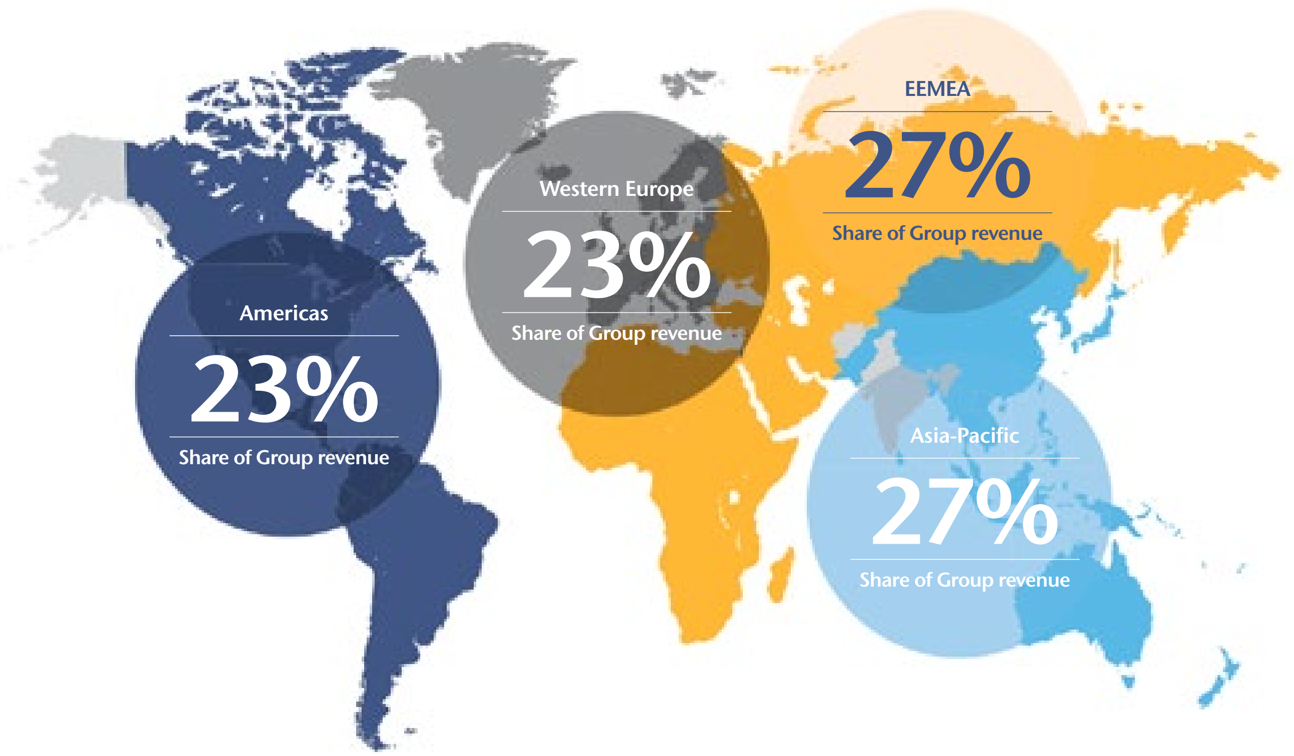
Lucky Strike increased volumes by 11% with growth in Argentina, France, Germany and Chile. Pall Mall volumes rose by 3%, with outstanding growth in Pakistan and increases in Canada, Romania and the United Kingdom partially offset by lower volumes in Italy, Spain and Uzbekistan.

John Daly
Chief Operating Officer

2012 highlights

- **All four regions increased operating margin, contributing to an excellent increase of 160 basis points to 37.4%.**
- **GDB volumes are now one-third of our total global volumes.**
- **Pall Mall is the largest Fine Cut brand in Western Europe.**
- **Group volumes were 694 billion, down 1.6%, mainly due to contractions in some of our larger markets.**

Our regional performance



	Revenue (£m)	Adjusted profit (£m)	Volume (bn)
Asia-Pacific	4,214 2011: 4,251	1,666 2011: 1,539	188 2011: 191
Americas	3,460 2011: 3,558	1,415 2011: 1,441	142 2011: 143
Western Europe	3,442 2011: 3,600	1,186 2011: 1,228	129 2011: 135
Eastern Europe, Middle East and Africa (EEMEA)	4,074 2011: 3,990	1,414 2011: 1,311	235 2011: 236

Notes:

– Profit discussed in the regional review is based on adjusted profit from operations and therefore excludes the impact of restructuring and integration costs, amortisation and impairment of trademarks and similar intangibles, goodwill impairment, exceptional provisions and gains on disposal of businesses and trademarks.

– Volumes change percentages, where shown in the Report, are based on the absolute numbers.

Asia-Pacific

Share of group revenue

27% 2011: 28%

Adjusted profit from operations (£m)

1,666 2011: 1,539

Adjusted profit was up £127 million to £1,666 million as a result of strong performances by a number of markets in the region and favourable exchange rates. However, this was partially offset by lower profit from South Korea and the increased level of investment in the Indonesian business. Adjusted profit at constant rates of exchange increased by £114 million or 7%. Volumes at 188 billion were down 2%, with increases in Bangladesh, Pakistan, Taiwan and Vietnam more than offset by lower volumes in South Korea, Indonesia and Japan. Adjusting for the one-off comparator in Japan, volumes would have been stable.

Malaysia	The growth in volumes, market share, profit and Global Drive Brands strengthened the Group's market leadership position. Dunhill achieved record share growth.
Australia	Profit was up as a result of cost saving initiatives, favourable exchange rate movements and higher pricing, partially offset by lower volumes. Market share was slightly down but ended the year with good momentum.
Japan	Profit grew, while volumes and market share were down, following the one-off sales in the same period last year. However, underlying market share reached a record high, driven by the success of new innovations in Kent and Kool.
Vietnam	Volumes and market share grew, driven by Kent, State Express 555 and Craven A. Profit increased as a result of productivity savings, higher pricing and increased volumes.
South Korea	Volumes and market share were down due to competitor pricing activities. Higher marketing investment stabilised market share during the last quarter impacting profits.
Taiwan	Strong performances by Dunhill and Pall Mall contributed to a record performance in market share. Increased volumes coupled with higher pricing resulted in a strong increase in profit.
Pakistan	A strong performance by Pall Mall and John Player Gold Leaf drove market share to a record high, strengthening the Group's leadership. Pall Mall is now the largest brand in the market. Higher volumes and pricing, coupled with productivity savings, drove a significant profit increase.
Bangladesh	A significant increase in profit was the result of both market share and volume growth due to the strong performances of Benson & Hedges and the local brands.
Indonesia	The Group continues to invest behind strategic brands. Launched in March, Dunhill became the fastest growing and most successful launch of an international kretek brand in the market. Profit declined, however, due to lower volumes in low margin brands and higher marketing investment and clove prices.

Americas

Share of group revenue

23% 2011: 23%

Adjusted profit from operations (£m)

1,415 2011: 1,441

Adjusted profit declined by £26 million to £1,415 million, mainly attributable to adverse exchange rate movements and lower profit from Mexico. Adjusted profit at constant rates of exchange rose by £103 million or 7%. Volumes were down 1 billion to 142 billion, mainly as a result of industry decreases in Brazil, partially offset by increases in Colombia, following the Protabaco acquisition. Organic volumes were down 4 billion to 139 billion.

Brazil	Strong profit growth was driven by an improved product mix and higher pricing. This was offset by the adverse exchange rate movement. Market share rose strongly but volumes were lower due to market contraction after a significant excise increase and a subsequent rise in illicit trade.
Canada	Volumes and market share increased, consolidating leadership in each of the segments. The company was the only one to increase market share. Profit was stable. Illicit trade was flat.
Mexico	There was good market share growth but lower volumes as a result of an increase in illicit trade following a significant excise-led price increase in 2011. Profits were down due to a tough comparator resulting from an excise windfall.
Argentina	Profit was higher, while volumes and market share were stable. The growth of Lucky Strike led to an increase in market share of the premium segment.
Chile	Higher volumes were achieved as a result of the strong performance of Lucky Strike and this led to an increase in profit.
Venezuela	Market share was higher and profit rose strongly as a result of price increases. This was partially offset by the inflationary pressure on costs and adverse product mix. Volumes were stable despite the growth in illicit trade.
Colombia	The integration of the companies following the acquisition resulted in a significant increase in volumes and profit. There was good growth from the Global Drive Brands and Mustang, the main brand acquired in the acquisition.

Western Europe

Share of group revenue

23% 2011: 23%

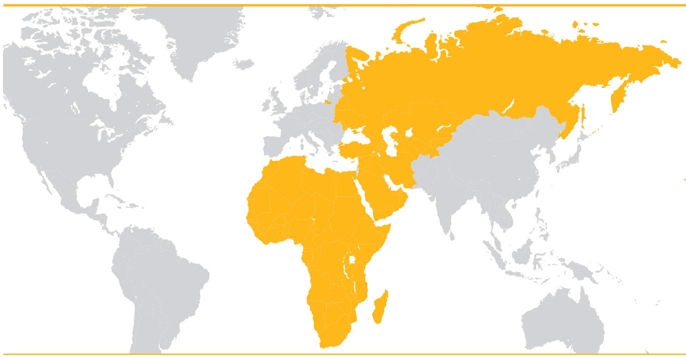
Adjusted profit from operations (£m)

1,186 2011: 1,228

Adjusted profit decreased by £42 million to £1,186 million, mainly as a result of adverse exchange rate movements and tough market conditions in southern Europe. This was partially offset by good performances in Germany, Romania, Switzerland, Sweden and the United Kingdom. Adjusted profit at constant rates of exchange increased by £34 million or 3%. Regional volumes were 5% lower at 129 billion mainly as a result of market contractions in Italy, Spain, Poland, Hungary and Denmark.

Italy	The difficult economic environment resulted in lower industry volumes, with market share and profit declines. However, market share and profit in the Fine Cut segment grew strongly.
Germany	Profit increased as a result of higher pricing and good cost management. Volumes rose in a declining market as a result of the good performances of Lucky Strike and Pall Mall, leading to an increase in market share. In the Fine Cut segment, share grew strongly due to the performance of Pall Mall.
France	Industry volumes were lower but market share increased. This was achieved through a strong performance of Lucky Strike. Profit increased due to improved pricing.
Switzerland	Profit grew strongly as a result of higher pricing and lower costs. Volumes were stable but market share rose due to strong performances of Parisienne, Lucky Strike and Pall Mall.
Spain	Industry volumes continued to decline sharply. Despite the strong growth of Lucky Strike, market share was down. Profit grew on the back of both pricing and a lower cost base.
Romania	Higher market share was the result of strong performances of Dunhill and Pall Mall. Profit grew as a result of both higher volumes and pricing.
Poland	Industry volumes continued to decline, reducing volumes and profit. Lucky Strike and the international brands performed well despite difficult trading conditions.
United Kingdom	Strong performances from Pall Mall and Rothmans led both to increased volumes and market share. Profit grew strongly due to price increases and cost management.
Denmark	Significant market contraction led to a decline in volumes, however, exit market share grew compared to the previous year. Profit grew strongly and margins improved.
Sweden	Profit increased strongly as a result of lower costs and higher prices, with volumes stable. Market share grew due to the performances of Pall Mall and Lucky Strike.

Eastern Europe, Middle East and Africa (EEMEA)



Share of group revenue

27% 2011: 26%

Adjusted profit from operations (£m)

1,414 2011: 1,311

Adjusted profit increased by £103 million to £1,414 million. This was principally due to stable volumes and price increases, partially offset by the adverse impact of exchange rate movements. Adjusted profit at constant rates of exchange increased by £200 million or 15%. Volumes were marginally lower than last year at 235 billion with increases in a number of markets including South Africa and Ukraine, partially offset by the declines in Egypt, Turkey and Nigeria.

Russia	Kent maintained its leadership of the premium segment and the successful launch of Rothmans drove market share higher. Strong profit growth was the result of higher pricing, an improved mix and productivity savings, with volumes essentially flat.
Ukraine	Volumes and market share increased with a good performance from Kent. However, profit was lower due to a competitive pricing environment and increased marketing investment.
Turkey	Continued volume declines in low margin brands impacted profit and market share, despite growth by Kent and Lucky Strike.
Gulf Cooperation Council (GCC) markets	Profit was up strongly due to a better product mix and price increases across all markets. Good growth in market share was mainly due to the performance of Dunhill and Rothmans. Volumes were in line with last year.
Egypt	Market instability led to record levels of illicit trade following multiple and significant excise increases over the past three years. Both profit and volumes decreased as a result.
Nigeria	Political and social unrest resulted in a substantial reduction in industry volumes, which led to lower profits.
South Africa	Profit in local currency grew but was more than offset by the adverse exchange rate movement. Volumes increased despite the continuing high incidence of illicit trade. Dunhill and Peter Stuyvesant confirmed their positions as market leaders.

Financial review

A strong performance in a difficult environment

Profit from operations

The Group profit from operations at £5,412 million grew by 15%, with revenue at £15,190 million, down by 1%. At constant rates of exchange, revenue was up 4% to £15,999 million.

In order to better understand the underlying performance of the business, it is necessary to adjust for a number of items relating to, for example, restructuring costs and one-off charges and provisions. We call the underlying profit after adjusting for these items, adjusted profit. These adjustments are described further below. Adjusted profit from operations was £5,681 million, up 3% from £5,519 million in 2011.

We also have to view the business results at constant rates of exchange in order to assess the underlying performance. Adjusted profit from operations translated at constant rates of exchange was up 8% to £5,970 million.

Organic growth

Certain transactions, which are set out in the table on page 31, impacted revenue and operating profit in 2012 and 2011. The net effect of these transactions was not material.

Operating margin

The Group continues to improve its operating margin through factory rationalisation, implementation of the new operating model, systems standardisation and productivity savings. In 2012, adjusted profit from operations, as a percentage of net revenue, improved to 37.4% compared to 35.8% in 2011. More details of the Group's adjusted operating performance can be found in the regional review.

Adjusting items

During 2012, the Group continued to incur costs which do not relate to the day-to-day operations of the business. The adjustments made to profit from operations are separately disclosed as memorandum information on the face of the income statement and in the segmental analysis.

Restructuring and integration costs of £206 million in 2012 principally relate to the implementation of the new operating model, the continuation of the factory closure and downsizing activities in Australia and the restructuring in Argentina. The costs also cover the social plan and other activities relating to the Bremen factory closure in Germany, the integration of Productora Tabacalera de Colombia, S.A.S. (Protabaco) into existing operations, as well as the write-off of non-compliant products and materials related to the implementation of plain packaging in Australia. In addition, they also include separation packages in respect of permanent headcount reductions in the Group.

The £193 million restructuring and integration charge in 2011 principally related to the factory closure and downsizing activities in Denmark and Australia respectively, a voluntary separation scheme and closure of the printing unit in Argentina, the closure of the Jawornik factory in Poland, the Tire factory in Turkey and the Lecce factory in Italy. The costs also cover the closure activities relating to the Bremen factory closure in Germany and the integration of Protabaco into existing operations, including acquisition costs, as well as other restructuring initiatives directly related to improving the efficiency and effectiveness of the Group as a globally integrated enterprise. In addition, they also include separation packages in respect of permanent headcount reductions in the Group.

During 2011, we impaired the remaining goodwill relating to the acquisition of Tekel in Turkey, by £273 million. In addition, as explained more fully in the contingent liabilities note 30 to the financial statements, the Group made a provision of £274 million for a potential claim under a 1998 settlement agreement entered into by a subsidiary in respect of the clean-up of sediments in the lower Fox River in Wisconsin.

The acquisitions of Bentoel, Tekel, ST, Protabaco and CN Creative Limited resulted in the capitalisation of trademarks and similar intangible assets, which are amortised over their expected useful lives, which do not exceed 20 years. The 2012 amortisation charge of £63 million, compared to £58 million in 2011, is included in depreciation, amortisation and impairment costs in the profit from operations.

Net finance costs

Net finance costs at £456 million were £4 million lower than last year, reflecting the Group's strong cash flow.

Percentage increases in revenue and in profit from operations

	Revenue growth	Profit growth
As reported	-1%	+15%
Adjusted		+3%
Adjusted at constant rates	+4%	+8%
Adjusted organic at constant rates	+4%	+8%

2012 highlights

- Adjusted profit from operations at constant rates of exchange increased by 8%.
- Adjusted diluted earnings per share rose by 7% to 207.5p per share.
- At constant rates of exchange, adjusted diluted earnings per share were 12% higher at 217.8p.
- Dividends for 2012 up by 7% to 134.9p per share.
- Strong free cash flow of £3,259 million equal to 81% of adjusted earnings.
- Share buy-back of £1.25 billion made in 2012, with £1.5 billion announced for 2013.
- Credit rating upgraded to A- by S&P.

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

Revenue	2012					2011		
	Reported revenue £m	Impact of exchange £m	Revenue at CC[1] £m	Organic adjust-ments[3] £m	Organic revenue at CC[1] £m	Reported revenue £m	Organic adjust-ments[3] £m	Organic revenue £m
Asia-Pacific	4,214	10	4,224		4,224	4,251		4,251
Americas	3,460	282	3,742	(46)	3,696	3,558		3,558
Western Europe	3,442	240	3,682		3,682	3,600	(24)	3,576
EEMEA	4,074	277	4,351		4,351	3,990		3,990
Total	15,190	809	15,999	(46)	15,953	15,399	(24)	15,375

Profit from operations	2012							2011		
	Profit[2] £m	Adjusting items £m	Adjusted profit[2] £m	Impact of exchange £m	Adjusted profit[2] at CC[1] £m	Organic adjust-ments[3] £m	Organic adjusted profit[2] at CC[1] £m	Adjusted profit[2,4] £m	Organic adjust-ments[3] £m	Organic adjusted profit[2] £m
Asia-Pacific	1,586	80	1,666	(13)	1,653		1,653	1,539		1,539
Americas	1,351	64	1,415	129	1,544	(17)	1,527	1,441		1,441
Western Europe	1,087	99	1,186	76	1,262		1,262	1,228		1,228
EEMEA	1,388	26	1,414	97	1,511		1,511	1,311		1,311
Total	5,412	269	5,681	289	5,970	(17)	5,953	5,519		5,519

Earnings per share	2012					2011		
	Reported £m	Adjusting items £m	Adjusted £m	Impact of exchange £m	Adjusted at CC[1] £m	Reported £m	Adjusting items £m	Adjusted £m
Profit from subsidiaries	5,412	269	5,681	289	5,970	4,721	798	5,519
Net finance costs	(456)		(456)	(23)	(479)	(460)		(460)
Associates and joint ventures	692	5	697	27	724	670	(11)	659
Profit before tax	5,648	274	5,922	293	6,215	4,931	787	5,718
Taxation	(1,526)	(70)	(1,596)	(71)	(1,667)	(1,556)	(24)	(1,580)
Non-controlling interest	(281)	(1)	(282)	(21)	(303)	(280)	(1)	(281)
Profit attributable to shareholders	3,841	203	4,044	201	4,245	3,095	762	3,857
Diluted number of shares	1,949		1,949		1,949	1,982		1,982
Diluted earnings per share (pence)	197.1		207.5		217.8	156.2		194.6

Notes

1 CC: constant currencies.

2 PFO: profit from operations.

3 Organic adjustments: mergers and acquisitions and discontinued operations – adjustments for 2012 are made for the Protabaco acquisition during 2011, while 2011 is adjusted for the termination of the distribution agreement in Norway (see page 169).

4 For the segmental analysis of reported profit from operations, with the relevant adjustments for 2011, see note 2 on page 120.

Financial review (continued)

Adjusted profit from operations
(£ million)

Adjusted diluted EPS
(pence)

Operating margin
(%)

Associates
The Group's share of the post-tax results of associates, included at the pre-tax profit level under International Financial Reporting Standards (IFRS), increased by £22 million to £692 million, after net adjusting costs of £5 million (2011: £11 million income).

In 2012, the Group's share of the adjusted post-tax results of associates increased by 6% to £697 million (2011: £659 million), or 10% at constant rates.

The adjusted contribution from Reynolds American increased by 4% to £448 million. At constant rates of exchange the increase was 3%. The Group's adjusted contribution from its associate in India, ITC, was £237 million, up 9%. At constant rates of exchange, the contribution would have been 23% higher than last year.

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

Profit before tax
Profit before tax was up £717 million at £5,648 million, reflecting the higher profit from operations, lower net finance costs and the increased contribution from associates.

Effective tax rate
The tax rates in the income statement of 27.0% in 2012 and 31.6% in 2011 are affected by the inclusion of the share of associates' post-tax profit in the Group's pre-tax results and by adjusting items.

The underlying tax rate for subsidiaries was 30.6% in 2012 and 31.2% in 2011. The decrease is the result of a change in the mix of profits.

Earnings per share
Basic earnings per share for 2012 were 198.1p, up 26% (2011: 157.1p). With the distortions that adjusting items can cause in profit, as well as the potential dilutive effect of employee share schemes, earnings per share are best viewed on the basis of adjusted diluted earnings per share. The calculation of this measure is explained in note 7 of the financial statements.

On this basis, the adjusted diluted earnings per share were 207.5p, a 7% increase over 2011, mainly as a result of the strong operating performance, offset by the adverse movement in exchange rates. When the impact of exchange rate movements are excluded, the adjusted diluted earnings per share (at constant rates) would have been 217.8p, a 12% increase on 2011.

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

With the recommended final dividend of 92.7p, the total dividends per share for 2012 are 134.9p, up 7% on the prior year. Under IFRS, the recommended final dividend in respect of a year is only provided in the accounts of the following year. Therefore, the 2012 accounts reflect the 2011 final dividend and the 2012 interim dividend amounting to 130.6p (£2,538 million) in total (2011: 119.1p – £2,358 million). The table on page 33 shows the dividends declared in respect of 2012 and 2011.

Dividends are declared and payable in sterling except for those shareholders on the branch register in South Africa, whose dividends are payable in rand. A rate of exchange of £:R = 13.34290 as at 26 February 2013, the closing rate for that day as quoted by Bloomberg, results in an equivalent final dividend of 1236.88683 SA cents per ordinary share. Further details of the final dividend (key dates and the South Africa branch register) are set out in the other statutory and regulatory information section.

Dividends declared

	2012		2011	
Ordinary shares	Pence per share	£m	Pence per share	£m
Interim	**42.2**	**815**	38.1	738
Final	**92.7**	**1,789**	88.4	1,723
	134.9	**2,604**	126.5	2,461

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

Clear parameters have been established, including levels of authority, on the type and use of financial instruments to manage the financial risks facing the Group. Such instruments are only used if they relate to an underlying exposure; speculative transactions are expressly forbidden under the Group's treasury policy. The Group's treasury position is monitored by a Corporate Finance Committee chaired by the Finance Director. Treasury operations are subject to periodic independent reviews and audits, both internal and external.

The Group continues to maintain investment-grade credit ratings and was upgraded during 2012 by Standard & Poor (S&P). As at 31 December 2012, the ratings from Moody's/S&P were Baa1 (positive outlook)/A- (stable outlook) (end 2011: Baa1/BBB+). The strength of the ratings has underpinned debt issuance and the Group is confident of its ability to successfully access the debt capital markets.

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

Underlying tax rate
(%)

Dividends per share declared
(pence)

Free cash flow per share as a ratio of adjusted diluted EPS
(%)

Liquidity

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group targets an average centrally managed debt maturity of at least five years with no more than 20% of centrally managed debt maturing in a rolling 12-month period. As at 31 December 2012, the average centrally managed debt maturity was 7.2 years (2011: 7.0 years) and the highest proportion of centrally managed debt maturing in a single rolling 12-month period was 19.3% (2011: 18.3%).

It is Group policy that short-term sources of funds (including drawings under both the US$2 billion commercial paper programme and the £1 billion euro commercial paper programme) are backed by undrawn committed lines of credit and cash. At 31 December 2012, no commercial paper was outstanding (31 December 2011: £85 million).

In the year ended 31 December 2012, the Group continued with transactions in the capital markets.

Financial review (continued)

In June 2012, the Group issued new US$2 billion bonds: US$500 million with a maturity of 2015; US$600 million with a maturity of 2017; and US$900 million with a maturity of 2022. In June 2012, the Group repaid a maturing €337 million bond and prepaid and cancelled a US$690 million syndicated facility due October 2012, a Mexican Peso 1,444 million borrowing due 2014 and a Mexican Peso 1,025 million borrowing due 2014. In July 2012, the Group also prepaid and cancelled a €450 million syndicated facility due October 2013. These repayments were financed from Group cash balances. In November 2012, the Group issued a new €750 million bond with a maturity of January 2023.

In June 2011, the Group repaid a maturing €530 million bond with the repayment financed from Group cash balances. In August 2011, the Group extended the maturity date of a US$200 million facility from 2011 to 2016, and simultaneously increased the size of the facility to US$240 million. The facility is drawable in Chilean peso and was drawn to the value of US$225 million at 31 December 2012 (31 December 2011: US$225 million). In September 2011, the Group repaid a Mexican peso 1,444 million borrowing which was due in September 2011 with a new Mexican peso 1,444 million borrowing due September 2014. In November 2011, the Group issued a new €600 million bond with a maturity of November 2021.

Capital structure

The Group defines capital as net debt and equity. The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of 4.5 times. The Group targets a gross interest cover, as calculated under its key central banking facilities, of greater than five. For 2012 it is 12.6 times (2011: 12.5 times). The Group assesses its financial capacity by reference to cash flow, net debt and interest cover. Group policies include a set of financing principles and key performance indicators including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital structure is managed and, in particular, the policies on dividends and share buy-backs are decided.

Cash flow

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

Operating cash flow decreased by £240 million, or 5%, to £5,087 million, reflecting working capital movements and increased net capital expenditure partially offset by the growth in underlying operating performance. The higher cash outflows in respect of taxation and the net movements relating to pension funds were offset by lower net interest and higher dividends and other appropriations from associates due to the Reynolds American share buy-back (£262 million in 2012 and £71 million in 2011). These led to the Group's free cash flow reducing by £67 million or 2% to £3,259 million.

The ratio of free cash flow per share to adjusted diluted earnings per share was 81% (2011: 86%).

Below free cash flow, the principal cash outflows for 2012 comprise the payment of the prior year final dividend and the 2012 interim dividend, which was £180 million higher at £2,538 million, as well as a £1,258 million outflow due to the continuation of the on-market share buy-back programme in 2012, including transaction costs.

During 2012, the cash outflow from net investing activities of £43 million relates mainly to the £14 million cash consideration paid on the purchase of CN Creative and a cash outflow of £24 million for the acquisition of non-controlling interests in Bangladesh. In 2011, the cash outflow of £311 million mainly relates to the £295 million purchase of Protabaco, comprising the purchase price less acquired net cash and cash equivalents. In addition, there was a cash outflow of £10 million for the acquisition of non-controlling interests in Chile and £6 million in respect of the purchase of trademarks.

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

These flows resulted in a net cash outflow of £637 million (2011: £191 million outflow). After taking account of other changes, especially exchange rate movements, total net debt was £545 million higher at £8,473 million at 31 December 2012 (2011: £7,928 million).

During 2012 it was decided to separately show the additional cash flows in respect of the funding of pension funds in deficit, or where one-off amounts have been repaid from pension fund surpluses to the Group companies. The amount is shown after operating cash flow but is included in the free cash flow. 2011 has been restated accordingly.

Cash flow and net debt movements

	2012 £m	2011 Restated* £m
Adjusted profit from operations	**5,681**	5,519
Depreciation, amortisation and impairment	**385**	447
Other non-cash items in operating profit	**45**	68
Profit from operations before depreciation and impairment	**6,111**	6,034
Increase in working capital	**(282)**	(141)
Net capital expenditure	**(742)**	(566)
Gross capital expenditure	**(798)**	(611)
Sale of fixed assets	**56**	45
Operating cash flow	**5,087**	5,327
Net of pension funds' shortfall funding and one-off receipts	**(164)**	(140)
Net interest paid	**(429)**	(469)
Tax paid	**(1,496)**	(1,447)
Dividends paid to non-controlling interests	**(259)**	(275)
Cash generated from operations	**2,739**	2,996
Restructuring costs	**(228)**	(217)
Dividends and other appropriations from associates	**748**	547
Free cash flow	**3,259**	3,326
Dividends paid to shareholders	**(2,538)**	(2,358)
Share buy-back (including transaction costs)	**(1,258)**	(755)
Net investment activities	**(43)**	(311)
Net flow from share schemes and other	**(57)**	(93)
Net cash outflow	**(637)**	(191)
External movements on net debt		
Exchange rate effects**	**89**	123
Net debt disposed		
Change in accrued interest and other	**3**	(19)
Change in net debt	**(545)**	(87)
Opening net debt	**(7,928)**	(7,841)
Closing net debt	**(8,473)**	(7,928)

* 2011 numbers have been restated to separately show the pension funds' shortfall funding.

** Including movements in respect of debt-related derivatives.

Financial review (continued)

Retirement benefit schemes

The Group's subsidiaries operate around 180 retirement benefit arrangements worldwide. The majority of the scheme members belong to defined benefit schemes, most of which are funded externally and many are closed to new entrants. The Group also operates a number of defined contribution schemes.

The present total value of funded scheme liabilities was £6,217 million (2011: £5,675 million), while unfunded scheme liabilities amounted to £378 million (2011: £346 million). The schemes' assets increased from £5,200 million in 2011 to £5,563 million in 2012.

After excluding unrecognised scheme surpluses of £15 million (2011: £77 million), the overall net liability for all pension and healthcare schemes in Group subsidiaries amounted to £1,047 million at the end of 2012, up from £898 million at the end of 2011.

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

Changes in the Group

On 18 December 2012, the Group acquired CN Creative, a UK-based company specialising in the development of e-cigarette technologies intended to offer smokers a less risky alternative to cigarettes. The company's entire share capital was acquired from private investors for £40 million. The company, which has its own research and development facilities, currently has several e-cigarette products on the market as well as new, innovative e-cigarette technologies in the development pipeline. The acquisition of CN Creative is a natural extension of the Group's approach to tobacco harm reduction that has been evolving over a number of years.

On 11 October 2011, the Group completed the transaction to acquire 100% of the privately owned Productora Tabacalera de Colombia, S.A.S. (Protabaco), for US$458 million. The business was integrated with the existing British American Tobacco business and from 1 January 2012 operated as one business.

The Group also terminated an arrangement whereby it distributed product on behalf of a third party in Norway, effective from 1 July 2011.

Share buy-back programme

The Board approved the continuation of the on-market share buy-back programme in 2012 with a value of up to £1.25 billion, excluding costs. During 2012, 38.9 million shares were bought at a value of £1.25 billion, excluding transaction costs (2011: £750 million). A continuation of the share buy-back to a value of £1.5 billion for 2013 has been agreed and will resume after publication of the preliminary results.

Net debt

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

	2012 £m	2011 £m
Net debt due within one year		
Borrowings	**(1,636)**	(1,766)
Related derivatives	**41**	5
Cash and cash equivalents	**2,081**	2,194
Current available-for-sale investments	**26**	57
	512	490
Net debt due beyond one year		
Borrowings	**(9,083)**	(8,510)
Related derivatives	**98**	92
	(8,985)	(8,418)
Total net debt	**(8,473)**	(7,928)

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. The Group believes that these additional measures, which are used internally, are useful to the users of the financial statements in helping them understand the underlying business performance.

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

Management reviews current and prior year segmental adjusted profit from operations of subsidiaries and adjusted post-tax results of associates and joint ventures at constant rates of exchange. This allows comparison of the Group's results had they been translated at last year's average rate of exchange. Other than in exceptional circumstances, this does not adjust for the normal transactional gains and losses in operations which are generated by exchange movements. As an additional measure to indicate the impact of exchange rate movements on the Group results, adjusted diluted earnings per share is also shown at constant rates of exchange.

In the presentation of financial information, the Group also uses another measure – organic growth – to analyse underlying business performance. Organic growth is the growth after adjusting for mergers and acquisitions and discontinued activities. Adjustments are made to current and prior year numbers, based on the current period Group position.

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

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

Accounting developments

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

The Group has not adopted any new and amended IFRSs or IFRIC interpretations that have had any significant effect on reported profit or equity or on the disclosures in the financial statements in 2012. With effect from 1 January 2013 the Group will adopt the revised accounting for employee benefits (IAS 19), and the next few years are likely to see more changes in the financial statements given the aims of standard setters and regulators. Had IAS 19 (Revised) been applied to the 2012 results, profit from operations would be £40 million lower at £5,372 million and profit for the year would have reduced by £47 million to £4,075 million.

Going concern

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

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

After reviewing the Group's annual budget, plans and financing arrangements, as well as the current trading activities of the Group, 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.

Financial review (continued)

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	
	2012	2011	**2012**	2011
US dollar	**1.586**	1.604	**1.626**	1.554
Canadian dollar	**1.584**	1.586	**1.619**	1.583
Euro	**1.234**	1.153	**1.233**	1.197
South African rand	**13.054**	11.632	**13.791**	12.547
Brazilian real	**3.109**	2.683	**3.328**	2.899
Australian dollar	**1.532**	1.554	**1.566**	1.516
Russian rouble	**49.277**	47.116	**49.656**	49.922
Japanese yen	**126.633**	127.826	**140.549**	119.572
Indian rupee	**84.838**	74.802	**89.061**	82.531

Ben Stevens
Finance Director and Chief Information Officer

Key Group risk factors

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

Each risk is considered in the context of the Group's strategy, set out earlier in this business review. Following a description of each risk, its principal causes and potential impact on the Group are summarised. The Group's response to each risk is highlighted. The action it is taking to mitigate the risk is also set out.

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

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

Developments in the assessment of Group risk

The Board's assessment of the key risks and uncertainties facing the Group has remained broadly unchanged over the past year, particularly with regard to illicit trade, excise and tax and financial risk. However, as a consequence of the Board's continuing reappraisal of Group risks and the activities in place to address them, some risks which have in previous years been considered as key Group risks are no longer assessed as such in terms of their impact and likelihood. These risks are not identified in this report. They are, nevertheless, still addressed as Group risks, remain on the Group risk register, and continue to be reviewed in accordance with the Group's risk management procedures. This applies, for example, to the management of the Group's cost base, which was included in last year's Annual Report but does not feature this year.

Conversely, the Group's internal audit procedures in 2012 identified a number of opportunities for the Group to enhance its Environment Health and Safety standards in multiple sites and operations. After a detailed consideration of the risks faced by operational employees, the Board decided to elevate the risk of injury, illness or death in the workplace to the status of a key Group risk in the course of the year, in order to recognise this as a fundamental concern of the Group and to drive improvements.

Regulatory risks facing the Group have been addressed in our risk management governance for a number of years, and reported as key risks previously. As this category of risk has become more important in the context of the future development of the Group's business, so has the need to ensure that all aspects of regulatory risk are specifically identified and addressed effectively. This year's report includes a number of sub-categories of regulatory risk that the Directors now consider to be key.

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.

Key Group risk factors (continued)

Illicit trade

Competition from illicit trade

Illicit trade in the form of counterfeit products, smuggled genuine products and locally manufactured products on which applicable taxes are evaded, continues to represent a significant and growing threat to the legitimate tobacco industry.

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

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

Global volume of illicit trade is currently estimated to be up to 12% of consumption. In the next 10 years, we believe that the problem is likely to increase, driven by the increased regulatory and compliance burden for legitimate manufacturers and fuelled by further significant excise increases.

Time frame: Long term

Principal causes

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

Excise and tax

Excise shocks from tax rate increases or structure changes

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.

A number of significant excise increases have taken place over the past two years, for example in Egypt, Greece, Japan, Mexico, Romania, Turkey and Brazil. To date, the Group has been able to balance these increases with its geographic spread, and continues developing effective measures to address the risk.

Time frame: Long term

Principal causes

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

Onerous disputed taxes, interest and penalties

The Group may face significant financial penalties, including the payment of interest, if it fails to meet its obligations to file tax returns and pay applicable taxes or in the event of an unfavourable ruling by a tax authority in a disputed area.

Time frame: Short term

- Non-filing or late filing of tax returns or incorrect filings.
- Non-payment or late payments of taxes.
- Unfavourable ruling by tax authorities in disputed areas and aggressive auditing and/or pursuit of tax claims.

Potential impact

- Erosion of brand equity.
- Reduced ability to take price increases.
- Investment in trade marketing and distribution is undermined.
- Product is commoditised.
- Lower volumes and reduced profits.

Strategic impact: Growth (organic revenue growth)

Mitigation activities

- Dedicated Anti-Illicit Trade (AIT) teams operating at global, regional, area and key market levels and internal cross-functional coordination.
- Active engagement with key external stakeholders.
- Cross-industry and multi-sector cooperation on a wide range of AIT issues.
- Global AIT strategy development supported by a research programme to further the understanding of the size and scope of the problem.
- AIT Intelligence Unit (including a dedicated analytical laboratory) cooperates with law enforcement agencies in pursuit of priority targets and capacity building.
- Strong internal business conduct and customer approval policies.

Risk owner: Legal Director

Potential impact

- Consumers reject the Group's legitimate tax-paid products for products from illicit sources.
- Reduced legal industry volumes.
- Reduced sales volume or alteration of sales mix.

Strategic impact: Growth (organic revenue growth)

Mitigation activities

- Requirement for Group companies to have in place formal pricing and excise strategies including contingency plans.
- Pricing and excise committees at regional, area and individual market levels.
- Engagement with local tax and customs authorities, where appropriate.
- Annual management review of brand portfolio, brand health and equity.

Risk owner: Finance Director

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

Strategic impact: Productivity (capital effectiveness)

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

Risk owner: Finance Director

Key Group risk factors (continued)

Financial

Translational foreign exchange rate exposures

The Group faces translational foreign exchange (FX) rate exposures for earnings/cash flows from its global business.

Time frame: Short term

Principal causes

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

Access to end market cash resources

Liquidity – access to cash and sources of finance – is essential to maintaining the Group as a going concern and for sustainably funding local operations. Inability to access all the Group's cash resources will impact the Group's capital structure, cost of capital, debt and equity quality and shareholder returns.

Time frame: Short term

Principal causes

- End markets with economies that are closely regulated by the state, with substantial government intervention in foreign exchange markets and limitation on the convertibility of local currency.
- Insufficient hard currency available to local operating companies to pay for imported goods, dividend remittances, royalties and fees.

Marketplace

Geopolitical tensions

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

Time frame: Short term

Principal causes

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

Risk of injury, illness or death in the workplace

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

Time frame: Short term

Principal causes

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

Potential impact

- Fluctuations in translational FX rates of key currencies against sterling introduce volatility in reported results.

Strategic impact: Productivity (capital effectiveness)

Mitigation activities

- While translational FX exposure is not hedged, its impact is identified in results presentations and financial disclosures; earnings are restated at constant rates for comparability.
- Debt and interest are matched to assets and cash flows to mitigate volatility where possible.

Risk owner: Finance Director

- Economic losses as a result of devaluation of assets (including cash) valued or held in local currency.
- Inability to mitigate accounting or financial exposures.
- Loss of commercial opportunities to manufacture and sell tobacco products.

Strategic impact: Productivity (capital effectiveness)

- On-going monitoring of 'trapped cash', with established maximum exposure limits in affected end markets.
- Controls in place to ensure full compliance in the repatriation of funds from countries subject to sanctions regimes.
- Projects designed to tackle currency conversion issues in specific markets and reduce foreign currency requirements.

Risk owner: Finance Director

Potential impact

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

Strategic impact: Growth (organic revenue growth)

Mitigation activities

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

Risk owner: Legal Director

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

Strategic impact: Responsibility

- Risk control systems in place to ensure equipment and infrastructure are provided and maintained.
- Launch of a refreshed EHS strategy, so that employees at all levels receive appropriate EHS training, information and communications.
- Analysis of incidents undertaken regionally and globally to identify increasing incident trends or high potential risks that require coordinated action to address.
- Dedicated global team to support management of EHS risks.
- Key issues and incidents monitored regionally and reported globally to oversee compliance.

Risk owner: Operations Director

Key Group risk factors (continued)

Regulation	Principal causes
Tobacco controls inhibit growth strategy There is a risk that the enactment of regulation that is not evidence-based or consistently interpreted and applied, with industry input, will impact on the Group's ability to achieve its strategic growth initiatives and increase business costs and complexity. **Time frame:** Long term	– Pressure from international organisations, governments and the private sector to pursue tobacco regulation which is not evidence-based. – Adoption of differing regulatory regimes in different countries/groups of countries and/or lack of consensus on interpretation/application. – Exclusion of the industry from participating in engagement with regulators and policy makers.
Product-based regulation impacts costs and consumer demand Regulation could drive commoditisation and a reduced ability to meet consumers' product expectations. Product-specific regulations and the requirement to measure and disclose tobacco product contents impact our cost base and ability to deliver a viable business model. **Time frame:** Long term	– Product regulation aimed at reducing the ability to differentiate cigarettes through severe restrictions on ingredients and design. – Regulation on the content and design of tobacco products which increases complexity and cost.
Loss of ability to directly communicate with consumer Strict and restrictive regulation on advertising, promotion and packaging may reduce the Group's ability to communicate with adult smokers and influence consumer preferences, resulting in increased commoditisation of the category. **Time frame:** Long term	– Adoption of the WHO's Framework Convention on Tobacco Control (FCTC) guidelines on packaging and labelling, advertising and promotion. – Adoption of more stringent national regulations, such as point-of-sale display bans and plain packaging.

Potential impact	Mitigation activities
– Adverse impact on ability to compete within the legitimate tobacco industry, and also with increased illicit trade. – Shocks to share price on enactment of regulation. **Strategic impact:** Growth (organic revenue growth)	– Engagement aligned across the Group to drive a balanced global policy framework for tobacco control via a number of projects and workshops and further development of the Group's Regulatory Futures team in 2012. – Prioritisation of key regulatory issues such as retail display bans, ingredients bans and pack space appropriation. – Stakeholder mapping and prioritisation, developing robust advocacy materials, building third-party alliances and a programme of targeted regulatory engagement. **Risk owner:** CORA Director
– Reduced consumer acceptability of new product specifications, leading to loss of volume and contributing to an increase in illicit trade. – Loss of volume due to regulation in individual markets impacting on established portfolio. – Increased cost and complexity of meeting product specific regulations. – Loss of reputation, penalties and closure of production as a result of non-compliance for inadvertent breach. **Strategic impact:** Growth (organic revenue growth)	– A leaf research programme established in order to address consumer differentiation, regulatory compliance and farmer sustainability. – A 'Ready for Regulation' workstream ensuring that the business is ready for the effects of regulation in ingredients and the associated impact on consumers, and the development of efficient process and infrastructure to manage the potential impact of regulatory testing and disclosure. – Effective and globally integrated processes for sales and operations planning processes, product specification and testing and new product initiatives. **Risk owner:** Operations Director
– Generic or plain packaging leads to loss of brand equity. – Reduced ability to compete and make new market entries. – Reduced brand equity and pricing power will result in downtrading and impact on profits. **Strategic impact:** Growth (organic revenue growth) and Responsibility (balanced regulation)	– Development of comprehensive plans to support markets to prepare for the implications of an increasingly strict regulatory environment and to address key regulatory issues. – Development of innovative solutions to evolve brand portfolio, product and design and product differentiation within the context of regulatory developments and consistent with Group policy and local law. – Programme of engagement with stakeholders at global, regional and individual market levels to address key regulatory issues, including plain packaging and product display initiatives, and identify potential unintended consequences, such as a contribution to increased illicit trade. **Risk owner:** Marketing Director

Corporate Governance

Chairman's introduction

As I state in my introductory remarks to shareholders, our corporate governance is an important element in how British American Tobacco is run. We strive to be at the forefront of changing standards and procedures on corporate governance as a leading UK listed plc.

Overall, the Board is responsible for the long-term success of the Company and how it is directed and controlled. As Chief Executive, Nicandro Durante leads the business. As Chairman, I lead the Board. In doing so, I must be sure of the Board's effectiveness in all aspects of its role. Each year our annual board evaluation process helps me to confirm this. We test our effectiveness as a team, how well our committees function and our commitment and performance as individuals. All Board members, including me, receive individual feedback from this process. You can read about the results of this year's evaluation in this section.

We are a diverse board, but we believe we form a strong team. We have a broad range of professional backgrounds and nationalities, and in 2012 a quarter of the Board were women. Each year after our strategy sessions, in which we focus on our long-term vision and objectives, we review our collective skills and experience against the long-term demands of the business as we see it evolving. The changes to the composition of the Board, set out in my introductory note, are a consequence of this process.

We take a clear and transparent approach to boardroom pay, which remains a widely discussed issue. We appointed a new Chairman of our Remuneration Committee in April 2012, Dr Gerry Murphy, and found more time in our Board calendar for additional meetings of the Committee. The Committee's report in this section describes for you its activities during the year, forthcoming initiatives that anticipate new reporting requirements coming in 2013 and changes that it has made to improve its effectiveness. You can also see a full breakdown of the pay and bonuses for our Executive Directors and how they were determined.

Succession planning played a part in other committee membership changes, as Sir Nicholas Scheele and Robert Lerwill will both be standing down as Non-Executive Directors of the Company at our AGM in 2013, each having served eight years on the Board. Sir Nicholas resigned from the Audit Committee after our last AGM, and both Ann Godbehere and Kieran Poynter were appointed to it. In order to maintain balance and time commitments, Ann and Kieran stepped down from the CSR Committee, and were replaced by Sir Nicholas and Christine Morin-Postel. Robert Lerwill continues as Chairman of the Audit Committee until the AGM this year when, with the benefit of the committee changes this year, the chair will transition smoothly to Kieran on Robert's retirement. As a former practising accountant until 2008, Kieran's wealth of financial experience is well suited to the role. I am also confident that Christine, who has extensive experience as a director of publicly listed companies and who has been a Non-Executive Director of the Company since 2007, will make an excellent Senior Independent Director when she succeeds Sir Nicholas in the role, on his retirement this year.

Risk management forms a significant part of the annual agenda of our Board, Audit Committee and CSR Committee, and our governance efforts across the Group as a whole. Risk links directly to our corporate strategy. This is why we report to you on our key Group risk factors up front in our business review. The Audit Committee's report in this section gives you more detail on the systems of risk management and internal control enabling us to safeguard our shareholders' investment and the Company's assets.

We believe that our Annual Report presents a balanced assessment of the Company and its prospects, and the key performance indicators that measure it, in a clear and understandable way. Good quality reporting is essential. So is meaningful dialogue with shareholders. Through our annual investor relations programme, we (and I personally) have discussed many aspects of corporate governance and strategy with our significant investors and analysts. You can read more about our shareholder engagement in this section. I look forward to more meetings with you in the run up to our AGM in April and at the meeting itself.

Richard Burrows
Chairman

Compliance statement

Throughout the year ended 31 December 2012 and to the date of this document, we applied the Main Principles and complied with the provisions of the UK Corporate Governance Code adopted in June 2010 (the Code). The Board considers that this Annual Report, and notably this section, provides the information shareholders need to evaluate how we have done so. For ease of reference, we prepare a separate annual compliance report by reference to each provision of the Code. This report is available at www.bat.com/governance. The Code is published by the Financial Reporting Council (FRC) and is available at www.frc.org.uk.

We comply with the Disclosure Rules and Transparency Rules requirements for corporate governance statements by virtue of the information included in this section, together with the information contained in the other statutory and regulatory information section of this report.

Leadership and governance

The Board

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

Individual roles

Leadership — Separate and distinct roles

Chairman
– Leadership of the Board
– Ensure Board effectiveness
– Facilitate contribution of Directors
– Set Board agenda
– Safeguard shareholder interests
– Ensure effective shareholder engagement

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

Oversight — Independent

Non-Executive Directors (NEDs)
– Help develop strategy
– Challenge management proposals
– Scrutinise performance of management
– Monitor reporting of performance
– Available to meet with major shareholders

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

Board Committees

The Board has established four principal Board Committees, to which it has delegated certain responsibilities. They are the Audit Committee, the Corporate Social Responsibility (CSR) Committee, the Nominations Committee and the Remuneration Committee. The roles, membership and activities of these Committees are described in detail in their individual reports in this section. Each Committee has its own terms of reference, available at www.bat.com/governance, which are reviewed and updated regularly to ensure their alignment with best practice.

The Board has also established a Corporate Committee, comprising the three Executive Directors, which is responsible for reviewing issues prior to their referral to the Board and its principal Committees.

Principal Board role

- Approving Group strategy
- Approving Group policies
- Approving major corporate activities
- Approving Annual Report
- Agreeing governance framework
- Agreeing Group budget
- Agreeing Board succession plan
- Reviewing risk management and internal control
- Reviewing Periodic Financial Reports
- Declaring interim/recommending final dividend

Collective decision making

The Chairman seeks a consensus at Board meetings but, if necessary, decisions are taken by majority. If any Director has concerns on any issue that cannot be resolved, such concerns are noted in the Board minutes. No such concerns arose in 2012.

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

Board programme

The annual Board programme is designed to enable the Board to drive strategy forward across all the elements of the Group's business model, which is set out in the business review. The key activities of the Board in 2012, grouped under the Group's four strategy pillars, is set out in the accompanying table. The Board's strategic priorities for 2013 are identified within the key performance indicators set out in the business review.

The Board devotes considerable attention to corporate governance matters relating to the Group's internal controls and compliance activities. A good example of this in 2012 was the Board's review and approval of a revised Group Statement of Delegated Authorities, by which the Board ensures that it is provided with sufficient oversight of the Group's operations, while acknowledging individual Group companies' autonomy and the flexibility needed in a modern global business.

Board of Directors




	Richard Burrows (67) Chairman	**Sir Nicholas Scheele (69)** Senior Independent Director	**Nicandro Durante (56)** Chief Executive	**Ben Stevens (53)** Finance Director and Chief Information Officer
Nationality	Irish	British/US	Brazilian/Italian	British
Position	Chairman since November 2009; Non-Executive Director since September 2009; and Chairman of the Nominations Committee.	Senior Independent Director since 2008; Non-Executive Director since 2005; and member of the Corporate Social Responsibility and Nominations Committees. Will retire at the conclusion of the 2013 AGM.	Chief Executive since March 2011.	Finance Director since 2008; additionally Chief Information Officer since 2010.
Key appointments	NED and member of the Remuneration Committee of Rentokil Initial plc; a Supervisory Board Member at Carlsberg A/S; NED and member of the Audit, Remuneration and Health, Safety, Environment and Community Committees of Eurasian Natural Resources Corporation PLC; and member of the Trilateral Commission.	Chairman of the Cambridge-MIT Institute, Key Safety Systems, Inc. (USA) and Global Metalsa SA de CV (Mexico) and a Director of Grupo Proeza (Mexico).	No external appointments.	No external appointments.
Skills and experience	Chief Executive of Irish Distillers; Co-Chief Executive of Pernod Ricard; Governor of the Bank of Ireland; Fellow of the Institute of Chartered Accountants of Ireland.	President and Chief Operating Officer of Ford Motor Company; knighted in 2001 for services to British exports; and Chancellor of Warwick University from 2002 until 2008.	COO from 2008; Regional Director for Africa and Middle East and member of the Management Board from 2006; senior general management roles in Brazil (including President of Souza Cruz) and in the UK and Hong Kong; has wide experience in senior international finance and management roles within the Group. Holds a degree in finance, economics and business administration.	Senior Group finance and general management roles; Head of Merger Integration following the merger with Rothmans; Chairman and Managing Director of the Pakistan Tobacco Company and British American Tobacco Russia; appointed to the Management Board in 2001 as Development Director becoming Director, Europe in 2004. Holds a BA (Hons.) in Economics from Manchester University and an MBA from Manchester Business School.




	John Daly (56) Chief Operating Officer	**Karen de Segundo (66)** Non-Executive Director	**Ann Godbehere (57)** Non-Executive Director	**Robert Lerwill (61)** Non-Executive Director
Nationality	Irish	Dutch	Canadian/British	British
Position	Chief Operating Officer since 2010.	Non-Executive Director since 2007; Chair of the Corporate Social Responsibility Committee; and member of the Nominations Committee.	Non-Executive Director since October 2011; Member of the Audit, Nominations and Remuneration Committees.	Non-Executive Director since 2005; Chairman of the Audit Committee; and member of the Nominations Committee. Will retire at the conclusion of the 2013 AGM.
Key appointments	Non-Executive Director of Reynolds American Inc.	NED and member of Audit & Risk, Nomination, Remuneration and Safety & Sustainability Committees of Lonmin plc; Supervisory Board Member and member of the Finance & Investment Committee at E.ON SE; and Member of the Board and member of the Audit Committee of Pöyry Oyj.	NED, member of the Nominations Committee and Chair of the Audit Committee of Rio Tinto plc; NED, member of the Audit Committee and Chair of the HR and Compensation Committee of UBS AG; NED, member of the Nominations and Risk Committees and Chair of the Audit Committee of Prudential plc; NED of Arden Holdings Ltd, Atrium Underwriting Group Ltd and Atrium Underwriters Ltd.	No key appointments.
Skills and experience	Marketing Director, P.J. Carroll & Company (Ireland); senior management roles in Europe and Asia; and Area Director Middle East & North Africa. Appointed to the Management Board as Regional Director for Asia-Pacific in October 2004. Holds a Diploma in Marketing and an International MBA.	Senior executive roles before retiring as CEO Shell International Renewables and President Shell Hydrogen in 2005. Holds a Masters degree in Law from Leiden University, an MBA from Michigan State University and is a Council Member of the Anglo Netherlands Society.	Chief Financial Officer of Swiss Re Group; Chief Financial Officer of Northern Rock during the initial phase of its public ownership; and Fellow of the Certified General Accountants of Canada.	Chartered Accountant; a former Director of Cable & Wireless plc and WPP Group PLC; Chief Executive of Aegis Group plc until 2008; NED of Transcom Worldwide S.A. until May 2012; and Chairman of Synergy Health plc until June 2012.

Christine Morin-Postel (66)
Non-Executive Director

Dr Gerard Murphy (57)
Non-Executive Director

	Christine Morin-Postel (66)	Dr Gerard Murphy (57)
Nationality	French	Irish
Position	Non-Executive Director since 2007; member of the Corporate Social Responsibility, Nominations and Remuneration Committees. Will become Senior Independent Director at the conclusion of the 2013 AGM.	Non-Executive Director since 2009; Chairman of the Remuneration Committee; and member of the Nominations Committee.
Key appointments	NED of Royal Dutch Shell PLC.	Member and Chairman of the Executive Committee of The Blackstone Group International Partners LLP; Board member of Merlin Entertainments Group, Jack Wolfskin, United Biscuits and Michaels Stores.
Skills and experience	Chief Executive of Société Générale de Belgique, Executive Vice-President and member of the Executive Committee of Suez and Chairman and CEO of Crédisuez S.A.; studied political sciences and graduated from the Institut de Contrôle Gestion.	Chief Executive Officer of Kingfisher plc, Carlton Communications plc, Exel plc, Greencore Group plc; senior operating roles at Diageo plc. Holds a BSc and PhD in food technology from University College Cork and an MBS in Marketing from University College Dublin.

Attendance at Board meetings in 2012

Name	Attended/Eligible to attend
Richard Burrows	6/6
Sir Nicholas Scheele[2]	6/6
Nicandro Durante	6/6
Ben Stevens	6/6
John Daly	6/6
Karen de Segundo	6/6
Ann Godbehere[1]	5/6
Robert Lerwill[2]	6/6
Christine Morin-Postel	6/6
Dr Gerry Murphy	6/6
Kieran Poynter	6/6
Anthony Ruys[1]	5/6

Notes:

1 Ann Godbehere and Anthony Ruys were both unable to attend one of the scheduled meetings each due to a long-standing prior engagement.

2 Robert Lerwill and Sir Nicholas Scheele will retire as Non-Executive Directors at the conclusion of the AGM on 25 April 2013.

The Board held six meetings in 2012. All of these were scheduled. One meeting was held off-site over two days, and was devoted to strategy. Six Board meetings are scheduled in 2013.

The Board of Directors is shown as at the date of this Annual Report.

Kieran Poynter (62)
Non-Executive Director

Anthony Ruys (65)
Non-Executive Director

Dr Richard Tubb (53)
Non-Executive Director

	Kieran Poynter (62)	Anthony Ruys (65)	Dr Richard Tubb (53)
Nationality	British	Dutch	US
Position	Non-Executive Director since 2010; member of the Audit, Nominations and Remuneration Committees. Will become Chairman of the Audit Committee at the conclusion of the 2013 AGM.	Non-Executive Director since 2006; member of the Audit and Nominations Committees.	Non-Executive Director since 28 January 2013; Member of the Corporate Social Responsibility and Nominations Committees.
Key appointments	NED and Chairman of the Audit and Compliance Committee of International Consolidated Airlines Group S.A.; NED, member of the Nomination, Remuneration and Risk Committees and Chairman of the Audit & Compliance Committee of F&C Asset Management plc; Chairman and NED of Nomura International PLC; and NED of The Royal Automobile Club Ltd.	Chairman of the Supervisory Board of NV Luchthaven Schiphol (NL); member of the Supervisory Board of JANIVO Holdings BV (NL); and NED of the Group's Indian associate, ITC Limited.	Brigadier General (retired), US Air Force; White House Physician Emeritus; member of the Board of Reference for Project Rescue and the Travel Medicine Advisory Board of Shoreland, Inc; advisory position at Lonsdale; and independent consultant for the Boston Consulting Group.
Skills and experience	Chartered Accountant; Chairman and Senior Partner of PricewaterhouseCoopers until 2008; served on the President's Committee of the Confederation of British Industry and as member of an advisory committee for the Chancellor of the Exchequer.	Marketing Director and Chairman of various Unilever subsidiaries; member of Executive Board, Vice Chairman and Chairman of Heineken. Holds a degree in Commercial Law from University of Utrecht and a Masters degree from Harvard Business School.	White House Physician from 1995 to 2009, including Physician to the President of the United States from 2002 until retirement in 2009; Clinical Assistant Professor at the Uniformed Services University; various medical positions in the US Air Force. Awarded his Doctor of Medicine in 1985.

Management Board

The Management Board, chaired by the Chief Executive, is responsible for overseeing the implementation by the Group's operating subsidiaries of the strategy and policies set by the Board, and for creating the framework for their successful day-to-day operation. Alongside the Finance Director and Chief Operating Officer, its other members comprise 11 senior Group executives listed here.

The Management Board held 13 meetings in 2012 (11 in 2011), including two off-site strategy meetings. Members of the Management Board regularly attend meetings of the Board, particularly when the Group's strategy and budget are being discussed.

In February 2013, the Board approved the creation of a new role on the Management Board in line with the Group's strategy of pursuing and developing a pipeline of next generation nicotine products to complement its core tobacco business. Des Naughton, Group Operations Director, has been appointed to the new role of Managing Director – Next-Generation Products, encompassing Nicoventures and CN Creative. Alan Davy, Group Head of Supply Chain, will join the Management Board as Group Operations Director. He joined the Group in 1988, and has held various roles in manufacturing, supply chain, and general management. These changes will take effect from 1 March 2013.

Principal Management Board role

- Developing Group strategy for approval by the Board
- Developing guidelines for regions and functions on issues affecting the Group
- Ensuring regional and functional strategies are effective and aligned
- Reviewing regional and functional budgets
- Monitoring Group operating performance
- Managing the central functions
- Overseeing the management and development of talent

Jack Bowles (49)

Nationality	French
Position	Director, Asia-Pacific

Jean-Marc Lévy (50)

Nationality	Swiss
Position	Group Marketing Director

Naresh Sethi (46)

Nationality	Indian/Australian
Position	Director, Western Europe

			
	Alan Davy (49)	**Giovanni Giordano (47)**	**Andrew Gray (48)**
Nationality	British	Italian/US	Brazilian/British
Position	Group Operations Director (from 1 March 2013)	Group Human Resources Director	Director, Eastern Europe, Middle East and Africa

			
	Des Naughton (46)	**Ricardo Oberlander (49)**	**Dr David O'Reilly (46)**
Nationality	British	Brazilian	British
Position	Group Operations Director (Managing Director – Next Generation Products from 1 March 2013)	Director, Americas	Group Scientific Director

		
	Kingsley Wheaton (40)	**Neil Withington (56)**
Nationality	British	British
Position	Group Corporate and Regulatory Affairs Director	Group Legal and Security Director and General Counsel

Board effectiveness

Balance and diversity

Diverse skills and expertise

The Board appreciates the benefit of diversity in all its forms, within its own membership and at all levels of the Group. Our Non-Executive Directors come from a broad range of industry and professional backgrounds, with varied experience and expertise aligned to the needs of the business. Short biographies of the Directors, including details of relevant skills and experience, and nationalities are set out in the Board of Directors pages in this section.

Gender diversity

Women made up a quarter of our Board in 2012. This meets the 2015 aspirational target for female representation on FTSE 100 Boards, set by Lord Davies in his recent report on the issue. The Board recognises the challenge and is encouraging initiatives to improve gender diversity in the management levels below the Board. We will report on our progress in more detail next year, in line with new diversity reporting requirements for 2013.

Independence and conflicts of interest

Independence

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

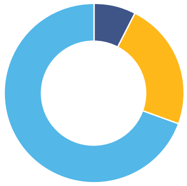
Conflicts of interest

The Board has formal procedures for managing compliance with the conflicts of interest provisions of the Companies Act 2006. The Company's Articles of Association permit the Board to authorise situational conflicts. Directors are required to give advance notice of any conflict issues to the Company Secretary, and these are considered either at the next Board meeting or, if the timing requires it, at a meeting of the Board's Conflicts Committee. Each year, the Board reviews all previously authorised situational conflicts, considering each one afresh. Directors are excluded from the quorum and vote in respect of any matters in which they have an interest.

No material conflicts were reported by Directors in 2012. Following Christine Morin-Postel's disclosure in 2011 of a potential conflict of interest in respect of the Group's exposure to clean-up costs for historic pollution to the Lower Fox River, Wisconsin (by virtue of her then non-executive directorship of a shareholder in Sequana SA, a French company involved in the dispute), she resigned from the Audit Committee with effect from 21 February 2012. She continued to absent herself from any discussion of the matter at Board meetings in 2012. She did not seek re-election to the board of Sequana's shareholder, and her directorship of that company therefore ceased on 28 May 2012.

Balance of Non-Executive Directors and Executive Directors

- Chairman **1**
- Executive Directors **3**
- Independent Non-Executive Directors **9**



Length of tenure of Non-Executive Directors

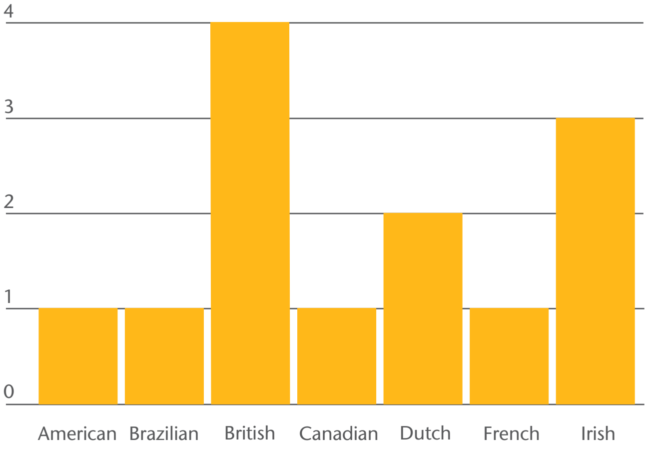
- 0-3 years **3**
- 3-6 years **3**
- 6-9 years **3**

Gender split of Directors

- Male **10***
- Female **3**

* 9 throughout 2012

Nationality



Strategic Board activities in 2012

Growth

– Satisfying itself throughout the year that management was on track to deliver the Group's strategy, and endorsing the direction and activities proposed by management to achieve the Group's strategic metrics.
– Considering the Group's innovation pipeline for combustible products in light of new consumer trends and insights, and how planned innovations can help strengthen its product portfolio.
– Considering the Group's proposed vision, strategy and pipeline for non-combustible products in light of consumer research and the regulatory landscape.
– Discussing the Group's Risk Register and how it is kept under review, improving the Board's understanding of Group-wide and regional risks, and helping it determine the Group's risk appetite in the context of specific growth opportunities.
– Keeping the Group's trading and performance under review, with regular attention to the performance of the Group's key markets and its Global Drive Brands.
– Considering the impact on the business of key Group risk factors (set out in the business review) and how these are mitigated, in consultation with the Audit Committee. For example, the Board considered the Group's tactical plans for dealing with one or more countries exiting suddenly from the Eurozone, following a detailed review by the Audit Committee.
– Regularly reviewing the Group's liquidity, confirming that the Company was conforming with its financing principles (including counterparty exposure limits) and approving major new financing decisions, such as the Group's issue of debt securities of US$2 billion in the US capital markets.

Productivity

– Overseeing initiatives aimed at delivering a globally integrated enterprise with cost and capital effectiveness (for example, the rolling implementation of the Group's new Operating Model and Global IT solution, anticipated to improve operating efficiency).
– Discussing the proposed strategic direction of leaf supply, intended to ensure that the Group can source greater quantities and secure a consistent supply of high-grade tobacco leaf.
– Considering how the key priorities for delivering the Group's strategy are allocated resources, and how the efficient deployment of those resources is best measured (for example, through brand spend effectiveness models).
– Discussing the purchase of the freehold to the Group's UK head office, which will deliver on-going financial efficiencies.

Responsibility

– Approving revised International Marketing Principles, intended to ensure that the Group's responsible approach to marketing reflects developments in marketing, technology, regulation and changing stakeholder expectations.
– Reviewing the Group's regulatory strategy in the context of the current regulatory landscape and likely regulatory progression in the Group's key markets over the next three to five years (notably in Australia, where plain packaging has now been introduced).
– Monitoring the Group's science-based approach to developing potentially reduced-risk products, including at Nicoventures, a company established to focus exclusively on the development and commercialisation of innovative, regulatory-approved nicotine products.
– Approving a new Environmental Policy, demonstrating the Group's commitment to environmentally responsible and sustainable business practices.

Winning organisation

– Reviewing the results of the Group's biennial employee survey 'Your Voice'. The Board welcomed the strong sense of teamwork and job satisfaction among staff as a reflection of the Group's culture and values. It also acknowledged that all leaders have a role in inspiring employees with a vision of the future. The Board noted that each function and region is turning the feedback from the survey into detailed action plans.
– Reviewing the talent pipeline to the Management Board and confirming proposed appointments, in consultation with the Nominations Committee.
– Discussing the reintroduction of the Group's Guiding Principles of 'Enterprising Spirit', 'Freedom through Responsibility', 'Open Minded' and 'Strength through Diversity', and how the Group's leaders will share these with employees and bring them to life through their actions, behaviour, and as role models.
– Reviewing detailed succession planning at Board level and re-emphasising the Board's desire for scientific and/or a Far-East Asian business experience in candidates for the next cycle of Non-Executive Director appointments.

Board effectiveness (continued)

Information and professional development

Board induction

On joining the Board, all Directors receive an induction covering their duties and responsibilities. Non-Executive Directors also receive a full programme of briefings on all areas of the Company's business from the Executive Directors, members of the Management Board, the Company Secretary and other senior executives. The expected time commitment from Non-Executive Directors for their induction is formalised in the standard letter of appointment and visits to an overseas factory location and the Group's R&D Centre in Southampton are required elements of the induction.

Following his appointment, Dr Richard Tubb will be attending induction briefings covering the Group's strategy, organisational structure, business functions, statutory reporting cycle, financing principles, R&D activities, IT strategy and legal and regulatory issues. He will also be attending sessions addressing corporate governance, the Group's internal control and risk management framework and the role of the external auditors. As part of his induction, he is due to visit one of the Group's factories.

Training and development

Non-Executive Directors are encouraged to attend meetings of the Group's regional Audit and CSR committees, in order to give them a better sense of the Group's regional operations. The Non-Executive Directors are also each invited to accompany a Regional Director on a scheduled market visit, in order that they receive regular exposure to the Group's business on the ground. In 2012, Non-Executive Directors went on market visits to Australia, Colombia and Spain.

The Board and its Committees receive regular update briefings on legal and regulatory developments. In 2012, these included corporate governance updates from the Company Secretary on the revised UK Corporate Governance Code and Guidance on Audit Committee's published by the FRC, changes to the regulatory requirements for annual reporting (including remuneration reporting) in 2013, the revised UK Stewardship Code for institutional investors and the good practice recommendations in Professor John Kay's report on UK equity markets.

The Chairman meets with each Non-Executive Director in the latter part of each year, at which they can discuss their individual training and development plans. As part of the Audit Committee's 2013 action points, its members will receive additional technical training every year in October.

Information and advice

The Board and its Committees receive Board papers for review in good time ahead of each meeting. The Company Secretary, under the direction of the Chairman, ensures good information flow 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.

All Directors have access to the advice and services of the Company Secretary, and a procedure is in place for them to take independent professional advice at the Company's expense if required.

Board evaluation

Evaluation process

The performance and effectiveness of the Board and its Committees, the Executive and Non-Executive Directors and the Chairman were assessed in 2012 using both questionnaires and one-on-one interviews with each Board member, conducted by the Company Secretary.

An evaluation report was prepared for the Board on the results of this exercise, and a summary of the findings is set out in the accompanying table, grouped by the themes used to structure the evaluation. While the Board and its Committees are considered to be fully effective, a number of new action points were identified (see table on page 56). In both 2010 and 2011, the Board evaluation process was externally facilitated. Details of continued progress against 2011 action points are also included.

Constructive feedback

Each of the four principal Committees received and separately considered a report on their own effectiveness. Further details of the findings and action points for each Committee are included in their respective reports in this section.

In addition, the Chairman received a report on the performance of the Executive Directors and Non-Executive Directors. A report on the Chairman's own performance was prepared for the Senior Independent Director. Individual feedback was given to all Board members. Individual Directors, including the Chairman, continued to perform well. All Directors, including the Chairman, were assessed to be making an effective personal contribution to the Board.

Shareholder engagement

Commitment to dialogue

The Board is committed to high-quality dialogue with shareholders. The Executive Directors lead in this respect, facilitated by the Head of Investor Relations. The Chairman also contacts major shareholders periodically, and in advance of the AGM each year, in order to understand their views and ensure that these are communicated to the Board. The Senior Independent Director and other Non-Executive Directors are available to meet with major shareholders at their request.

Annual programme

A full programme of engagement with identified priority investors and analysts, both in the UK and overseas, is undertaken each year by the Head of Investor Relations. He is often accompanied by one or more Executive Directors and Management Board members.

Over 400 meetings were held in 2012 with over 275 of the Company's institutional shareholders in 10 countries, spanning four continents. In terms of percentage shareholding, the Company spoke with the owners of the majority of its shares. The Chairman had 14 personal meetings with major shareholders in the course of the year.

Regular investor presentations are also given. These are published on www.bat.com. Results presentations are available by webcast. There is a debt micro site on www.bat.com for debt investors, which includes comprehensive bondholder information on credit ratings, debt facilities, outstanding bonds and maturity profiles.

The AGM provides a useful opportunity for shareholder engagement and, in particular, for the Chairman to explain the Company's progress and receive questions from investors. The chairmen of the Audit, CSR and Remuneration Committees are normally available to take relevant questions and all other Directors attend, unless illness or another pressing commitment precludes them from doing so. All Directors at the time attended the AGM in April 2012. Details of the date and location of our AGM in 2013 can be found in the other statutory and regulatory information section.

Topics of discussion

A wide range of issues was discussed with shareholders in 2012. Many wanted to talk about challenges facing the Group and our approach to them. Regulation was one such challenge, in particular how our marketing model can adapt to plain packaging regulation. Another related to excise increases and how these affect our product pricing and encourage illicit trade. The challenging global economic environment was a frequent topic, specifically our exposure to weakness in the Eurozone. The Company also spoke about its strategy for future growth, through both combustible and non-combustible product innovations.

At least twice a year, the Head of Investor Relations presents a report to the Board on our investor relations activities, identifying the key 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.

Significant shareholders

At 31 December 2012, the following substantial interests (3% or more) in the Company's ordinary share capital (voting securities) had been notified to the Company in accordance with section 5.1.2 of the Disclosure Rules and Transparency Rules. As at 27 February 2013, the Company had not received notification either of any change in the interests below or that any other person holds 3% or more of its ordinary shares.

Name	Number of ordinary shares	% of issued share capital
BlackRock, Inc.	132,891,526	6.88
The Capital Group Companies, Inc.	67,664,399	3.51
Reinet Investments S.C.A.	84,303,670	4.37
Legal & General Group plc	79,243,066	4.10

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

Board effectiveness (continued)

Board evaluation

Leadership

Findings	Action points
The Board was assessed as having a clear understanding of the Group's business and the financial and operational issues it faces, receiving excellent briefings from the Executive Directors. The Board is confident of its ability to accurately assess the Group's overall performance on the basis of the integrity of the information and analysis it receives from management. The Board was very satisfied with the progress made at its off-site strategy sessions in 2012.	*Shareholder engagement:* Chairman and the Chairman of the Remuneration Committee to offer to meet together with institutions and key shareholders to discuss corporate governance and remuneration. *Remuneration policy:* Review the Group's remuneration policies and their alignment to Group strategy in consultation with shareholders, in advance of regulatory changes due in 2013.

Oversight

Findings	Action points
The Board considers that it is afforded excellent oversight of the Group's activities. In particular, Non-Executive Directors regard their participation in the Audit/CSR committee framework as an important part of this oversight and risk is also monitored effectively by the Board in this context. Following its strategy sessions, the Board was keen that analysis of the impact of key risks continues to be a central component of these debates.	*Audit oversight:* A summary of all required actions at the Regional Audit Committee level to be tracked by the Audit Committee. *CSR peer comparison:* Review how the Company compares to industry peers in terms of delivery and reporting of its CSR agenda.

Meetings

Findings	Action points
The annual Board programme was considered to be comprehensive and agendas to be properly prioritised, with sufficient time devoted to strategic matters. The quality of Board papers scored highly. Their delivery electronically via iPads (a 2011 action point implemented in 2012) was embraced as a useful technology delivering administrative efficiencies. The balance between pre-read, presentations and debate in Board meetings had improved. The Chairman's management of debate and the effectiveness of Board discussions were considered to be very good. Calls from the Chairman on issues between meetings offered the Non-Executive Directors a useful 'early warning system' that they valued.	*CSR Committee focus:* Change standard agenda items to increase focus on regulation and harm reduction.

Progress made in 2012

- Additional meetings of the Remuneration Committee were held in July and December.
- Additional time has been found to extend the Remuneration Committee meetings in the diary for 2013 and 2014.
- A secure electronic delivery system for Board papers was introduced in April 2012, via iPad devices, offering a complete suite of Board functionality.
- Having been used alongside hardcopy papers in 2012, it is anticipated that Board papers (other than to the Chairs of the Committees) will be delivered via the new electronic system exclusively from 2013 onwards.

Support

Findings	Action points
The Company Secretarial team was judged to be responsive and effective. Non-Executive Directors were happy with their access to and engagement with the business. All Directors were comfortable with the level of training and support they received.	*Audit Committee training:* A new technical training session for Committee members to be scheduled at each October Audit Committee meeting.

Progress made in 2012

- A session on R&D and non-combustibles will be included in an induction for any new Director.
- The time commitment expected for the induction has been formalised in the letter of appointment.

Composition

Findings	Action points
The strategic importance of the Far-East Asian market, and progress in R&D, reinforced the desire for Far-Eastern and/or Science experience on the Board. Directors acknowledged that, at Board level, the Company has a good gender balance. A number of Directors looked forward to further progress on gender diversity at senior management level.	*Board and Committee balance and skills:* Non-Executive Directors with science-based skills and/or Asian background and experience to be appointed to the Board.

Progress made in 2012

The shortlisting and interviewing of candidates with the required skills and background has continued throughout 2012, culminating in Dr Richard Tubb's appointment in 2013. The search for a Non-Executive Director with an Asian background is continuing in 2013.

Working together

Findings	Action points
It was recognised that the Executive Directors were a dynamic and confident leadership team, but who valued input from the Non-Executive Directors. The Non-Executive Directors felt that the Board environment, and inclusive tone set by the Chairman, was conducive to honest and constructive challenge to management proposals. Board members emphasised that they appreciate receiving feedback on the views of institutional investors, following the Chairman's regular shareholder engagement activities throughout the year.	*Chairman's briefings:* Chairman to provide a regular update at Board meetings on his activities and meetings with investors and institutions.

Progress made in 2012

Time has been allocated at the end of each Board meeting, as appropriate, for a discussion of recent shareholder and other stakeholder activities undertaken by the Chairman since the previous meeting.

Audit and accountability

Audit Committee

Current members

Robert Lerwill (Chairman)
Anthony Ruys
Kieran Poynter
Ann Godbehere

Attendance at meetings in 2012

Name	Attended/Eligible to attend
Robert Lerwill[4]	5/5
Anthony Ruys	5/5
Kieran Poynter[3]	3/3
Ann Godbehere[3]	3/3
Sir Nicholas Scheele[2]	2/2
Christine Morin-Postel[1]	1/1

Notes:

1 Christine Morin-Postel ceased to be a member on 21 February 2012.

2 Sir Nicholas Scheele ceased to be a member on 26 April 2012.

3 Ann Godbehere and Kieran Poynter became members on 26 April 2012.

4 Robert Lerwill will cease to be a member following his retirement as a Non-Executive Director at the conclusion of the AGM on 25 April 2013, at which point Kieran Poynter will take over as Chairman of the Committee.

The Chief Operating Officer and the Finance Director attend all meetings of the Committee but are not members and other Directors attend by invitation. 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.

Robert Lerwill, Ann Godbehere and Kieran Poynter have recent and relevant financial experience.

As a matter of best practice, the Committee meets alone with the external auditors at the end of every meeting and also meets separately with the Group Head of Audit and Business Risk 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 Board meeting 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.

Summary Terms of Reference

The Audit Committee is responsible for:

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

The Committee's terms of reference are available at www.bat.com/governance.

Committee evaluation

The Committee considered a report prepared by the Company Secretary on the effectiveness of the Committee as assessed during the 2012 Board evaluation. While the Committee was considered to be functioning well, a number of action points were identified:

Action points

Training and development: A technical briefing session on an Audit related topic should be included in the annual calendar.

Chairman's induction: The new Chairman of the Committee should receive a comprehensive induction to facilitate a smooth handover.

Committee oversight: The Committee should receive a regular global overview of internal audit 'required actions' and how these are being tracked, recognising that this information was already presented to each Regional Audit Committee individually.

Financial and business reporting

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

Key activities of the Audit Committee in 2012

The Committee held five meetings in 2012. All of these were scheduled.

Standing items of business

The Committee considered the following standing items:

– the Group's 2011 results and its 2012 half-yearly results and interim management statements, and external auditors reports in respect of them;
– periodic reports from the Group's regional audit and CSR committees and corporate audit committee;
– the results of the annual goodwill impairment assessment;
– periodic reports from the Group Head of Audit and Business Risk on international audits and the management responses and action plans being put in place to address any concerns raised;
– the 2013 Internal Audit Plan;
– a report from the Head of Group Security on security risks and frauds and losses arising during the preceding year;
– compliance with the Group's Standards of Business Conduct and records management procedures; and
– an annual review of the external auditors' independence.

Review of the Group risk register

The Committee considered the following risk topics:

– risks relating to the continuing roll-out of the Group's revised Operating Model and single IT operating system, considered a significant area of potential risk given the importance of successful implementation to deliver future costs savings;
– risks relating to the Group's ability to launch new products and roll out innovations into the Global Drive Brands and other brands in its portfolio, which could impact on value and segment share in strategic markets;
– risks relating to significant or unexpected excise tax rate increases or structure changes, that can lead to reduced industry volumes and increased illicit trade in a market. The Committee reviewed in detail a case study on Brazil, where recent significant changes to the excise system have been introduced;
– developments and risks arising in connection with the Fox River matter in the US, and other litigation involving Group companies (see the statement on contingent liabilities at note 30 in the notes on the accounts); and
– risks relating to the potential sudden exit of one or more countries from the Eurozone, the potential impact on the Group, and the likely effect on its competitors. The Committee also reviewed the Group's business continuity plans in respect of such an event, and noted that a dedicated Euro Exit Risk Committee had been meeting on a regular basis to review and track plans and to monitor developments.

Further specific matters

The Committee considered the following specific matters:

– the inclusion of adjusting items in the consolidated financial statements for the year under review, including restructuring costs (including costs relating to the implementation of the Group's revised Operating Model and single IT operating system), trademark amortisation (relating to the Tekel, ST, Bentoel and Protabaco brands), and other items; and
– the recent report by Lord Sharman on going concern and liquidity risk, agreeing that in future a paper will be presented to the Committee on the steps taken to validate the 'Going Concern' assessment at the half year, as well as at year-end.

The business review includes an explanation of the way the Group generates value and preserves it over the long term (its business model) and its strategy for delivering its objectives.

Going concern

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

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

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

Audit and accountability (continued)

External auditors

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

Auditor independence

The Audit Committee has an established policy aimed at safeguarding and supporting the independence and objectivity of the Group's external auditors, which is regularly reviewed and updated to ensure that it reflects best practice.

The basic principle of the policy is that the Group's external auditors may be engaged to provide services only in cases where those services do not impair their independence and objectivity, and provided that the total annual fees for non-audit services do not exceed the sum of annual fees for audit and audit-related services. In particular, the external auditor may not be engaged to provide services in circumstances where the provision of such services would result in the external auditor:

- having a mutual or conflicting interest with any Group company;
- being placed in the position of auditing its own work;
- acting as a manager or employee of any Group company; or
- being placed in the position of advocate for any Group company.

Subject to the above, the external auditor is permitted to provide certain tax and other non-audit services. The Committee recognises that using the external auditors to provide such services can often bring significant benefits to the Group as a result of their detailed knowledge of its business. However, a tender process is required for permitted categories of tax and other non-audit services where the anticipated spend is above specified thresholds, unless a waiver from this requirement is agreed by the Group Finance Director and notified to the Audit Committee.

The policy requires the submission to the Audit Committee, typically prior to the year end, of a work plan identifying the total fees for all audit-related services, tax services and other non-audit services which it is anticipated will be undertaken by the external auditor in the following year. Specific itemisation is required for tax services and other non-audit services in excess of the tender thresholds referred to above. Updated work plans must then be submitted to the Audit Committee at the mid-year and year end. In this way, the Audit Committee has full visibility of the Group spend on non-audit services throughout the year, enabling it to discharge its responsibility for keeping such fees under review and ensuring that neither their level, nor their nature, risk impairing the external auditor's independence and objectivity. A breakdown of audit, audit-related and non-audit fees paid to PricewaterhouseCoopers firms and associates in 2012 is provided in note 3(d) in the notes on the accounts and is summarised as follows:

Services provided by PricewaterhouseCoopers and associates

	2012 £m	2011 £m
Audit services	**9.5**	9.7
Audit-related assurance services	**1.0**	0.2
Total audit and audit-related services	**10.5**	9.9
Other assurance services	**0.2**	–
Tax advisory services	**2.5**	3.8
Tax compliance	**0.9**	1.3
Other non-audit services	**0.5**	0.6
Total non-audit services	**4.1**	5.7

Note: IT-related services amounted to £0.4m in 2012 (2011: £0.2m). These services are presented within non-audit services and have been re-presented into this category in the comparative information.

In 2012 non-audit fees paid to PricewaterhouseCoopers amounted to 39% of the audit and audit-related assurance fees paid to them (2011: 57 %).

Annual assessment

The Audit Committee assesses annually the qualification, expertise and resources, and independence of the Group's external auditors and the effectiveness of the audit process. The Committee's assessment is informed by an external audit satisfaction survey completed by members of senior management, which it reviews in detail. In addition the Finance Director, Group Legal Director, Head of Internal Audit, Company Secretary and the Committee Chair all meet with the external auditors to discuss the progress of the audit and any significant issues are included on the Audit Committee's agenda for consideration during the year.

The Audit Committee has completed its assessment of the external auditors for the financial period under review. It has satisfied itself as to their qualification, expertise and resources and remains confident that their objectivity and independence are not in any way impaired by reason of the non-audit services which they provide to the Group. The Committee recognises that certain projects on which they are engaged will necessarily span a number of years and that they will continue to provide those services for the length of the project. Currently projects relating to the Group's long-term IT initiatives fall within this category.

The Committee has recommended to the Board, for approval by shareholders, the reappointment of PricewaterhouseCoopers as the Company's external auditors. Resolutions will be proposed at the AGM on 25 April 2013 to reappoint PricewaterhouseCoopers as the Company's auditors and to authorise the Directors to agree their remuneration for the 2013 audit.

Standards of Business Conduct

The Audit Committee is responsible for monitoring compliance with the Company's Standards of Business Conduct (the 'Standards'), which underpin the Group's commitment to good corporate behaviour. The Standards require all staff to act with high standards of business integrity, comply with all applicable laws and regulations and ensure that business standards are never compromised for the sake of results. They were updated in 2011 in order to ensure that they remain at the forefront of best practice and are aligned with the provisions of the UK Bribery Act 2010.

Every Group company and every employee worldwide, including senior management and the Board of Directors, is expected to live up to the Standards. Guidance on them is provided across the Group, including through training and awareness programmes. All Group companies have adopted the Standards or local equivalents.

Senior managers in the Group must report on annual compliance with the Standards within the Group company or department for which they are responsible. Information on compliance with the Standards is gathered at a regional and global level and reported to the regional audit and CSR committees and to the Audit Committee. The CSR Committee reviews any Group reputational issues arising from non-compliance with the Standards.

The Standards, and information on the total number of incidents reported under them in 2012 (and the number of established breaches), is available at www.bat.com/governance. The number of incidents reported under the Standards has been reviewed by Ernst & Young LLP as part of their process for providing assurance of the British American Tobacco Sustainability Report 2012. Their full assurance statement is available at www.bat.com/assurance.

In 2012, 45 instances of suspected improper conduct contrary to the Standards (excluding employee fraud and theft against Group companies) were reported to the Audit Committee (2011: 28). 16 were established as breaches and appropriate action taken (2011: 11). In 24 cases, an investigation found no wrongdoing (2011: 14). In five cases, the investigation continued at the year-end (2011: three). No instances involved sums or matters considered material to the Group.

Confidential reporting procedures

The Standards of Business Conduct also set out the Group's whistleblowing policy, enabling staff, in confidence, to raise concerns without fear of reprisal (provided they are raised in good faith). The policy is supplemented by local procedures throughout the Group and at the Group's London headquarters, which provide staff with further guidance and enable them to report matters in a language with which they are comfortable. The Audit Committee receives quarterly reports on whistleblowing incidents. It remains satisfied that the Group's policy and the procedures enable proportionate and independent investigation of matters raised and ensure that appropriate follow-up action is taken.

Of the total number of business conduct incidents reported in 2012, set out above, 39 were brought to management's attention through whistleblowing reports from employees, ex-employees, third parties or unknown individuals reporting anonymously (2011: 19).

Political contributions

The Audit Committee is responsible for reviewing donations made for political purposes throughout the Group. No donation was made in 2012 to any political party registered in the UK under the Political Parties, Elections and Referendums Act 2000. Subsidiaries of the Company incorporated in the following countries made contributions to non-EU political parties in their respective countries totalling £5,583 (2011: £209,104):

Country	Amount	Description
Samoa	£604	Sponsored dinner tables at separate functions held by the two main political parties in Samoa, the Human Rights Protection Party and Tautua Samoa Party
South Africa	£4,979	Sponsored dinner table at the African National Congress' National Elective Conference

The Company's current authority to make donations to EU political organisations and to incur political expenditure expires on 25 April 2013. Although neither the Company nor its subsidiaries have any 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 in the interests of the Company or its subsidiaries to do so or where expenditure may be categorised as such.

Accordingly, shareholders' authority will be sought at the AGM on 25 April 2013 to renew the existing authority, but for a shorter duration (one year, instead of four as previously) and at a lower level (£100,000, instead of £1,000,000 as previously). Full details are set out in the Notice of Meeting.

Audit and accountability (continued)

Risk management and internal control

Board oversight

The Board is responsible for determining the nature and extent of the significant risks that the Group is willing to take to achieve its strategic objectives and for maintaining sound risk management and internal control systems. With the support of the Audit Committee, it carries out a review of the effectiveness of the Group's risk management and internal control systems annually and reports to shareholders that it has done so. This review covers all material controls including financial, operational and compliance controls and risk management systems. As part of its review in 2012, the Board noted that despite a number of changes to the Group Risk Register, which demonstrated the dynamic process underpinning it, the Group's risk profile remained stable.

Overview

The Company maintains its system of risk management and internal control with a view to safeguarding shareholders' investment and the Company's assets. It is designed to identify, evaluate and manage risks that may impede the achievement of the Company's business objectives. It cannot, and is not designed to, eliminate them entirely. The system therefore provides a reasonable, not absolute, assurance against material misstatement or loss. A description of the key risk factors that may affect the Group's business is provided in the business review.

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

Audit and CSR committee framework

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

The Group's regional audit and CSR committees (which are all chaired by an Executive Director and attended by one or more of the Non-Executive Directors) 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 corporate audit committee focuses on the risks and the control environment within the Group's operations that do not fall within the regional committees' remit, for example head office central functions, global programmes and above-region projects. It comprises members of the Management Board and is chaired by the Chief Executive and attended by one or more of the Non-Executive Directors.

The relevant external and internal auditors regularly attend meetings of these committees and have private audiences with members of the committees after every meeting. 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

Risk registers, based on a standardised methodology, are used at Group, regional, area and individual market level to identify, assess and monitor the key risks (both financial and non-financial) faced by the business at each level. Information on prevailing trends, for example whether a risk is considered to be increasing or decreasing over time, is provided in relation to each risk and all identified risks are assessed at three levels (high/medium/low) by reference to their impact and likelihood. Mitigation plans are required to be in place to manage the risks identified. The risk registers and mitigation plans are reviewed on a regular basis. Regional and above-market risk registers are reviewed regularly by the relevant regional audit and CSR committee or the corporate audit committee, as appropriate.

At Group level, specific responsibility for managing each identified risk is allocated to a member of the Management Board. The responsible Management Board member is identified in relation to each risk set out in the key Group risk factors section of the business review. The Group risk register is reviewed regularly by a committee of senior managers, chaired by the Finance Director, and twice yearly by the Corporate Committee. In addition, it is reviewed annually by the Board and twice a year by the Audit Committee. The Board and each such committee reviews changes in the status of identified risks, assessing the impact of changes in impact and likelihood, and the Audit Committee also spends time focusing on selected key risks in detail.

Internal control processes

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

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

Internal audit function

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

Financial reporting controls

The Group has in place a series of policies, practices and controls in relation to the financial reporting and consolidation process, which are designed to address key financial reporting risks, including risks arising from changes in the business or accounting standards. The Group Manual of Accounting Policies and Procedures sets out the Group accounting policies, its treatment of transactions and its internal reporting requirements. The internal reporting of financial information for the purpose of preparing the Group's financial statements quarterly, half-yearly and at the year-end is signed off by the heads of finance responsible for the Group's markets and business units. In addition, the heads of finance responsible for the Group's markets and all senior managers are required to confirm annually that all information relevant to the Group audit has been provided to the Directors and that reasonable steps have been taken to ensure full disclosure in response to requests for information from the external auditors.

The effectiveness of the Group's financial reporting controls is assessed through self-certification as part of the Control Navigator exercise described above and evaluation by internal audit in the context of the annual audit plan. The integrity of the Group's public financial reporting is further supported by a number of processes and steps to provide assurance over the completeness and accuracy of the content, including:

- review by the Chairman, Executive Directors and members of the Management Board;
- review and recommendation by the Audit Committee; and
- review and approval by the Board.

Annual review

The Turnbull Guidance (the Guidance) sets out best practice on internal control for UK-listed companies to assist them in assessing the application of the Code's Principles and compliance with the Code's Provisions with regard to risk management and internal control. The processes described above, and the reports that they give rise to, enable the Board and the Audit Committee to monitor the risk management and internal control framework on a continuing basis throughout the year and to review its effectiveness at the year-end. The Board, with advice from the Audit Committee, has completed its annual review of the effectiveness of the system of risk management and internal control for 2012. No significant failings or weaknesses were identified and the Board is satisfied that, where areas for improvement were identified, processes are in place to ensure that remedial action is taken and that progress is monitored. The Board is satisfied that the system of risk management and internal control is in accordance with the Guidance.

Corporate social responsibility

CSR Committee

Current members

Karen de Segundo (Chairman)
Christine Morin-Postel
Sir Nicholas Scheele
Dr Richard Tubb (with effect from 28 January 2013)

Attendance at meetings in 2012

Name	Attended/Eligible to attend
Karen de Segundo	4/4
Ann Godbehere[2]	2/2
Christine Morin-Postel[1]	2/2
Dr Gerry Murphy[2]	1/2
Kieran Poynter[2]	2/2
Sir Nicholas Scheele[1,3]	2/2

Notes:

1 Christine Morin-Postel and Sir Nicholas Scheele became members with effect from 26 April 2012.

2 Ann Godbehere, Dr Gerry Murphy and Kieran Poynter ceased to be members on 26 April 2012.

3 Sir Nicholas Scheele will cease to be a member on 25 April 2013 upon his retirement as a Non-Executive Director.

Dr Gerry Murphy was unable to attend one meeting of the CSR Committee due to a conflicting business engagement.

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

The CSR Committee is authorised to seek the information it requires from, and require the attendance at any of its meetings of, any Director or member of management, and all employees are expected to cooperate with any request made by the Committee. It is authorised by the Board to obtain, at the Company's expense, 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.

Summary Terms of Reference

The CSR Committee is responsible for:

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

The Committee's terms of reference are available at www.bat.com/governance.

Committee evaluation

The Committee considered a report prepared by the Company Secretary on the effectiveness of the Committee as assessed during the evaluation of the Board in 2012. While the Committee was considered to be functioning well, a number of action points were identified:

Action points

Committee focus and forward agenda: Less focus on in-depth country presentations and increased focus on regulation and harm reduction (the Committee also finalised its forward agendas for 2013 in light of these new areas of focus).

Peer review: A review of how the Company compares to its industry peers in terms of delivery and reporting of its CSR agenda (this is scheduled for 2013).

Committee composition: The addition of a member with scientific background would augment the Committee's skillset (Dr Richard Tubb was appointed to the Committee in January 2013).

CSR governance

The Committee is supported at regional and local levels through combined audit and CSR committees. The structure supports the embedding of CSR and sustainability principles across the Group and allows performance against those principles to be monitored. The regional audit and CSR committees meet three times annually, and they follow a standard agenda, in order that materials and issues that are presented and raised at local and regional level may feed into Board level discussions and vice versa.

Key activities of the CSR Committee in 2012

The CSR Committee held four scheduled meetings in 2012, including a meeting held at the end of February to review and give final approval to the Company's annual Sustainability Report. Other items considered by the Committee included:

CSR governance

- Feedback and update reports from the regional audit and CSR committees and consideration of CSR-related internal audit reports and recommendations, including in relation to the organisation of the Group's approach to environmental, health and safety issues.
- A continuing review of the potential reputational impact arising from incidents of non-compliance with the Standards of Business Conduct.

CSR policies and compliance

- Potential risks in the countries where the Group does business that are of potential concern from a human rights perspective and the measures and controls in place to mitigate those risks.
- Environmental, health and safety measures, including consideration of the 2012 performance data, to promote a safety behaviour culture throughout the Group, the recommendation for adoption by the Board of a revised Group Environmental Policy and the setting of new environmental targets.
- Adherence to the Group's International Marketing Standards (IMS) and the recommendation for adoption by the Board of the new International Marketing Principles, which replace the IMS and reflect developments in marketing, technology, regulation and stakeholder expectations.
- A review of the current third term of the Biodiversity Partnership with three non-governmental organisations – the Tropical Biology Association, Earthwatch and Fauna & Flora International – focusing on biodiversity in agricultural landscapes and the ecosystems on which they depend in key areas where the Group sources leaf.
- Adherence to the Group's global approach to youth smoking prevention (YSP), a review of the list of targeted markets for YSP focus and of YSP-related activities.
- A review of the Group's corporate social investment activities and plans for new guidelines on the focus of spend.

Sustainability planning and reporting

- Central and local stakeholder dialogue activities during 2012 and plans for dialogue activities in 2013.
- A review of the 2011 Sustainability Report, including a summary of external feedback and endorsements, Ernst & Young LLP's Assurance Management report and approval for the Group's future approach to sustainability reporting.
- An assessment of the progress made against the 2011 sustainability goals and commitments.
- The re-engagement of Ernst & Young LLP to provide assurance services for a further one-year period.

Group sustainability agenda

The Group's sustainability agenda, based on feedback from stakeholders, aims to build value for shareholders and other stakeholders by addressing our social, environmental and economic impacts. This concept of sustainable value underpins all of the Group's sustainability activities.

The sustainability agenda is an integral part of delivering the Group strategy and focuses on five key impact areas:

Harm reduction: Striving to bring commercially viable, consumer acceptable reduced-risk products to market;

Marketplace: Upholding high standards of corporate conduct within our marketplace;

Environment: Actively addressing the impact of the Group's business on the natural environment;

Supply chain: Working for positive social, environmental and economic impacts in the Group's supply chain; and

People and culture: Working to ensure we have the right people and culture to meet the Group's goals.

Statement of Business Principles

The Group's Statement of Business Principles sets out the expectations for the responsible management of the Group's business. It was developed in 2002 in consultation with stakeholders, supported by the Institute of Business Ethics. The Statement comprises three principles – Mutual Benefit, Responsible Product Stewardship and Good Corporate Conduct – and 18 Core Beliefs that explain in more detail what each principle means for the Group. It is available on www.bat.com.

Human rights

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. Our approach to human rights draws on the OECD Guidelines, in addition to the UN Declaration of Human Rights and further information in this respect is provided in our Sustainability Summary and at www.bat.com.

Corporate social responsibility (continued)

Sustainability reporting

The Company has produced independently assured reports since 2001 and believes this long history of reporting demonstrates a serious commitment to corporate responsibility and sustainability.

The Company was the first tobacco company to begin reporting on social, environmental and economic performance. From the outset, a robust and rigorous approach has been applied to the Group's reporting processes at both Group and local level. This included following the AA1000 Assurance Standard and Global Reporting Initiative (GRI) guidelines and includes independent assurance of all reports and engagement with stakeholders through independently facilitated stakeholder dialogue sessions.

This approach has allowed the Company to meet greater demands for corporate transparency. Dialogue has helped the Company to take stakeholder views into account, enabling better business decisions. Independent assurance has been essential in supporting this commitment to continuous improvement.

In 2013, the approach to reporting will change with a shift away from an annual Sustainability Report to producing shorter, more focused sustainability communications throughout the year. This includes a Sustainability Summary, published alongside the 2012 Annual Report, covering the Company's performance and key issues for the business and stakeholders. This will be supported by the publication of periodic issue-specific reports from 2013 onwards to provide stakeholders with more in-depth information on the topics that are of most interest to them. This will be complemented by additional sustainability information on the Group's corporate website, www.bat.com.

External recognition

In 2012, British American Tobacco was included in both the Dow Jones Sustainability World and Europe Indexes for the 11th year running. The Indexes track the economic, environmental and social performance of leading sustainability-driven companies worldwide. The Company's overall score was 88%, maintaining our place as industry leader.

The Company was ranked 5th overall out of 127 European companies for addressing biodiversity impacts in a new report by European ratings agency, Vigeo, scoring highest in the 'efficiency of measures' category. We featured in the Carbon Disclosure Project's Carbon Disclosure Leadership Index, with a score of 86%. This index highlights those companies in the FTSE 350 Index that have shown the most professional approach to managing and disclosing their climate change impacts.

The Company was ranked in the top quartile of companies in Transparency International's "Transparency in Corporate Reporting: Assessing the World's Largest Companies" study. We were also ranked second in the FTSE 350 for our approach to sustainability assurance in the annual Carbon Smart ranking of assurance practices, and were highly commended at PricewaterhouseCoopers' annual Building Public Trust Awards for 'People Reporting in the FTSE 100'.

Corporate social investment

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

Guidance on selecting, managing and evaluating major CSI activities is provided to Group companies, however, it is recognised that local community needs are as diverse as the communities themselves. As a result, within both the parameters of this guidance and the guidelines on focus of spend as agreed during 2012, CSI is managed at a local level to ensure the most appropriate projects are supported.

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

Charitable contributions

Payments for charitable purposes in 2012 amounted to £11.6 million (2011: £13.7 million), £1.8 million of which was paid in the UK (2011: £1.9 million).

Appointments to the Board

Nominations Committee

Current members

Richard Burrows (Chairman)
Sir Nicholas Scheele
Karen de Segundo
Ann Godbehere
Robert Lerwill
Christine Morin-Postel
Dr Gerry Murphy
Kieran Poynter
Anthony Ruys
Dr Richard Tubb (with effect from 28 January 2013)

Attendance at meetings in 2012

Name	Attended/Eligible to attend
Richard Burrows	4/4
Sir Nicholas Scheele[1]	4/4
Karen de Segundo	4/4
Ann Godbehere	4/4
Robert Lerwill[1]	4/4
Christine Morin-Postel	4/4
Dr Gerry Murphy	4/4
Kieran Poynter	4/4
Anthony Ruys	4/4

Notes:

1 Sir Nicholas Scheele and Robert Lerwill will cease to be members following their retirement as Non-Executive Directors at the conclusion of the AGM on 25 April 2013.

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

The Nominations Committee is responsible for identifying candidates to fill vacancies on the Board. This process includes an evaluation of the skills and experience to be looked for in candidates to ensure continuing Board balance and relevant experience. The selection process will generally involve interviews with a number of candidates, using the services of external search firms specialising in board level recruitment to identify and shortlist appropriate candidates. This process was followed for the recruitment of Dr Richard Tubb, who was shortlisted by an external consultancy and interviewed by the Chairman and Executive Directors, and members of the Nominations Committee, which then recommended his appointment to the Board. Further non-executive appointments remain under active consideration.

Summary Terms of Reference

The Nominations Committee is responsible for:

– reviewing the structure, size and composition of the Board and Management Board to ensure that both have an appropriate balance of skills, expertise, knowledge and (in the case of the Board) independence;
– reviewing the succession plans for the Executive Directors and members of the Management Board;
– ensuring that the procedure for appointing new Directors is rigorous and transparent and that appointments are made on merit against objective criteria and with due regard for the benefits of diversity, including gender diversity;
– making recommendations to the Board on suitable candidates for appointment as Board Directors or as members of the Management Board; and
– assessing the time needed to fulfil the roles of Chairman, Senior Independent Director and Non-Executive Director, and ensuring that Non-Executive Directors undertake that they will have sufficient time to fulfil their duties.

The Committee's terms of reference are available at www.bat.com/governance.

Committee evaluation

The Committee considered a report prepared by the Company Secretary on the effectiveness of the Committee as assessed during the evaluation of the Board in 2012. While the Committee was considered to be functioning well, the Committee agreed the following action point.

Action point

Meetings: Review frequency of meetings and regular agenda items.

The Committee noted that further work aimed at improving gender diversity at senior management level was in hand and progress would be monitored. Further details and commentary on diversity are included in the Board evaluation section of the corporate governance statement.

Terms of appointment to the Board

The Executive Directors have rolling contracts of one year. The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment. All Non-Executive Directors have terms of appointment of one year only, which are considered for renewal around the time of the Company's AGM when, in accordance with the UK Corporate Governance Code, each Director is subject to election or re-election by the shareholders (see below). Details of the Company's policy on Executive Directors' service contracts and the terms of appointment for Non-Executive Directors are set out in the remuneration report.

Appointments to the Board (continued)

Key activities of the Nominations Committee in 2012

The Nominations Committee held four meetings during 2012, two of which were scheduled and two of which were convened to address Board and Management Board succession issues. The other specific items considered by the Committee included:

– revised standard terms of appointment for Non-Executive Directors, updated to make clear that a minimum time commitment of 30 days per year was likely to be required in the first year of service to take into account the time required for a full Board induction, and that telephone attendance at Board meetings was permissible in exceptional circumstances;

– the recruitment of Dr Richard Tubb and his appointment to the Board as a Non-Executive Director, with the assistance of an external recruitment consultancy;

– the steps being taken to search for potential non-executive appointments, in particular a candidate with Asian experience;

– changes in the composition of the Management Board, including:

  – the departure of Mark Cobben and David Fell from the Management Board with effect from 31 December 2012;

  – the appointment of Jack Bowles, previously Regional Director, Americas, to the role of Regional Director, Asia-Pacific, with effect from 1 January 2013;

  – the appointment of Ricardo Oberlander to the role of Regional Director, Americas, with effect from 1 January 2013; and

  – the appointment of Naresh Sethi, previously Group Business Development Director, to the role of Regional Director, Western Europe, with effect from 1 January 2013.

A further review of succession planning for Executive Directors and for the Management Board will take place in April 2013.

The Board continues to take into account the need for it to refresh its membership progressively over time. Non-Executive Directors will normally be expected to serve for six years. They may be invited to serve for longer, but service beyond nine years is unlikely. Any additional service beyond six years is subject to rigorous review.

Directors' interests and indemnities

Further details of Directors' contracts and letters of appointment, remuneration and emoluments, and their interests in the shares of the Company (including interests in share options and deferred shares) as at 31 December 2012 are given in the remuneration report. No Director had any material interest in a contract of significance (other than a service contract) with the Company or any subsidiary company during the year.

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

Annual General Meeting 2013

At this year's AGM on 25 April 2013, the Company will be submitting all eligible Directors for re-election (all Directors, with the exception of Sir Nicholas Scheele and Robert Lerwill) and, in the case of Dr Richard Tubb, election for the first time.

The Company's Articles of Association provide that any Director who has been appointed by the Board since the last AGM is required to retire from the Board at the next AGM and, being eligible, may offer himself or herself for reappointment. Accordingly, Dr Richard Tubb will retire and offer himself for re-appointment in accordance with these provisions.

Non-Executive Directors who serve for a total of more than six years are subject to a particularly rigorous review. This has been done in 2012 and 2013 in the case of Anthony Ruys, who will have served for just over seven years at the time of the 2013 AGM. Robert Lerwill and Sir Nicholas Scheele, each of whom has served for eight years, will retire at the conclusion of the 2013 AGM.

The Chairman's letter accompanying the Notice for this year's AGM confirms that the performance of the Directors being proposed for re-election continues to be effective and that they continue to demonstrate commitment to their roles as Non-Executive Directors, including commitment of the necessary time for Board and Committee meetings and other duties. Biographical details of the Directors are also provided.

Remuneration report

Dear Shareholder

Regulatory changes

I became Chairman of the Remuneration Committee in April 2012, during a time of change in the regulatory landscape for the setting and reporting of directors' remuneration. In June 2012 the Business Secretary, Vince Cable, proposed reforms to the governance of executive pay and the Department for Business, Innovation and Skills (BIS) has also consulted on remuneration disclosures with regulations expected to be introduced for companies' reporting years ending on or after 1 October 2013.

This means that this remuneration report will be the last in the present format. In future, it is expected that it will be split into two distinct sections: a policy report and an implementation report. The aim is to allow shareholders access to better quality information that is more clearly set out and that demonstrates how executive remuneration directly links to each company's strategy and performance.

Our remuneration report in the past has been commended by a number of our shareholders for its detail, clarity and transparency; and we are working hard to continue to make sure that we meet our shareholders' expectations as well as comply with the new regulations. The Committee has set aside extra time in 2013 to review all aspects of our executive remuneration policies prior to shareholder consideration of the policy report at the AGM in 2014.

2012 in summary

Analysis of past performance

It is important that executive pay at British American Tobacco is aligned to the Company's performance. The Committee therefore asked its remuneration consultants to examine both the performance of the Company's incentive schemes as well as shareholder returns over the last five years to 31 December 2011. Their analysis looked at the recent payouts under the Long-Term Incentive Plan (LTIP) and International Executive Incentive Scheme (IEIS) and assessed these against analysts' forecasts at the time of awards. The analysis showed that total shareholder return of the Company over that period was 155% compared to 6% for the FTSE 100. With regard to both the LTIP and IEIS pay-outs, these had been in the median to upper quartile range over that five-year period, and had been above the upper quartile in the last three years.

This strong linkage between performance and reward demonstrates that our remuneration policies and the associated reward packages for Executive Directors and members of the Management Board are, indeed, closely aligned to the delivery of the Group's strategic goals. Over the same five-year period, the majority of our shareholders has supported our approach to remuneration and has given a positive advisory vote on the remuneration report (in 2012 with a 94.77% vote in favour).

Evaluation of the Remuneration Committee

During 2012, the Committee has continued to build on the conclusions of previous Board evaluations. The number of scheduled meetings was increased from two to three in 2012 (plus an additional ad hoc meeting) and it increases to four in 2013 with a detailed forward planning agenda being prepared. An internally facilitated evaluation of the Committee was conducted in 2012. Specific details are set out below but the key focus for me is the need for improved consultation with investors and other key stakeholders on our remuneration policies ahead of their presentation in the new style remuneration report and vote at the 2014 AGM. As the new Chairman of the Committee, I look forward to meeting a cross-section of shareholders and their representative bodies during the year to discuss these issues.

Dr Gerry Murphy
Chairman, Remuneration Committee

Remuneration report (continued)

Remuneration Committee

Current members

Dr Gerry Murphy (Chairman)
Ann Godbehere
Christine Morin-Postel
Kieran Poynter

During the year ended 31 December 2012, the Remuneration Committee comprised all of the Non-Executive Directors of the Company. Dr Gerry Murphy succeeded Anthony Ruys as Chairman of the Committee with effect from the conclusion of the Annual General Meeting on 26 April 2012.

Karen de Segundo, Robert Lerwill, Anthony Ruys and Sir Nicholas Scheele all stood down as members of the Remuneration Committee with effect from 27 February 2013. Dr Gerry Murphy (Chairman of the Remuneration Committee), Ann Godbehere, Christine Morin-Postel and Kieran Poynter will all continue as members of the Committee; the slimmed-down membership brings this Committee into alignment with the other principal Committees of the Company's Board and with best practice. It will facilitate the Company's continuing review and focus on Directors' remuneration in the light of the Government's reforms on executive pay.

At the date of this report the Committee comprises the independent Non-Executive Directors of the Company as set out in the box above.

Attendance at meetings in 2012

Name	Attended/Eligible to attend
Gerry Murphy	4/4
Karen de Segundo	4/4
Ann Godbehere[1]	3/4
Robert Lerwill	4/4
Christine Morin-Postel	4/4
Kieran Poynter	4/4
Anthony Ruys	4/4
Sir Nicholas Scheele	4/4

Note:

1 Ann Godbehere was unable to attend a meeting due to a conflicting long-standing prior engagement.

No Executive Director or Management Board member plays any part in determining his or her own remuneration. In determining remuneration for the year, the Committee considered reports from Deloitte LLP, the Committee's remuneration consultants, and also consulted the Chief Executive, the Group Human Resources Director and the Group Head of Reward.

The Remuneration Committee is authorised by the Board to seek any information it requires from, and require the attendance at any of its meetings of, any Director or member of management. During the year ended 31 December 2012, both the Chief Executive and the Chairman were consulted and invited to attend meetings of the Committee.

The Committee is authorised by the Board to obtain, at the Company's expense, outside legal or other independent professional advice. During the year, Deloitte provided remuneration services and advice to the Remuneration Committee at a cost of £270,150 (2011: £101,800). In 2012, these services included additional comparator group analysis of the performance of the Company's incentive schemes over the last five years and attendance at associated meetings including briefing sessions for the recently appointed Group Human Resources Director and Chairman of the Remuneration Committee. Deloitte is an international professional services firm which, during the year, has also provided tax, corporate finance and consulting services to British American Tobacco Group companies around the world. Deloitte is also a member of the Remuneration Consultants' Group and a signatory to the voluntary code of conduct in relation to executive remuneration consulting in the UK.

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

Summary Terms of Reference

The Remuneration Committee is responsible for:

- setting executive remuneration policies covering salary and benefits; performance-based variable rewards; pensions; and the terms of service contracts;
- determining, within the terms of the agreed policy, the specific remuneration packages for the Chairman, the Executive Directors and the members of the Management Board, both on appointment and on review and, if appropriate, any compensation payment due on termination of appointment;
- the setting of targets applicable for the Company's performance-based variable reward schemes and determining achievement against those targets, exercising discretion where appropriate and as provided by the applicable scheme rules; and
- monitoring and advising the Board on any major changes to the policy on employee benefit structures for the British American Tobacco Group.

The Committee's current terms of reference are available on www.bat.com/governance.

Remuneration Committee evaluation 2012

Process – the Remuneration Committee was the subject of an in-depth, externally facilitated, evaluation in both 2010 and 2011. In 2012 the Company Secretary conducted an internal evaluation into the effectiveness of the Committee, including a review of the action points raised over the previous two years. Overall, the Committee is considered to be effective in discharging its obligations and fulfilling its remit.

Findings, action points and progress – these developments build upon the 2011 evaluation and are set out below:

Number and structure of meetings

Finding	Action points/progress
The Committee had already increased its scheduled meetings as a result of the previous year's evaluation and revised its calendar of agenda items.	The number of formal meetings has also been increased again to four scheduled meetings in 2013 and additional time has been allocated for those meetings. This reflects a revised and expanded agenda which allows the Committee to plan for the new regulatory environment and disclosures required in 2014.

Remuneration policy and strategy

Finding	Action points/progress
The Group's approach to its reward strategy has been to keep it as simple and as straightforward as possible.	This approach is unlikely to change but the Committee is keen to ensure that the reward strategy remains closely aligned with the Group's business strategy as it is evolving.

Consultation with institutional shareholders

Finding	Action points/progress
This is currently organised on an ad hoc basis although the Chairman of the Company, Richard Burrows, regularly meets with shareholders and discusses remuneration issues with them.	With the new regulatory framework being introduced the Committee recognises that a more formalised approach may be necessary and indeed welcomed by shareholders. During 2013, the Committee will be considering how best to consult with shareholders.

Key activities of the Remuneration Committee in 2012

The Remuneration Committee met four times during 2012: three scheduled meetings in February, July and October and an ad hoc meeting in December. The Committee followed its regular work programme in respect of which it:

- benchmarked, reviewed and set the salaries for the Executive Directors and the Management Board members taking into account the pay and employment conditions elsewhere in the Group, and particularly in the UK;
- assessed the achievement of the targets for the 2011 IEIS award and set the IEIS targets for 2012;
- assessed the measurement of the performance conditions for the vesting of the LTIP 2009 award;
- determined the LTIP awards for March 2012 for the Executive Directors and members of the Management Board and the general LTIP population and their associated performance conditions;
- assessed the achievement of the targets for the 2011 Share Reward Scheme award and set the targets for the 2012 award;
- monitored the continued application of the Company's shareholding guidelines for the Executive Directors and the Management Board members;
- maintained oversight of the Group's salary review processes to ensure consistency of application;
- reviewed the remuneration report for the year ended 2011 prior to its approval by the Board and subsequent approval by shareholders at the AGM in April 2012; and

Remuneration report (continued)

– conducted a preliminary review in October 2012 of the current remuneration policy and approach for the review of salaries scheduled for February 2013, including specific changes to the constituents of the Pay Comparator Group.

In addition, the Remuneration Committee considered the following:

– an analysis of the voting patterns in respect of the advisory vote on the Company's remuneration report over the last five years;
– an examination and analysis of shareholder returns and the performance of the Company's incentive schemes over the last five years looking in particular at the returns compared to the FTSE 100 and the payouts under the LTIP and IEIS including an assessment of these against analysts' forecasts at the time of the awards;
– the terms of appointment and termination in connection with Management Board appointments and departures during the year;
– the Chief Executive's Brazilian pension entitlements – the Fundação Albino Souza Cruz (FASC);
– a proposal to allow senior managers (including certain members of the Management Board) impacted by the UK pension tax on pension accruals over £50,000 per annum, to opt to exchange the current allowance of 20% of salary in excess of 95% of the pension scheme's salary cap, for a 1/60th accrual defined benefit promise in the unfunded unapproved retirement benefit scheme (UURBS);
– certain changes to the Company car scheme and cash for car allowances for the Executive Directors and Management Board members (which had significantly fallen below median since last reviewed in January 2006) with effect from 1 April 2012 in tandem with parallel equivalent changes for the UK eligible population;
– a number of briefing notes regarding the voting guidelines of the Company's largest shareholders together with updates on the reforms of the Department of Business Innovation & Skills (BIS) on executive pay and the related draft regulations;
– for the IEIS, the introduction of an extended definition of the Global Drive Brand volume metric to include volume targets for the Fine Cut tobacco category in Western Europe at a local end market level for specific markets only; and
– a review of the report on the effectiveness of the Remuneration Committee as outlined above.

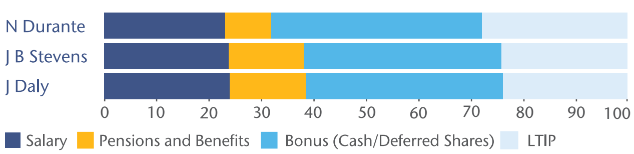
Remuneration policy

Group reward strategy: a straightforward approach

The Company continues to apply a simple, straightforward and understandable approach to remuneration. The remuneration package comprises core fixed elements (base salary, pension and other benefits) and two performance-based variable elements (a single cash and share incentive annual bonus plan (IEIS), and a single long-term incentive scheme (LTIP)) with the performance-based elements forming approximately 60% of the total remuneration package. This simple remuneration structure is expected to continue although the Remuneration Committee will review the policy elements applicable to the IEIS and LTIP during 2013 ahead of the presentation of the full remuneration policy to shareholders at the AGM in 2014.

The Remuneration Committee may, within the limits of the rules of the IEIS and LTIP, exercise its discretionary powers in the determination of a bonus or incentive award and later in its assessment of the applicable performance conditions resulting in the respective payout or vesting under those incentive schemes. It is rare that the Committee exercises this discretion as it will ordinarily rely on the actual performance outcomes in its assessment of the Company's performance.

Executive Directors' percentage of fixed and variable remuneration



Key performance indicators

Financially based Group key performance indicators (KPIs) linked to the Group's strategy form the majority of the performance-related bonus metrics with market share being an important additional non-financial indicator. The Executive Directors and the members of the Management Board are also held accountable for their performance in respect of other business measures comprising a mixture of other financial and non-financial targets. Payouts and grants under the respective incentive schemes are directly linked to the Company's objectives, achieving a high level of alignment with the long-term interests of the Company and its shareholders.

Fixed and variable remuneration

The current Executive Directors' percentage of fixed and variable remuneration for 2012 is illustrated in the bar chart on this page. This is based on a number of assumptions: (1) base salary is annual salary; (2) pension represents the annual service cost to the Company as disclosed in accordance with IAS24; (3) benefits are core benefits such as car allowance, private medical and personal accident insurance; (4) bonus is the amount received for performance in 2012 delivered in cash and deferred shares; and (5) LTIP is the annualised expected value at 'target' performance of the long-term incentive award granted in 2012 expressed as a percentage of base salary. Fixed remuneration comprises: salary, pension and benefits. Variable remuneration comprises: bonus (cash and deferred shares) and LTIP.

Incentive schemes: verification of performance

The Company's strategy clearly underpins the remuneration policy for all employees. In particular, performance criteria for the IEIS are aligned to the Group's KPIs (see business review). Awards under the LTIP only vest to the extent that total shareholder returns and earnings per share have met appropriate thresholds. The design of the IEIS and its positioning as the Company's sole bonus scheme means that the risk of inappropriate individual behaviours driving reward opportunities is minimised. The methodology used and the calculations performed in determining the annual outcomes of the IEIS's four performance measures are reported on by the external auditors. Further, internal audit also provides a relevant control framework (see audit and accountability in the corporate governance section). The Remuneration Committee is therefore confident that there are clear processes in place to provide sufficient comfort that the Company only rewards verified performance.

Remuneration comparator group

The setting of remuneration for Executive Directors remains underpinned by responsible assessment against a comparator group. The approach is focused on a peer group made up of companies that meet the criteria of a consumer goods focus, an international spread of operations and a competitor for top management talent. It includes selected FTSE 100 companies and, the Group's key competitor, Philip Morris International (the Pay Comparator Group). This is supplemented by market data of listed companies of a similar size and complexity to the Company, as well as the practice of the FTSE 30 companies. The Pay Comparator Group as at 31 December 2012 is set out below.

AstraZeneca	Reckitt Benckiser
BP	Reed Elsevier
BT Group	Royal Dutch Shell
Diageo	SABMiller
GlaxoSmithKline	Tesco
Imperial Tobacco Group	Unilever
Pearson	Vodafone
Philip Morris International	WPP Group

Changes for 2013

In October 2012, the Remuneration Committee reviewed the rationale for and the constituents of the Pay Comparator Group. It concluded that: (1) notwithstanding the Group's global business, the orientation of the current Pay Comparator Group towards UK listed companies remained appropriate; and (2) comparator companies Associated British Foods, British Sky Broadcasting and Marks & Spencer be removed on the grounds of a smaller level of market capitalisation and/or limited international scope, with the revisions being implemented in time for the 2013 salary review.

Salary

Purpose	– reward individual performance – reflect skills and experience – attract and retain key management talent
Delivery	– monthly – cash
Policy	– annual review in February (with salary changes effective from April) or ad hoc review on a significant change of responsibilities – reviewed against general pay trends and a company size and complexity model coupled with: (1) the Pay Comparator Group; and, for Executive Directors, (2) published salary data of listed companies of a similar size and complexity to the Company – reviewed against contextualised individual performance – base salary is pensionable
2012 update	– no change to policy – minor revisions to the Pay Comparator Group

Process

The process of salary review for the Executive Directors and the Management Board members takes into account outcomes arising from the salary review process for senior managers and other levels in the organisation. The Committee then applies the key policy principles set out in the table above.

Executive Directors – salaries	**Base salary from 1 April 2013 £**	Base salary at 1 April 2012 £
Nicandro Durante (Chief Executive)	**1,100,000**	1,050,000
Ben Stevens (Finance Director and Chief Information Officer)	**817,000**	782,000
John Daly (Chief Operating Officer)	**721,000**	690,000

Increases for 2013

The Management Board members in role will receive salary increases averaging around 3.9% and in the range from 2.1% to 5.3%; UK based employees will receive salary increases averaging around 3.5%, in each case with effect from 1 April 2013.

Benefits in kind

In addition to basic salary, the Executive Directors receive certain benefits in kind, principally: a car or car allowance; the use of a driver; the installation and then maintenance of home security systems; tax advice (where appropriate); and private medical and personal life and accident insurance. With effect from 1 February 2013, the Executive Directors and members of the Management Board were additionally eligible for general practitioner 'walk-in' medical services. With the exception of the car or car allowance it is also the practice of the Company to pay the tax that may be due on any such benefits.

Remuneration report (continued)

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

Purpose	– incentivise the attainment of corporate targets on an annual basis – attract and retain key management talent
Delivery	– annual award – 50% cash – 50% shares (deferred shares through the Deferred Share Bonus Scheme) – variable subject to Company's performance over preceding 12 months – dividend equivalent payment
Policy – referenced to strategic performance measures/key performance indicators (KPIs) as highlighted	– four measures for performance for 2012 with the following weightings: **adjusted profit from operations** (40%); **Group's share of key subsidiary markets** (20%); **Global Drive Brand volumes** (20%); and **cash flow from operations** (20%) – the annual 'on-target' bonus opportunity for the Chief Executive is 100% of base salary with a maximum award of 200% of salary, and for the Chief Operating Officer and the Finance Director and Chief Information Officer the 'on-target' bonus opportunity is 90% with a maximum award of 180% – for the Management Board the 'on-target' bonus opportunity is 67.5% of the base salary with a maximum award of 135% of salary – awards are non-pensionable
2012 update	– structure and potential bonus opportunity remain unchanged – review of IEIS scheduled for 2013 – a limited extension in 2013 to the definition of the Global Drive Brand volume metric

Operation of the IEIS

The IEIS rewards short-term business performance within the context of the Group's longer-term strategy. Appropriately stretching business and financial performance targets are set by the Remuneration Committee at the beginning of each year. The annual bonus opportunity for 2012 remained unchanged with four measures and associated weightings as set out above. These four performance measures provide a simple and appropriate mix of criteria that look to assess the vitality and performance of the Company while still providing full clarity for both shareholders and eligible participants about the required areas of performance.

Measures of performance

Relevant performance points for each of the four measures are: 'threshold' (which must be exceeded to attract any bonus payout in respect of that measure); 'target' (which amounts to the budgeted performance); and 'maximum' (the level of performance, exceeding budget, and at which the bonus payout for that measure is capped). No element of the bonus is guaranteed and, as in previous years, the specific performance targets are commercially sensitive and not made public.

Senior managers

For senior managers only the total payouts reflect performance at a global, regional, area or end market level, as applicable to their roles. The annual bonus opportunity for senior managers remained unchanged in 2012 with the annual 'on-target' bonus opportunity being 45% of base salary with a normal maximum award of 90% of salary rising to 135% of base salary in cases of excellent performance. The award for senior managers continues to be delivered in variable proportions split between cash and deferred shares according to grade.

Assessment of performance

In February each year, the Committee receives a report allowing it to assess the extent to which each of the performance measures has been achieved. Subject to the Committee exercising its judgment with regard to the Company's overall performance, the total payout is determined by the Company's performance for each measure relative to that measure's performance points.

Performance 2012

In respect of the year ended 31 December 2012, the performance against the measures and the total payouts under the IEIS were:

IEIS: measures of performance	Threshold	Between threshold and target	Target	Between target and maximum	Maximum
Performance in 2012 (2011):					
Adjusted profit from operations (40%)					✓(✓)
Group's share of key subsidiary markets (20%)			✓		(✓)
Global Drive Brands volumes (20%)				✓	(✓)
Cash flow from operations (20%)					✓(✓)

In respect of the year ended 31 December 2012, the total payouts under the IEIS are shown below. The actual performance-related payments are shown in Table 5 of the appendices to the remuneration report (annual cash bonus and deferred share bonus) on pages 89-91.

Payout: 50% in cash, 50% in deferred shares	2012 %	2011 %
Nicandro Durante (Chief Executive)	**170.1**	200.0
Ben Stevens (Finance Director and Chief Information Officer)	**153.1**	180.0
John Daly (Chief Operating Officer)	**153.1**	180.0
Management Board members	**114.8**	135.0

For senior managers whose bonus was linked to global performance the total payout under the IEIS in respect of the year ended 31 December 2012 was 102.1% (2011: 135%), paid 61.6% in cash and 40.5% in deferred shares.

IEIS 2013: revision

The introduction of an extended definition of the Global Drive Brand volume metric to include volume targets for the Fine Cut tobacco category in Western Europe at a local end market level for specific markets only. The introduction of this very specific target was driven by a combination of changing consumer behaviour allied with particular economic factors in that region and will have a marginal impact only on the targets set at Group level for the Global Drive Brand volume metric for the Executive Directors and members of the Management Board.

Deferred Share Bonus Scheme

Awards made under the Deferred Share Bonus Scheme are in the form of free ordinary shares in the Company that are normally held in trust for three years and no further performance conditions apply in that period. This element of 'reward deferral' has been a key element of the Company's bonus structure for a number of years and, in certain circumstances, such as resigning before the end of the three-year period, participants may forfeit all of 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 Share Bonus Scheme at the dividend record date.

Remuneration report (continued)

Long-term incentives

Purpose	– incentivise growth in earnings per share and total shareholder return (TSR) over a three-year period – attract and retain key management talent
Delivery	– discretionary annual award – awards of shares – variable subject to Company performance over three-year period – dividend equivalent payment
Policy – referenced to strategic performance measures/key performance indicators (KPIs) as highlighted	– maximum annual award of 400% of salary – three-year performance period – **TSR performance** (50% of the total award) combines both the share price and dividend performance during the three-year performance period as against two comparator groups (25% for each measure): (1) constituents of the FTSE 100 Index; and (2) a peer group of international FMCG companies – **earnings per share measure** (50% of the total award) relates to earnings per share growth (on an adjusted diluted basis) relative to inflation (measured as RPI)
2012 update	– no changes to the LTIP

The long-term element of remuneration continues to be delivered through the Company's LTIP. All the Executive Directors, Management Board members and senior employees participate in the Long-Term Incentive Plan adopted in 2007 (the 2007 LTIP). The 2007 LTIP provides for awards of free ordinary shares, provided demanding and appropriately stretching performance conditions are met over a three-year period.

Award levels

The current award levels for Executive Directors and Management Board members are set out in the table below. Senior managers receive awards of 75% or 25% of salary dependent on grade.

LTIP awards	**Multiple of base salary % 2012**	Multiple of base salary % 2011
Chief Executive	**400**	400
Finance Director and Chief Information Officer	**300**	300
Chief Operating Officer	**300**	300
Management Board	**200**	200

LTIP dividend payments

Since 2005, participants have been entitled to receive a dividend equivalent payment to the value of the dividends that they would have received as shareholders on their vesting awards. The LTIP dividend equivalent payment continues to be important in aligning further the interests of senior management with those of shareholders. The values of the LTIP dividend equivalent payments for the Executive Directors are shown as individual emoluments in Tables 4 and 5.

Following assessment by the Remuneration Committee, LTIP awards are normally exercisable after three years and only to the extent that the performance conditions are satisfied at the end of the three-year performance period. Any proportion of an award that lapses does not attract the payment of the LTIP dividend equivalent payment.

Performance

The percentage of award vesting is based on a combination of total shareholder return (TSR) and earnings per share (EPS) performance conditions measured over a three year period. The Remuneration Committee periodically reviews the suitability of TSR and EPS as performance measures. The Committee continues to ensure that the current combination of measures provides a balance relevant to the Group's business and market conditions as well as providing a common goal for the Executive Directors, the Management Board members and shareholders.

TSR performance condition

A total of 50% of the total award is based on the Company's TSR performance against two comparator groups (25% 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 both of the comparator groups, 50% of the total award vests in full. 6% of the total award vests for median performance. There is pro rata vesting between these two points. The TSR portions of an LTIP award do not vest for below median performance.

Comparator groups

These comparator groups, which are regularly reviewed to ensure that they will remain both relevant and representative, are chosen to reflect the Company's financial and business trading environments.

As at 31 December 2012, the following LTIP awards were outstanding and the applicable FMCG peer group in respect of each of those awards is shown below:

Outstanding LTIP Awards 31 December 2012	Award date	Vesting date
	28 March 2012	28 March 2015
	13 May 2011	13 May 2014
	25 March 2010	25 March 2013

FMCG peer group		
Anheuser-Busch InBev	HJ Heinz	Nestlé
Campbell Soup	Imperial Tobacco Group	PepsiCo
Carlsberg	Japan Tobacco	Pernod Ricard
Coca-Cola	Johnson & Johnson	Philip Morris International
Colgate-Palmolive	Kellogg	Procter & Gamble
Danone	Kimberley-Clark	Reckitt Benckiser
Diageo	Kraft Foods[1]	SABMiller
Heineken	LVMH	Sara Lee[2]
		Unilever

Notes:

1 Kraft Foods demerged into Kraft Foods Group and Mondelez International in October 2012; Mondelez International is now tracked.

2 Sara Lee Corporation completed the spin-off of DE Master Blenders 1753 and renamed the remaining business as Hillshire Brands. Neither of these new entities is tracked following the demerger.

Measurement of TSR

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

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

EPS performance condition

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

EPS targets

These EPS targets are consistent with and support the Company's strategy to deliver high single-digit EPS growth (on average) over the medium to long term. The Remuneration Committee considers that these current targets continue to be appropriately stretching.

Calculation of EPS

Growth in EPS for these purposes is calculated on an adjusted diluted EPS basis using a formula which incorporates: (1) an increase in adjusted diluted EPS between the base year and the final year of the performance period, expressed as an annual growth rate over the period; and (2) the annualised retail price (RPI) growth between the last month of the year immediately preceding the performance period and the last month of the final financial year of the performance period.

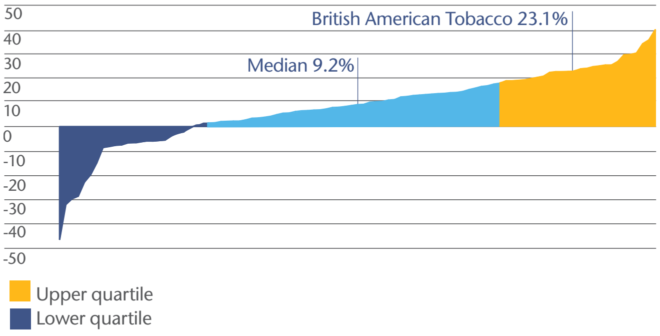
This method is considered to be a fair and reasonable measure of performance.

Vesting of LTIP award made in 2010

An LTIP award was made to Executive Directors and Management Board members on 25 March 2010 with the performance period being completed at 31 December 2012 (the 2010 Award). The Remuneration Committee has assessed the performance of the Company against the two performance conditions. On the TSR measure, the Company ranked 15th out of the FTSE 100 group of companies, giving a vesting of 25% for performance at the upper quartile. A vesting of 25% was also achieved for ranking fifth out of the peer group of international FMCG companies, this also being upper quartile. EPS growth was 6.5% per annum in excess of inflation. The overall assessment of both LTIP measures, therefore, resulted in a vesting of 87.1% of the award.

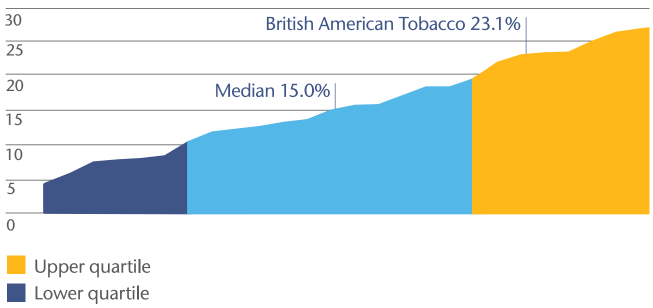
In accordance with the rules of the 2007 LTIP, the Remuneration Committee also resolved that the participants would receive an LTIP dividend equivalent payment on the vesting of their 2010 awards.

Total shareholder return (annual %)
FTSE 100 – 1 January 2010 to 31 December 2012
The FTSE 100 comparison is based on three months' average values

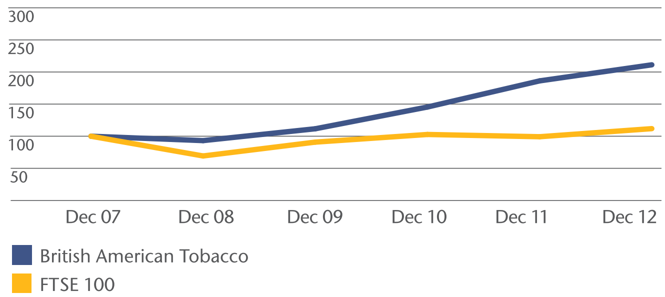


Remuneration report (continued)

Total shareholder return (annual %)
FMCG group – 1 January 2010 to 31 December 2012
The FMCG group comparison is based on three months' average values



Historical total shareholder return performance
Growth in the value of a hypothetical £100 holding over five years FTSE 100 comparison based on a 30 trading day average values



Long-Term Incentive Plan – vesting of past awards: years ended 2010 to 2012

The following table shows the vesting of the award made in 2010 in the context of the performance of LTIP awards vesting during the years ended 31 December 2010 to 31 December 2012, inclusive.

LTIP award date	25-Mar-10	27-Mar-09	15-May-08
Year ended	31-Dec-12	31-Dec-11	31-Dec-10
Performance period	2010/2012	2009/2011	2008/2010
Vesting date	25-Mar-13	27-Mar-12	15-May-11
TSR – FTSE 100 group of companies:			
Ranking – upper quartile	15	21	12
Percentage of vesting award	25	25	25
TSR – FMCG peer group:			
Ranking – upper quartile	5	5	2
Percentage of vesting award	25	25	25
Earnings per share growth:			
Percentage per annum above inflation	6.5	10.8	15.9
Percentage of vesting award	37.1	50	50
Total vesting percentage	87.1	100	100

Performance graph and historical total shareholder return performance

Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 requires that the Company must provide a graph comparing the TSR performance of a hypothetical holding of shares in the Company with a broad equity market index over a five-year period. In this context, the Directors have again chosen to illustrate the performance of TSR against the FTSE 100 Index over a five-year period, commencing on 1 January 2008. 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.

LTIP – clawback provision

Since 2011, the rules of the 2007 LTIP have given the Remuneration Committee the discretion to 'claw back' or reduce (or forfeit entirely) a participant's unvested award. This would be considered in circumstances where there had been a material mispresentation involving the participant in connection with a prior vested award.

LTIP – change of control

The rules of the 2007 LTIP provide that in the event of a change of control of the Company as a result of a takeover, reconstruction or winding up of the Company (not being an internal reorganisation), LTIP awards will become exercisable for a limited period based on the period of time 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 schemes

All-employee share schemes

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

Sharesave Scheme

The Sharesave Scheme is approved by HM Revenue & Customs (HMRC). Eligible employees, including the Executive Directors and Management Board members, have been granted employee savings-related share options to subscribe for ordinary shares in the Company. Options are granted to be exercisable in conjunction with either a three-year or five-year savings contract up to a monthly limit of £250. Options are normally granted at a discount of 20%

to the market price at the time of the invitation, as permitted under the rules of the Sharesave Scheme. At 31 December 2012, Nicandro Durante and Ben Stevens each held options under the Sharesave Scheme.

Employee Share Ownership Plan

The Employee Share Ownership Plan is an HMRC-approved share incentive plan, which incorporates a Partnership Scheme and a free shares element, the Share Reward Scheme.

Partnership Share Scheme

The Partnership Share Scheme is open to all eligible employees, including Executive Directors and Management Board members. Employees can allocate part of their pre-tax salary to purchase shares in the Company. The maximum amount that can be allocated in this way is £1,500 in any year. Shares purchased are held in a UK-based trust, normally capable of transfer to participants tax-free after a five-year holding period. At 31 December 2012, Nicandro Durante participated in the Partnership Share Scheme.

Share Reward Scheme

Under the Share Reward Scheme, eligible employees (including Executive Directors and members of the Management Board) receive an award of shares in April of each year in which the Scheme operates in respect of performance in the previous financial year. An award of £2,553 will be made to Executive Directors and Management Board members on 2 April 2013 in respect of the year ended 31 December 2012. The performance conditions are aligned to those set for the IEIS in respect of the same performance period. The plan shares are held in a UK-based trust for a minimum period of three years and during that time the trust will exercise its voting rights as directed by the plan's participants. The maximum individual award under the Share Reward Scheme is £3,000.

Options and awards outstanding

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

During the year, new ordinary shares were issued by the Company in relation to the Sharesave Scheme and to certain participants in the Share Option Scheme resident outside the UK. Under the Sharesave Scheme, a total of 806,406 options over ordinary shares in the Company were outstanding at 31 December 2012. The options outstanding under the Sharesave Scheme are exercisable until end October 2017 at option prices ranging from 1,360p to 2,536p.

The British American Tobacco Group Employee Trust (BATGET)

BATGET is used to satisfy the vesting and exercise of awards of ordinary shares made under the Deferred Share Bonus Scheme, the 2007 LTIP (and the predecessor Long-Term Incentive Plan, the 1998 LTIP) as well as the exercise of options under the Share Option Scheme. The number of shares held in BATGET to satisfy outstanding awards is consistently monitored by a committee of senior management that reports to the Board's Employee Share Schemes Committee.

Funding of the BATGET

BATGET is funded by interest-free loan facilities from the Company totalling £600 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 £538 million at 31 December 2012 (2011: £424 million). The loan is either repaid from the proceeds of the exercise of options or, in the case of ordinary shares acquired by BATGET to satisfy the vesting and exercise of awards, the Company will subsequently waive the loan provided over the life of the awards. If the options lapse, ordinary shares may be sold by BATGET to cover the loan repayment.

Ordinary shares held in the BATGET

Details of the ordinary shares in the Company held by BATGET are set out below.

	1 January 2012	**31 December 2012**
Number of ordinary shares	12,123,853	**10,520,098**
Market value of ordinary shares	£370.4m	**£328.3m**
Percentage of the issued share capital of the Company	0.59	**0.51**

BATGET currently waives dividends on the ordinary shares held by it. BATGET waived payment of the final dividend for 2011 of £10.3 million in May 2012 and the interim dividend for 2012 of £4.6 million in September 2012.

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

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

Shareholding guidelines

The Remuneration Committee's guidelines require Executive Directors to hold shares in the Company equal to the value of a percentage of salary as set out on page 80 and exclude shares earned but not yet vested under Company share incentive plans. Management Board members are also required to hold shares in the Company equal to the value of 100% of their salary. These guidelines are a practical way in which executives are encouraged to build up a high level of personal shareholding to ensure alignment of interest with shareholders.

Remuneration report (continued)

Executive Directors – shareholding guidelines

Executive Director	Required percentage of base salary	Number of eligible ordinary shares held at 31 December 2012	Value of eligible ordinary shares held at 31 December 2012 £	Actual percentage of base salary at 31 December 2012
Nicandro Durante (Chief Executive)	300	150,713	4,703,753	448
Ben Stevens (Finance Director and Chief Information Officer)	200	57,977	1,809,492	231
John Daly (Chief Operating Officer)	200	48,306	1,507,630	218

Note:
The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 31 December 2012 was 3,121.00p

Transitional provisions are in place for those Executive Directors and Management Board members who do not meet the requirements of the shareholding guidelines upon appointment. In such cases, individuals may, generally, only sell a maximum of up to 50% 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 6 on page 92.

Executive Directors' pension benefits

Purpose	– provision of competitive post-retirement benefits – attract and retain key management talent
Delivery	– British American Tobacco UK Pension Fund and Company supplementary pension arrangements – relevant overseas arrangements – monthly/quarterly pension payment
Policy	– pension accrual does not exceed 1/40th of annual base salary – Fund normal pensionable age of 60 – maximum pension payable will not exceed two-thirds of base salary averaged over the preceding 12 months at age 60 – UK Pension Fund retains a scheme-specific cap – excess benefits over the scheme-specific cap and the statutory annual allowance (effective from the commencement of the pension input period from 1 October 2010) continue to be accrued within an unfunded unapproved retirement benefit scheme where possible

British American Tobacco UK Pension Fund

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

The Pension Fund, for members who joined before 1 April 2005, is a non-contributory defined benefit scheme. The early retirement rules in the Pension Fund permit a member to draw the accrued retirement pension within five years of Fund normal retirement age without actuarial reduction, subject to the employing company's agreement. Alternatively, an Executive Director may choose to leave and take a pension at any time on or after his or her 50th birthday without the employing company's agreement, subject to a reduction as determined by the Pension Fund trustee in conjunction with the Pension Fund actuary. Accrual rates differ according to individual circumstances but do not exceed 1/40th of pensionable salary for each year of pensionable service.

The Pension Fund, which closed its defined benefit section to new members with effect from 1 April 2005, has historically provided varying accrual rates for different levels of management reflecting the then current external market practice. The Pension Fund has approximately 800 active defined benefit members, 4% of which accrue at 1/40th of annual base salary consistent with that provided for the relevant Executive Directors; 13% of defined benefit members accrue at 1/48th with the remainder accruing at 1/60th of annual base salary. The practice of increasing accrual rates as individuals progress through the organisation was discontinued with effect from 1 July 2009.

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

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

British American Tobacco UK Pension Fund – John Daly and Ben Stevens

John Daly and Ben Stevens each joined the Pension Fund after 1989. As a result, prior to 6 April 2006, these individuals were subject to the HMRC cap on pensionable earnings (notionally £137,400 for the tax year 2012/13). In addition, each has an unfunded pension promise from the Company in respect of earnings above the cap on an equivalent basis to the benefits provided by the Pension Fund. This is provided through membership of an unfunded unapproved retirement benefit scheme (UURBS). Further to the changes to the applicable tax regulations, the pension accrual in the Pension Fund for John Daly has been restricted to the statutory annual allowance of £50,000 with the balance of approximately £4,960 being provided through the UURBS. Ben Stevens has reached the lifetime allowance of £1.5m and has therefore ceased accrual in the Pension Fund with all future benefits being provided through membership of the UURBS.

During the year, there has been no change to the overall pension entitlement of either Director.

These commitments are included in note 12 on the accounts. Members of the Pension Fund are entitled to receive increases in their pensions once in payment in line with price inflation (as measured by the Retail Prices Index) up to 6% per annum.

P J Carroll Directors' Plan – John Daly

John Daly was formerly a member of the P J Carroll Directors' Plan in Ireland. He is also entitled to a deferred benefit currently amounting to €108,382 per annum, payable from the age of 60. This benefit is scheduled to increase each year between January 2012 and December 2015 by the lower of 4% or the Irish Consumer Price Index. The increase amount is confirmed each year by the Minister of Social Protection in Ireland and for 2012 is based on average inflation which was assumed to be 1.70%.

Fundação Albino Souza Cruz (FASC) and UURBS – Nicandro Durante

Souza Cruz SA is a Brazilian registered company in which the Group has a 75% interest. Its shares are listed on the Sao Paulo stock exchange and the remuneration, reward and pensions policies and practices of Souza Cruz reflect those of the Brazilian corporate market.

At the beginning of 2012, Nicandro Durante's pension entitlements were as follows:

(1) Since December 1981, membership of the FASC in Brazil. This is a non-contributory defined benefit scheme and includes a spouse's death in service benefit equal to 37.5% of the member's prospective pension at normal retirement age. Accrual rates do not exceed 1.85% of basic salary (excluding bonus) averaged over the 12 months to normal retirement age, for each year of pensionable service. Nicandro Durante's Brazilian pensionable salary was reviewed by the Company annually with reference to the salary of that of a General Manager of Souza Cruz SA and adjusted annually by the same percentage as that applied to pensioners in receipt of benefits from the FASC. Benefits from the FASC remained subject to the rules of that scheme.

(2) Effective from 1 March 2006 (being the date of his appointment as a member of the Management Board) an accrual of 0.65% for each year of service (the UK Accrual Rate) on a basic sterling salary comparable to that of a General Manager of Souza Cruz SA; £706,850 per annum with effect from 1 April 2012. At retirement the pension will be based on a 12 months' average and will be provided through the UURBS.

(3) With effect from 1 January 2011 (being the date of his appointment as Chief Executive), Nicandro Durante commenced an accrual of 2.5% for each year of service on a basic salary in excess of that stated in (2) above. At retirement the pension is based on a 12 months' average and will be provided through the UURBS.

Following legislative changes to the applicable UK tax relief regulations in respect of members of overseas pension arrangements, Nicandro Durante decided, in the circumstances, to commence the receipt of his benefits from the FASC in Brazil with effect from 1 April 2012. The FASC pension benefits amount to approximately £410,000 per annum (after adjusting for currency exchange) reflecting Nicandro Durante's 31 years' service at Souza Cruz.

The decision to commence the receipt of the FASC pension benefits terminated the contractual rights that Nicandro Durante had in respect of his former employment with Souza Cruz. At the date of termination of the Souza Cruz contract, he received a single payment, long-service award of £106,918 in accordance with the terms of that agreement. Reference to the long-service award is also made in the section on Executive Directors' contracts.

Further, the Remuneration Committee ruled that any resulting tax charge for the period from 1 April 2011 to 31 March 2012 would be tax equalised by way of a non-recurring payment to Nicandro Durante; such amount to be determined following the confirmation of how the relevant tax regulations apply. No further compensation will be made or element of remuneration adjusted in lieu of further pension accrual in the FASC.

Remuneration report (continued)

Executive Directors' pension entitlements – audited

	Fund/Scheme	Normal retirement age	Total accrued pension at 31 Dec 2011 £	Total accrued pension at 31 Dec 2012 £	Gross increase/ (decrease) in accrued pension £	Increase/ (decrease) in accrued pension net of inflation £	Transfer value of net increase/ (decrease) in accrual over period £	Transfer value of accrued pension at 31 Dec 2011 £	Transfer value of accrued pension at 31 Dec 2012 £	Total change in transfer value during period £
Nicandro Durante	Fundação Albino Souza Cruz (FASC [6]– Brazil)	60	431,602	**409,674**	**(21,928)[3]**	**(41,659)**	**(669,527)**	6,393,456	**6,584,068**	**190,612[3]**
	UK: UURBS	60	33,654	**47,980**	**14,326**	**13,283**	**327,174**	848,279	**1,181,844**	**333,565**
Total			465,256	**457,654**	**(7,602)**	**(28,376)**	**(342,353)**	7,241,735	**7,765,912**	**524,177**
Ben Stevens	UK: Pension Fund and UURBS	60	231,047	**260,758**	**29,711**	**22,549**	**523,665**	5,532,318	**6,055,703**	**523,385**
John Daly	P J Carroll (Ireland)	60	89,775	**89,403**	**(372)[3]**			1,349,816	**1,552,437**	**202,621[3]**
	UK: Pension Fund and UURBS	60	119,167	**141,667**	**22,500**	**18,806**	**469,430**	3,042,458	**3,536,278**	**493,820**
Total			208,942	**231,070**	**22,128**	**18,806**	**469,430**	4,392,274	**5,088,715**	**696,441**

Notes:

1 The amount of total accrued pension is the pension that would be paid annually on retirement based on service to the end of the year, excluding any increase granted under statute before retirement.

2 The value of net increase in accrued pension represents the incremental value to the Executive Director of his service during the year, calculated on the assumption that service is terminated at the year-end.

3 Nicandro Durante's and John Daly's FASC and P J Carroll pensions are denominated in Brazilian real and euros respectively, and therefore the gross change in (1) accrued benefit and (2) transfer value includes the following amounts relating to currency exchange: Nicandro Durante (1) £50,738 decrease and (2) £751,591 decrease; and John Daly (1) £2,600 decrease and (2) £39,085 decrease.

4 The transfer value basis used for valuing benefits accrued in the UURBS is consistent with that used by the Trustee of the Pension Fund for the ongoing funding of the Pension Fund.

The transfer value basis used for valuing benefits accrued in both the FASC and P J Carroll schemes are consistent with relevant local practice in Brazil and Ireland. This is a change in approach and has resulted in the 2011 transfer values being restated, which more accurately reflects the level of assets required by the Group to fund the relevant pension entitlements (2011 previously reported total transfer values were: Nicandro Durante £11,727,318; and John Daly £5,334,521).

The transfer value basis reflects local market practice and conditions and is sensitive to local mortality assumptions, discount rates, inflation and the scheme pension increase policy. Transfer values do not represent sums payable to individual Executive Directors and, therefore, cannot be added meaningfully to annual remuneration.

5 The UK 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.

6 At the date of termination of the contractual rights that Nicandro Durante had in respect of his former employment with Souza Cruz SA and the commencement of the receipt of the FASC pension benefits (2 April 2012), he received a single payment, long-service award of £106,918 in accordance with the terms of that agreement.

Executive Directors' service contracts

Duration of contracts

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

The Remuneration Committee, however, has discretion to agree longer contracts in the event that an Executive Director is recruited externally or from overseas, when it may then be appropriate to offer a contract with an initial period of longer than one year, reducing to a one-year rolling contract after the expiry of the initial period. All of the current Executive Directors have a one-year rolling contract only.

Compensation payments – general

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 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 event that a contract is terminated for cause (such as gross misconduct), the Company may terminate the contract with immediate effect and no compensation would be payable.

Awards under share incentive schemes – status of leavers

Awards made under the Company's share incentive schemes will vest or transfer to an individual upon termination of their contract in accordance with the specific circumstances set out in the rules of the schemes. Such circumstances will include:

- death
- injury/disability
- ill-health
- redundancy (within the meaning of the applicable legislation).

In all other circumstances, the awards will lapse immediately unless the Remuneration Committee, in its absolute discretion, decides otherwise. The Committee exercises its discretion by reference to guidelines that set out a list of possible relevant factors to assist in the determination of a leaver's status. These include whether an individual:

- resigns from the Company to work for a competitor or to undertake a similar type of role to that carried out for the Company (indicative of discretion not to release awards);
- is dismissed for any reason such as misconduct or poor performance (indicative of discretion not to release awards);
- resigns intending to cease working altogether or to pursue a completely different career (indicative of discretion to release awards);
- delays their resignation from the Company to accommodate the Company's plans or the demands of their current workload (indicative of discretion to release awards);
- departs with the agreement of the Company (indicative of discretion to release awards).

In exercising its discretion, the Remuneration Committee will also take into account the individual's overall performance as well as their contribution to the Company during their period of employment. The Committee will not exercise its powers of discretion in such a way that it will discriminate against any individual on the grounds of that person's age, sex, sexual orientation, disability, race or religious belief.

Pension entitlements

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.

Nicandro Durante – former Brazilian contractual rights

Nicandro Durante has a service contract with the Company in the form outlined above. In addition, as a result of the application of local labour laws in Brazil, during the year Nicandro Durante retained certain termination or compensation rights in respect of his former employment with Souza Cruz SA (which had commenced in December 1981) until 2 April 2012.

These additional rights with Souza Cruz ended at the time when Nicandro Durante drew his pension from the FASC as outlined above. At the date of the termination of the Souza Cruz contract, Nicandro Durante received a single payment, long-service award of £106,918 in accordance with the terms of that agreement. No other compensation was payable in accordance with the termination of the Souza Cruz rights.

Remuneration report (continued)

Executive Directors – service contracts

Executive Director	Execution date of current service contract	Date first appointed to the Board	Date of last reappointment at AGM	Length of service as an Executive Director as at 2013 AGM (Years/Months)	Percentage vote in favour of re-election at 2012 AGM
Nicandro Durante	10 December 2010	1 January 2008	26 April 2012	5.4	99.98
Ben Stevens	26 March 2008	3 March 2008	26 April 2012	5.2	99.98
John Daly	24 October 2010	1 September 2010	26 April 2012	2.8	99.98

Executive Directors' external appointments

Policy

Executive Directors and members of the Management Board are able to accept one substantive external Board appointment provided that permission is respectively sought from the Board or Chairman. Any fees from such appointments are retained by the individual in recognition of the increased level of personal commitment required.

Current appointments

None of the Executive Directors or Management Board members currently holds such an appointment.

Reynolds American Inc

John Daly, an Executive Director of the Company, has been a non-executive director of Reynolds American Inc (RAI) since 1 December 2010. RAI is an associate undertaking of the Company and John Daly was designated by Brown & Williamson Holdings, Inc. (a wholly-owned indirect subsidiary of the Company), as its nominee to sit on the board of RAI. In accordance with present arrangements, the Group received a fee of US$271,980 from RAI (2011: US$237,000) in respect of John Daly's service in that role for the year ended 31 December 2012.

Non-Executive Directors' terms of appointment

The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment. In accordance with the requirements of the UK Corporate Governance Code, all Non-Executive Directors have terms of appointment of one year only which are considered for renewal around the time of the Company's AGM. Each Director is then subject to election or re-election by shareholders every year.

Length of service

The date of appointment, the most recent reappointment and length of service for each Non-Executive Director, together with the percentage of votes in favour of re-election at the 2012 AGM, are shown in the following table.

Non-Executive Directors – length of service	Date first appointed to the Board	Date of last reappointment at AGM	Length of service as a Non-Executive Director as at 2013 AGM (Years/Months)	Percentage vote in favour of re-election at 2012 AGM
Karen de Segundo	1 October 2007	26 April 2012	5.7	99.98
Ann Godbehere	3 October 2011	26 April 2012	1.7	99.74
Robert Lerwill	1 January 2005	26 April 2012	8.4	99.83
Christine Morin-Postel	1 October 2007	26 April 2012	5.7	99.91
Gerry Murphy	13 March 2009	26 April 2012	4.1	99.94
Kieran Poynter	1 July 2010	26 April 2012	2.10	99.94
Anthony Ruys	1 March 2006	26 April 2012	7.2	99.83
Sir Nicholas Scheele	28 February 2005	26 April 2012	8.2	99.74
Richard Tubb	28 January 2013	–	0.3	–

Termination

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 current fees structure for the Non-Executive Directors is:

	With effect from 1 Jan 2013 £	Jan-Dec 2012 £
Basic fee	**90,000**	90,000
Supplements:		
– Senior Independent Director	**30,000**	28,000
– Audit Committee Chairman	**30,000**	28,000
– CSR Committee Chairman	**25,000**	23,000
– Nominations Committee Chairman	**–**	–
– Remuneration Committee Chairman	**30,000**	28,000
Committee Membership Fees (not Chairmen):		
– Audit Committee	**6,250**	5,000
– CSR Committee	**6,250**	5,000
– Nominations Committee	**–**	–
– Remuneration Committee	**6,250**	5,000

Annual review

The fees for the Non-Executive Directors are considered annually and are determined in light of market best practice and with reference to the time commitment and responsibilities associated with the roles. The most recent review in October 2012, using external benchmarking and a related comparator group, concluded that: (1) the basic fee for Non-Executive Directors was above the upper quartile and therefore should remain unchanged; (2) the supplements paid to the Senior Independent Director and the Committee Chairmen had fallen behind the median; and (3) the fees paid for committee memberships were well below the median. The fees were revised as shown above with effect from 1 January 2013.

Aggregate limit

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

Travel and related expenses

Non-Executive Directors are generally reimbursed for the cost of travel and related expenses incurred by them as Directors of the Company in respect of attendance at Board, Committee and General meetings. In the instances where the cost of reimbursement of such expenses are classified as a benefit to the Director, it is also the practice of the Company to pay the tax which may be due on any such benefits. With effect from 1 February 2013, the Non-Executive Directors were eligible for general practitioner 'walk-in' medical services. They receive no other pay or benefits. It is the policy of the Board that the spouses of the Executive Directors and Non-Executive Directors may, from time to time, accompany the Directors to overseas or UK based Board meetings and otherwise at hospitality functions during the year. Spouses did not attend any such Board meetings in 2012.

Anthony Ruys – ITC Limited

Anthony Ruys has been a Non-Executive Director of ITC Limited (ITC) (an associate undertaking of the Company) since 20 January 2009. During the year ended 31 December 2012, Anthony Ruys received INR 740,000 (£8,309) in fees from ITC (2011: INR 720,000 (£8,724)). This amount is the subject of an annual supplement from a Group company so that he receives a total annual fee for this appointment of £75,000. Anthony Ruys also has an interest in options over shares in ITC – see Table 8 on page 97.

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.

Terms of appointment

Richard Burrows has been a Director of the Company since 1 September 2009 and has been Chairman of the Company from 1 November 2009. In common with the terms of appointment for the Non-Executive Directors, Richard Burrows has a term of appointment of one year only which is considered for renewal around the time of the Company's AGM each year unless the appointment is terminated earlier by: (1) the Company giving three months' notice or a discretionary compensation payment in lieu of notice; or (2) by him giving one month's written notice, with the Company having discretion to make a compensation payment in lieu of such notice. The compensation payment is limited to any fees which are payable for such part of the relevant notice period as the Board does not require him as Chairman to perform his duties.

Remuneration

The current terms of Richard Burrows' appointment provide for: (1) an annual fee of £600,000; (2) the use of a driver; (3) private medical insurance and personal accident insurance benefits; and (4) the reimbursement by the Company of the cost of return airline tickets to London from his home in Ireland in connection with his duties as Chairman. With effect from 1 February 2013, Richard Burrows was eligible for general practitioner 'walk-in' medical services. In common with the Non-Executive Directors, Richard Burrows does not participate in the British American Tobacco share schemes, bonus schemes or incentive plans and is not a member of any Group pension plan.

In February 2013, the Remuneration Committee reviewed the fees for the Chairman against practice in the FTSE 30:

	Fees from 1 April 2013 £	Fees at 1 April 2012 £
Richard Burrows (Chairman)	**620,000**	600,000

Copies of service contracts and terms of appointment

Copies of the Executive Directors' service contracts and the details of the terms of appointment of each Non-Executive Director and the Chairman are available for inspection during normal business hours at the Company's registered office and will also be available for inspection at the AGM on 25 April 2013.

Appendices to the remuneration report

Table 1: Aggregate emoluments – audited

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

	2012 £	2011 £
Salaries and fees	**3,971,718**	3,732,000
Benefits: cash and non-cash	**526,716**	868,923
Performance-related pay		
– cash bonus	**2,019,841**	2,260,000
– deferred share bonus	**2,019,841**	2,260,000
– DSBS and LTIP dividend equivalents	**916,114**	578,618
– Share Reward Scheme	**8,916**	7,767
Former Directors		1,051,593
Total	**9,463,146**	10,758,901

The figures shown for benefits in Tables 1 to 5 are shown as gross amounts as it is the normal practice of the Company to pay the tax which may be due on any benefits, with the exception of the car or car allowance.

Table 2: Fees of the Chairman – audited

Richard Burrows

	Fees £	Benefits £	2012 Total £	Fees £	Benefits £	2011 Total £
Total	**592,500**	**86,571**	**679,071**	558,750	112,673	671,423

Note:

Benefits comprise:	2012 £	2011 £
– health insurance	**11,667**	12,643
– use of a company driver	**60,935**	50,050
– maintenance of home security systems	**6,931**	8,939
– hotel accommodation and related expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events	**7,038**	41,041
Total	**86,571**	112,673

Appendices to the remuneration report (continued)

Table 3: Individual fees of the Non-Executive Directors – audited

	2012								2011		
	Board fees £	Senior Independent Director £	Audit Committee £	Remuneration Committee[4] £	CSR Committee £	Fees £	Benefits £	Total £	Fees £	Benefits £	Total £
K de Segundo	**90,000**			**5,000**	**23,000**	**118,000**	**107**	**118,107**	113,000	1,192	114,192
A Godbehere (from 3 Oct 2011)	**90,000**		**3,391**	**5,000**	**1,609**	**100,000**		**100,000**	23,750		23,750
R Lerwill	**90,000**		**28,000**	**5,000**		**123,000**	**3,896**	**126,896**	118,000	3,550	121,550
C Morin-Postel	**90,000**		**718**	**5,000**	**3,391**	**99,109**	**2,407**	**101,516**	95,000	920	95,920
G Murphy	**90,000**			**20,599**	**1,609**	**112,208**		**112,208**	95,000	1,154	96,154
K Poynter	**90,000**		**3,391**	**5,000**	**1,609**	**100,000**		**100,000**	95,000	105	95,105
A Ruys[3]	**90,000**		**5,000**	**12,401**		**107,401**	**6,988**	**114,389**	118,000	7,464	125,464
Sir Nicholas Scheele	**90,000**	**28,000**	**1,609**	**5,000**	**3,391**	**128,000**	**5,340**	**133,340**	123,000	29,687	152,687
Former NED											
A M Llopis (until 28 Apr 2011)									31,667	2,253	33,920
Total	**720,000**	**28,000**	**42,109**	**63,000**	**34,609**	**887,718**	**18,738**	**906,456**	812,417	46,325	858,742

Notes:

1 The total benefits shown for these Directors exclude the reimbursement of travel expenses (air, rail and taxi fares) in respect of Directors' attendance at Board meetings of the Company in the UK in respect of which UK tax is payable. The gross amounts of the travel costs and the tax that is due thereon is £52,720 (2011: £102,706).

2 Benefits for these Non-Executive Directors include those expenses incurred in connection with accompanied attendance at business functions.

3 Anthony Ruys: additional payments for services as a non-executive director of ITC Limited, the Group's associate undertaking in India.

	2012 INR	£	2011 INR	£
Director's fees – ITC Limited	**740,000**	**8,309**	720,000	8,724
Fees supplement – British American Tobacco Group		**66,691**		66,276
Total	**740,000**	**75,000**	720,000	75,000

4 Fees were payable to members of the Remuneration Committee from 1 January 2012. No fees are paid in respect of membership of the Nominations Committee.

Table 4: Summary of individual emoluments of Executive Directors – audited

	Salary £	Benefits £	Performance-related pay £	Total 2012 £	2011 £
Nicandro Durante	**1,037,500**	**191,332**	**2,157,172**	**3,386,004**	3,598,525
Ben Stevens	**774,000**	**114,378**	**1,543,704**	**2,432,082**	2,392,736
John Daly	**680,000**	**115,697**	**1,263,836**	**2,059,533**	2,219,802
Former Executive Director					
Paul Adams (until 28 February 2011)					1,017,673
Total	**2,491,500**	**421,407**	**4,964,712**	**7,877,619**	9,228,736

Note:

1 The Executive Directors' emoluments shown above do not include, in respect of the LTIP awards made in March 2010 and which vest on 25 March 2013: (1) the illustrative values of those awards as at 26 February 2013 (reference should be made to the illustrative values shown for each Executive Director in Table 7); and (2) the values of the LTIP dividend equivalent payments to be made in respect of those awards which are: Nicandro Durante £225,576; Ben Stevens £211,256; and John Daly £121,738.

Table 5: Analysis of remuneration of Executive Directors – audited

Nicandro Durante

	2012 £		2011 £
Salary	**1,037,500**	Salary	1,000,000
Benefits: cash[1]	**16,245**	Benefits: cash	15,840
Benefits: non-cash[1]	**175,087**	Benefits: non-cash	323,023
Annual cash bonus	**893,025**	Annual cash bonus	1,000,000
Value of deferred share bonus	**893,025**	Value of deferred share bonus	1,000,000
Cash dividend equivalent (DSBS)[2]	**44,974**	Cash dividend equivalent (DSBS)	34,136
Cash dividend equivalent (LTIP)[2]	**323,176**	Cash dividend equivalent (LTIP)	222,937
Share Reward Scheme: value of shares received during the year	**2,972**	Share Reward Scheme: value of shares received during the year	2,589
Total – see Table 4	**3,386,004**	Total – see Table 4	3,598,525

Notes:

1 Benefits comprise:

	2012 £	2011 £
Cash:		
– car allowance	**16,245**	15,840
Non-cash:		
– life and health insurance	**15,776**	14,139
– tax advice	**6,370**	49,340
– the use of a company driver	**64,932**	63,633
– travel and related costs in respect of relocation from Brazil	**13,952**	142,686
– employee welfare and medical payments made by Souza Cruz S.A. in respect of subsisting employment rights in Brazil	**52,359**	36,202
– maintenance of home security systems in the UK and Brazil	**8,781**	10,013
– other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events	**12,917**	7,010
Total	**191,332**	338,863

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

Appendices to the remuneration report (continued)

Table 5: Analysis of remuneration of Executive Directors – audited (continued)

Ben Stevens

	2012 £		2011 £
Salary	**774,000**	Salary	742,500
Benefits: cash[1]	**13,920**	Benefits: cash	13,560
Benefits: non-cash[1]	**100,458**	Benefits: non-cash	93,929
Annual cash bonus	**598,621**	Annual cash bonus	675,000
Value of deferred share bonus	**598,621**	Value of deferred share bonus	675,000
Cash dividend equivalent (DSBS)[2]	**41,858**	Cash dividend equivalent (DSBS)	32,245
Cash dividend equivalent (LTIP)[2]	**301,632**	Cash dividend equivalent (LTIP)	157,913
Share Reward Scheme: value of shares received during the year	**2,972**	Share Reward Scheme: value of shares received during the year	2,589
Total – see Table 4	**2,432,082**	Total – see Table 4	2,392,736

Notes:

1 Benefits comprise:

	2012 £	2011 £
Cash:		
– car allowance	**13,920**	13,560
Non-cash:		
– life and health insurance	**9,367**	7,030
– the use of a company driver	**77,718**	75,838
– maintenance of home security systems	**3,872**	2,761
– other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events	**9,501**	8,300
Total	**114,378**	107,489

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

John Daly

	2012 £		2011 £
Salary	**680,000**	Salary	650,000
Benefits: cash[1]	**13,920**	Benefits: cash	147,272
Benefits: non-cash[1]	**101,777**	Benefits: non-cash	118,554
Annual cash bonus	**528,195**	Annual cash bonus	585,000
Value of deferred share bonus	**528,195**	Value of deferred share bonus	585,000
Cash dividend equivalent (DSBS)[2]	**27,805**	Cash dividend equivalent (DSBS)	19,919
Cash dividend equivalent (LTIP)[2]	**176,669**	Cash dividend equivalent (LTIP)	111,468
Share Reward Scheme: value of shares received during the year	**2,972**	Share Reward Scheme: value of shares received during the year	2,589
Total – see Table 4	**2,059,533**	Total – see Table 4	2,219,802

Notes:

1 Benefits comprise:

	2012 £	2011 £
Cash:		
– car allowance	**13,920**	13,560
– contractual payment in respect of relocation from Hong Kong		133,712
Non-cash:		
– life and health insurance	**9,283**	6,191
– tax advice	**4,050**	3,954
– the use of a company driver	**75,418**	74,181
– installation (2011) and maintenance of home security systems	**7,349**	28,976
– other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events	**5,677**	5,252
Total	**115,697**	265,826

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

Appendices to the remuneration report (continued)

Table 6: Directors' interests in British American Tobacco p.l.c. ordinary shares of 25p

	At 1 Jan 2012	Acquired (Disposed) During 2012	At 31 Dec 2012	Changes from 31 Dec 2012	At 27 Feb 2013
Chairman					
Richard Burrows	10,000		**10,000**		**10,000**
Executive Directors					
Nicandro Durante	150,261	1,661	**151,922**	8[1]	**151,930**
Ben Stevens	58,059	833	**58,892**		**58,892**
John Daly	36,543	12,052	**48,595**		**48,595**
Non-Executive Directors					
Karen de Segundo	2,000		**2,000**		**2,000**
Ann Godbehere		477	**477**		**477**
Robert Lerwill	3,000		**3,000**		**3,000**
Christine Morin-Postel	4,700	(1,700)	**3,000**		**3,000**
Gerry Murphy	3,000		**3,000**		**3,000**
Kieran Poynter	5,000		**5,000**		**5,000**
Anthony Ruys	3,000		**3,000**		**3,000**
Sir Nicholas Scheele	5,000		**5,000**		**5,000**
Total	280,563	13,323	**293,886**	8	**293,894**

Notes:

1 The changes in Directors' interests since 31 December 2012 relate to the purchase by Nicandro Durante of a total of eight shares pursuant to the Company's Partnership Share Scheme.

2 Based on the performance for 2012, the Executive Directors will each be awarded a number of ordinary shares to the value of £2,553 pursuant to an award of shares under the Share Reward Scheme on 2 April 2013.

3 In addition to the shares shown above, the Executive Directors have further interests in the ordinary shares in the Company set out in Table 7 below and which are held in trust pursuant to the DSBS. The value of these shares has been included as Directors' emoluments in the prior year. Details of the DSBS are given in the Remuneration Report.

4 On 31 December 2012, the Group's employee share ownership trust referred to in the Remuneration Report held a total of 10,520,098 ordinary shares in the Company. All participating employees, including the Executive Directors, are deemed to have a beneficial interest in these shares.

Table 7: Executive Directors: (1) Long-Term Incentive Plan 2007 awards; (2) Deferred Share Bonus Scheme share interests; and (3) share options – ordinary shares of 25p in British American Tobacco p.l.c. – audited

Nicandro Durante

Shares – Long-Term Incentive Plan

	Performance period	Award date	Closing mid-market price at award date p	At 1 Jan 2012 Number of shares	Awarded in 2012 Number of shares	Vested in 2012 Number of shares	Lapsed in 2012 Number of shares	At 31 Dec 2012 Number of shares	Value vested in 2012 £	Vesting date	Illustrative value vesting 2013 £
	2009/2011	27-Mar-09	1,534.0	94,996		94,996			3,039,872	27-Mar-12	
	2010/2012	25-Mar-10	2,278.0	69,751				**69,751**		25-Mar-13	2,078,968[2]
	2011/2013	13-May-11	2,704.0	147,329				**147,329**		13-May-14	
	2012/2014	28-Mar-12	3,180.5		124,688			**124,688**		28-Mar-15	
Total				**312,076**	**124,688**	**94,996**		**341,768**	**3,039,872**		**2,078,968**

Shares – Deferred Share Bonus Scheme

	Holding period	Award date	At 1 Jan 2012 Number of shares	Awarded in 2012 Number of shares	Released on 27 Mar 2012 Number of shares	Closing mid-market price at release date p	At 31 Dec 2012 Number of shares
	2009/2011	27-Mar-09	29,164		29,164	3,200.0	
	2010/2012	25-Mar-10	17,005				**17,005**
	2011/2013	25-Mar-11	22,056				**22,056**
	2012/2014	28-Mar-12		31,172			**31,172**
Total			**68,225**	**31,172**	**29,164**		**70,233**

Options – Sharesave Scheme

	At 1 Jan 2012 Number of shares	Grant date	Grant price p	Granted in 2012 Number of shares	Exercised on 9 Jan 2012 Number of shares	Market price p	Gain £	At 31 Dec 2012 Number of shares	Dates from which exercisable	Latest expiry date
	1,421	24-Nov-06	1,152.0		1,421	3,010.0	26,402		Jan-12	Jun-12
		28-Mar-12	2,536.0	591				**591**	May-17	Oct-17
Total	**1,421**			**591**	**1,421**		**26,402**	**591**		

The Long-Term Incentive Plan Notes, the Deferred Share Bonus Scheme Notes and the Sharesave Scheme Notes are set out at the end of the Directors' shares and options disclosures for Table 7.

Appendices to the remuneration report (continued)

Table 7: Executive Directors: (1) Long-Term Incentive Plan 2007 awards; (2) Deferred Share Bonus Scheme share interests; and (3) share options – ordinary shares of 25p in British American Tobacco p.l.c. – audited (continued)

Ben Stevens

Shares – Long-Term Incentive Plan

Performance period	Award date	Closing mid-market price at award date p	At 1 Jan 2012 Number of shares	Awarded in 2012 Number of shares	Vested in 2012 Number of shares	Lapsed in 2012 Number of shares	At 31 Dec 2012 Number of shares	Value vested in 2012 £	Vesting date	Illustrative value vesting 2013 £
2009/2011	27-Mar-09	1,534.0	88,663		88,663			2,837,216	27-Mar-12	
2010/2012	25-Mar-10	2,278.0	65,323				**65,323**		25-Mar-13	1,946,981[2]
2011/2013	13-May-11	2,704.0	79,558				**79,558**		13-May-14	
2012/2014	28-Mar-12	3,180.5		70,137			**70,137**		28-Mar-15	
Total			**233,544**	**70,137**	**88,663**		**215,018**	**2,837,216**		**1,946,981**

Shares – Deferred Share Bonus Scheme

Holding period	Award date	At 1 Jan 2012 Number of shares	Awarded in 2012 Number of shares	Released on 27 Mar 2012 Number of shares	Closing mid-market price at release date p	At 31 Dec 2012 Number of shares
2009/2011	27-Mar-09	26,114		26,114	3,200.0	
2010/2012	25-Mar-10	15,925				**15,925**
2011/2013	25-Mar-11	23,702				**23,702**
2012/2014	28-Mar-12		21,041			**21,041**
Total		**65,741**	**21,041**	**26,114**		**60,668**

Options – Sharesave Scheme

At 1 Jan 2012 Number of shares	Grant date	Grant price p	Granted in 2012 Number of shares	Exercised in 2012 Number of shares	At 31 Dec 2012 Number of shares	Date from which exercisable	Latest expiry date
1,000	25-Nov-09	1,555.0			**1,000**	Jan-15	Jun-15

The Long-Term Incentive Plan Notes, the Deferred Share Bonus Scheme Notes and the Sharesave Scheme Notes are set out at the end of the Directors' shares and options disclosures for Table 7.

John Daly

Shares – Long-Term Incentive Plan

Performance period	Award date	Closing mid-market price at award date p	At 1 Jan 2012 Number of shares	Awarded in 2012 Number of shares	Vested in 2012 Number of shares	Lapsed in 2012 Number of shares	At 31 Dec 2012 Number of shares	Value vested in 2012 £	Vesting date	Illustrative value vesting 2013 £
2009/2011	27-Mar-09	1,534.0	51,931		51,931			1,661,792	27-Mar-12	
2010/2012	25-Mar-10	2,278.0	37,643				**37,643**		25-Mar-13	1,121,971[2]
2011/2013	13-May-11	2,704.0	71,823				**71,823**		13-May-14	
2012/2014	28-Mar-12	3,180.5		60,785			**60,785**		28-Mar-15	
Total			**161,397**	**60,785**	**51,931**		**170,251**	**1,661,792**		**1,121,971**

Shares – Deferred Share Bonus Scheme

Holding period	Award date	At 1 Jan 2012 Number of shares	Awarded in 2012 Number of shares	Released on 27 Mar 2012 Number of shares	Closing mid-market price at release date p	At 31 Dec 2012 Number of shares
2009/2011	27-Mar-09	15,151		15,151	3,200.0	
2010/2012	25-Mar-10	8,601				**8,601**
2011/2013	25-Mar-11	17,833				**17,833**
2012/2014	28-Mar-12		18,235			**18,235**
Total		**41,585**	**18,235**	**15,151**		**44,669**

Options – Sharesave Scheme

At 1 Jan 2012 Number of shares	Grant date	Grant price p	Granted in 2012 Number of shares	Exercised in 2012 Number of shares	At 31 Dec 2012 Number of shares	Date from which exercisable	Latest expiry date
457	25-Mar-11	1,974.0			**457**	May-14	Oct-14

The Long-Term Incentive Plan Notes, the Deferred Share Bonus Scheme Notes and the Sharesave Scheme Notes are set out at the end of the Directors' shares and options disclosures for Table 7.

Appendices to the remuneration report (continued)

Table 7: Executive Directors: (1) Long-Term Incentive Plan 2007 awards; (2) Deferred Share Bonus Scheme share interests; and (3) share options – ordinary shares of 25p in British American Tobacco p.l.c. – audited (continued)

Long-Term Incentive Plan notes

1 The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on the vesting date for the March 2009 award (27 March 2012) was 3,200p.

2 The March 2010 award will vest on 25 March 2013 at 87.1% in the manner described in the remuneration report. For illustrative purposes only, the share price on 26 February 2013, being the latest practicable date prior to publication, of 3,422p has been used to value the vesting awards.

3 The performance conditions applicable to the LTIP awards relate to an apportionment between measures relating to TSR and EPS-based criteria with reference to a three-year performance period. TSR combines both the share price and dividend performance of the Company as set against two comparator groups: (a) the FTSE 100 Index at the beginning of the performance period; and (b) a peer group of FMCG companies. A total of 50% of the total award is based upon each of two separate measures (25% for each measure). 50% of an award is based on EPS growth relative to inflation. Further details of the performance conditions are set out in the long-term incentives section of the remuneration report.

4 There have been no variations in the terms and conditions of the LTIP interests during the year.

5 The awards made in May 2011 and March 2012 are due to vest in May 2014 and March 2015 respectively. At 31 December 2012, the performance percentage reflecting performance to date, was 75.4% for the May 2011 award and 24.2% for the March 2012 award.

Deferred Share Bonus Scheme notes

1 Each Executive Director has an interest in the ordinary shares of the Company, as shown in the Deferred Share Bonus Scheme tables, which are held in trust pursuant to the British American Tobacco Deferred Share Bonus Scheme.

2 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.

Sharesave Scheme notes

1 Sharesave Scheme: in respect of the Executive Directors, no options lapsed during the year ended 31 December 2012. There have been no variations in the terms and conditions of these interests in share options during the year. Options granted under the Sharesave Scheme are exercisable in conjunction with a three year or five year savings contract up to a monthly limit of £250. Options are normally granted at a discount of 20% to the market price at the time of the invitation, as permitted under the rules of the Sharesave Scheme.

2 The aggregate gain on the exercise of Sharesave Scheme options was £26,402 (2011: £nil).

3 The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 31 December 2012 was 3,121.0p and the range during the year was 2,897.5p to 3,488.0p. The market price on 31 December 2012 exceeded the grant price of all the options detailed in the Options tables for the Executive Directors.

Table 8: Non-Executive Director's share options Ordinary Shares of INR1 each in ITC Limited – audited

Anthony Ruys

ITC Employee Stock Option Scheme

	At 1 Jan 2012 Number of options[2]	At 1 Jan 2012 Number of shares over which options held[2]	Grant Date	Grant price per option	Granted in 2012 Number of options	Number of shares over which options granted	Exercised in 2012 Number of options	At 31 Dec 2012 Number of options	Number of options that may be exercised	Dates from which exercisable	Latest expiry date
	20,000	200,000	23-Jul-09	Rs.1,090.00				**20,000**	6,000	23-Jul-10	23-Jul-15
									6,000	23-Jul-11	23-Jul-16
									8,000	23-Jul-12	23-Jul-17
	20,000	200,000	22-Jul-10	Rs.1,461.75				**20,000**	6,000	22-Jul-11	22-Jul-16
									6,000	22-Jul-12	22-Jul-17
									8,000	22-Jul-13	22-Jul-18
	10,000[3]	100,000	26-Aug-11	Rs.2,023.5				**10,000**	3,000	26-Aug-12	26-Aug-17
									3,000	26-Aug-13	26-Aug-18
									4,000	26-Aug-14	26-Aug-19
			27-Jul-12	Rs.2,494.5	10,000	100,000		**10,000**	3,000	27-Jul-13	27-Jul-18
									3,000	27-Jul-14	27-Jul-19
									4,000	27-Jul-15	27-Jul-20
Total	50,000	500,000			10,000	100,000		**60,000**	60,000		

Notes:

1 ITC Limited (ITC) is an associate undertaking of the Company and is listed on stock exchanges in India. Anthony Ruys, a Non-Executive Director of the Company, is also a non-executive director of ITC. Anthony Ruys has been granted options over shares in ITC under the ITC Employee Stock Option Scheme 2006 which provides for the grant of options to its non-executive directors as permitted by the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines 1999 (the Scheme).

2 Each option entitles its holder to apply for and to be allotted 10 ordinary shares in ITC of INR1 each upon the payment of the grant price during the appropriate exercise period. An exercise period begins at the date of vesting of an option and expires at the end of five years from that vesting date. The vesting period for the conversion of an option under the Scheme is as follows: (a) 30% vests 12 months from date of grant; (b) 30% vests 24 months from date of grant; and (c) 40% vests 36 months from the date of grant.

3 The number of options granted in 2011 and applicable number of shares over which they have been granted was incorrectly stated in the 2011 Annual Report and has therefore been restated in the current year.

Appendices to the remuneration report (continued)

Status of remuneration report

This report has been prepared in accordance with the relevant provisions of the Companies Act 2006 and Schedule 5 and Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. The report also meets the relevant requirements of the Listing Rules of the UK Listing Authority and describes how the Board has applied the Principles of Good Governance relating to Directors' remuneration as set out in the UK Corporate Governance Code referred to in the corporate governance statement. As required by the Companies Act 2006, a resolution to approve the Directors' remuneration report (the Report) will be proposed at the AGM of the Company on 25 April 2013, at which the financial statements will be presented for approval. The vote will have advisory status, will be in respect of the remuneration policy and overall remuneration packages and will not be specific to individual levels of remuneration. The Companies Act 2006 requires the auditors to report to the Company's shareholders on the 'audited information' within the Report and to state whether, in their opinion, those parts of the Report have been prepared in accordance with the Companies Act 2006. The report of the independent auditors, in respect of the Company, addresses those aspects of this Report, and those which have been subject to audit have been clearly marked: Executive Directors' pension entitlements, Table 1, Table 2, Table 3, Table 4, Table 5, Table 7 and Table 8.

On behalf of the Board

Dr Gerry Murphy
Chairman of the Remuneration Committee

27 February 2013

Other statutory and regulatory information

Companies Act 2006

The Companies Act 2006 requires the Company to set out in this report the development and performance of the business of the Group during the financial year ended 31 December 2012, including an analysis of the position of the Group at the end of the financial year, and a description of the principal risks and uncertainties facing the Group.

Principal activities

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

Group results and dividends

Results

The Group results are addressed fully in the financial statements and in the Directors' report: business review.

Final dividend – recommendation

The Board recommends to shareholders for approval at the Annual General Meeting on 25 April 2013, a final dividend of 92.7p per ordinary share of 25p for the year ended 31 December 2012.

Final dividend – key dates and South Africa branch register

In compliance with the requirements of the London Stock Exchange (LSE) and Strate, the electronic settlement and custody system used by the JSE Limited (JSE), the following are the salient dates for the payment of the final dividend:

Event	Date 2013
Last day to trade (LDT) cum-dividend (JSE)	8 March
Shares commence trading ex-dividend (JSE)	11 March
Shares commence trading ex-dividend (LSE)	13 March
Record date (JSE and LSE)	15 March
Payment date	8 May

As the Group reports in sterling, dividends are declared and payable in sterling except for shareholders on the branch register in South Africa whose dividends are payable in rand. A rate of exchange of £:R = 13.34290 as at 26 February 2013 (the closing rate for that date as quoted on Bloomberg), results in an equivalent final dividend of 1,236.88683 SA cents per ordinary share. From the commencement of trading on 28 February 2013 (the date of the preliminary announcement) until the close of business on 15 March 2013, no removal requests between the UK main register and the South Africa branch register (in either direction) are permitted. Further, from the close of business on 8 March 2013 until the close of business on 15 March 2013, no transfers between the UK main register and the South Africa branch register are permitted and no shares may be dematerialised or rematerialised between 11 March 2013 and 15 March 2013, both days inclusive.

South Africa branch register: Dividend Withholding Tax information

South African Dividend Withholding Tax of 185.53302 SA cents per ordinary share will be withheld from the gross final dividend paid to shareholders on the South Africa branch register at the rate of 15% unless a shareholder qualifies for an exemption. After Dividend Withholding Tax has been withheld, the net dividend will be 1,051.35381 SA cents per ordinary share.

The Company, as a South Africa non-resident, was not subject to the secondary tax on companies (STC) regime which used to operate before the introduction of Dividend Withholding Tax. No STC credits are available for set-off against the Dividend Withholding Tax liability on the final dividend which is regarded as a 'foreign dividend' for the purposes of the South Africa Dividend Withholding Tax. British American Tobacco p.l.c. is registered with the South African Revenue Service (SARS) with tax reference number 9378193172.

Dividend Withholding Tax and the information provided above is only of direct application to shareholders on the South Africa branch register. Shareholders on the South Africa branch register should refer to 'Shareholder and contact information' for the contact details of Computershare Investor Services (Pty) Ltd, the Company's registrar for the branch register.

Dividend information

Further details of the total amounts of dividends paid in 2012 (with 2011 comparatives) are given in note 8 on the accounts.

Annual General Meeting (AGM)

The AGM will be held at The Banqueting House, Whitehall, London SW1A 2ER at 11.30am on 25 April 2013. Details of the business to be proposed at the meeting are contained in the Notice of Annual General Meeting which is sent to all shareholders and is also published on www.bat.com.

The Company provides for the vote on each resolution to be by poll rather than by show of hands. This provides for greater transparency and allows the votes of all shareholders to be counted, including those cast by proxy. The Chairman announces the provisional voting results at the meeting, and the final results are announced on the same day through the Regulatory News Service and on www.bat.com.

Share capital

As at 31 December 2012, the Company had an allotted and fully paid share capital of 2,026,267,623 ordinary shares of 25p each with an aggregate nominal value of £506.6 million (including treasury shares and shares owned by the employee share trusts).

At the close of business on 26 February 2013 (the latest practicable date prior to the recommendation of the final dividend for the year ended 31 December 2012), the Company had a total of

Other statutory and regulatory information (continued)

1,930,496,805 ordinary shares in issue (excluding treasury shares). The Company held 95,892,487 ordinary shares in treasury giving a total issued share capital of 2,026,389,292 ordinary shares.

Stock market listings

Premium listing

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

Secondary listing

Since 28 October 2008, the Company's ordinary shares have had a secondary listing on the JSE Limited in South Africa (JSE), under the abbreviated name BATS and the trading code BTI. As at 31 December 2012, 270,808,601 ordinary shares of the Company (being 14.03% of the Company's issued ordinary share capital – excluding treasury shares) were on its South Africa branch register for which Computershare Investor Services (Pty) Ltd are share registrars.

American Depositary Receipts

The Company's ordinary shares are also traded on NYSE MKT in the form of American Depositary Receipts (ADRs) under the symbol BTI with a CUSIP number 110448107. Each ADR represents two of the Company's ordinary shares and at 31 December 2012, 39,272,271 ADRs were outstanding, represented by 78,544,542 ordinary shares. Citibank, N.A. continues to act as depositary for the ADR programme.

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

Purchase of own shares

Share buy-back programme 2012

The Board reinstated its on-market share buy-back programme following the Company's Preliminary Announcement on 27 February 2012 and under the authority granted by shareholders in 2011. At the 2012 AGM, the Company was given authority to purchase up to 196,600,000 of its ordinary shares. The minimum price that may be paid for such shares is 25p and the maximum price is an amount equal to 105% of the average of the middle market prices shown in the quotation for an ordinary share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the ordinary share is contracted to be purchased.

During the year ended 31 December 2012, the Company made on-market repurchases totalling 38,894,725 of its own ordinary shares, representing 2.01% of the issued share capital (excluding treasury shares) as at 31 December 2012 and at a value of £1,250 million, excluding transaction costs. In accordance with the Company's policy, all of these repurchased shares are held as treasury shares and as at 31 December 2012 the number of treasury shares was 95,892,487. While treasury shares are held no dividends are paid on them and they have no voting rights. Treasury shares may be resold at a later date.

Renewal of authority to purchase shares

The present authority for the Company to purchase its own shares will expire at the 2013 AGM, where it is proposed that the Company's authority to purchase its own shares is renewed. This will enable the share buy-back programme to continue for a further year. In the opinion of the Directors, the exercise of this authority is likely to result in an increase in the Company's earnings per share and will be in the interests of its shareholders generally. Details of the applicable resolution and explanatory notes are contained in the Notice of Annual General Meeting which is sent to all shareholders and is also published on www.bat.com.

Significant agreements – change of control

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

On 25 November 2010, the Company, B.A.T. International Finance p.l.c. 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 £2 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.

Details of the change of control provisions contained in the Company's Long-Term Incentive Plans are given in the remuneration report.

Contractual arrangements

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

Articles of Association

The following description summarises certain provisions of the Company's current Articles of Association (as adopted by special resolution at the Annual General Meeting on 28 April 2010), applicable English law and the Companies Act 2006 (the Companies Act). This summary is qualified in its entirety by reference to the Companies Act and the Company's Articles of Association, a copy of which is available on www.bat.com.

Share capital

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

Objects and purposes

The Company is incorporated under the name of British American Tobacco p.l.c. and is registered in England and Wales under registered number 3407696. Under the Companies Act 2006, the Company's objects are unrestricted.

Directors: appointment and retirement

The Company's Articles of Association provide for a Board of Directors, consisting (unless otherwise determined by ordinary resolution of the shareholders) of not fewer than five Directors, not subject to any maximum, who shall manage the business of the Company.

The Directors and the Company (by ordinary resolution) may appoint a person who is willing to act as a Director, either to fill a vacancy or as an additional Director. A Director appointed by the Directors shall retire at the next Annual General Meeting and will put himself/herself forward to be reappointed by the shareholders. Such a Director shall not be taken into account in determining the number or identity of the Directors to retire by rotation at that next Annual General Meeting.

At each Annual General Meeting, all Directors shall retire from office by rotation who: (1) held office at the time of each of the two preceding Annual General Meetings and who did not retire at either of them; and (2) if the number of Directors retiring in (1) above is less than one-third of the Directors who are subject to retirement by rotation (or, if their number is not three or a multiple of three, is less than the number which is nearest to but does not exceed one-third of the Directors), such additional number of Directors as shall, together with the Directors retiring under (1) above, equal one-third of the Directors (or, if their number is not three or a multiple of three, the number which is nearest to but does not exceed one-third of the Directors).

Subject to the provisions of the Companies Act and the Articles of Association, the Directors to retire at an Annual General Meeting under (2) above will be those who have been in office the longest since their appointment or last reappointment.

Notwithstanding these provisions contained in the Articles of Association, the Company is not restricted to the number of Directors who may retire and seek re-election each year. The Articles of Association merely set a minimum number of Directors who must be subject to retirement by rotation each year. As a result, since the introduction of the provision of UK Corporate Governance Code in 2011 that all Directors of FTSE 350 companies should be subject to annual re-election by shareholders, all of the Directors of the Company will be subject to either election (i.e. those Directors appointed by the Board of Directors during the year) or re-election at the forthcoming Annual General Meeting to be held on 25 April 2013.

A Director who retires at an Annual General Meeting and is not reappointed shall retain office until the meeting elects someone in his place or, if it does not do so, until the conclusion of the meeting. In addition to any power of removal under the Companies Act, the Company may, by special resolution, remove a Director before the expiration of his period of office and, subject to the Articles of Association, may by ordinary resolution, appoint another person who is willing to act as a Director, and is permitted by law to do so, to be a Director instead of him. A person so appointed shall be subject to retirement as if he had become a Director on the day on which the Director in whose place he is appointed was last appointed or reappointed a Director.

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

Directors: meetings and voting

The quorum for meetings of Directors is two Directors. The Directors may delegate any of their powers that are conferred upon them under the Articles of Association to such person or committee as they consider appropriate.

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

1. the giving to him of a guarantee, security or indemnity in respect of money lent to, or an obligation incurred by him for the benefit of, the Company or any of its subsidiaries;
2. the giving to a third party of a guarantee, security or indemnity in respect of an obligation of the Company or any of its subsidiaries for which the Director has assumed responsibility (in whole or part and whether alone or jointly with others) under a guarantee or indemnity or by the giving of security;
3. the giving to him of any other indemnity which is on substantially the same terms as indemnities given, or to be given, to all of the other Directors and/or to the funding by the Company of his expenditure on defending proceedings of the doing by the Company of anything to enable him to avoid incurring such expenditure where all other Directors have been given, or are to be given, substantially the same arrangements;

Other statutory and regulatory information (continued)

4. any proposal concerning the purchase of Directors' and officers' liability insurance;
5. any proposal concerning his being, or intending to become, a participant in the underwriting or sub-underwriting of an offer of any such shares, debentures or other securities for subscription, purchase or exchange;
6. any arrangements which relate in any way to a retirement benefits scheme or any arrangement for the benefit of the employees of the Company or any of its subsidiaries including but without being limited to an employees' share scheme, which does not accord to any Director any privilege or advantage not generally accorded to the employees and/or former employees to whom the arrangement relates; and
7. any transaction or arrangement with any other company, being a company in which the Director is interested only as an officer, creditor or shareholder, provided that he is not the holder of or beneficially interested in 1% or more of the equity share capital of that company (or of any other company through which his interest is derived) and not entitled to exercise 1% or more of the voting rights available to members of the relevant company (disregarding, for the purposes of this proviso: (i) any shares held by a Director as bare or custodian trustee and in which he has no beneficial interest; (ii) any shares comprised in an authorised unit trust scheme in which the Director is interested only as a unit holder; and (iii) any shares of that class held as treasury shares).

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

Directors: borrowing powers

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

Directors: interests

Provided that the Director has disclosed to the other Directors the nature and extent of any material interest of his, a Director, notwithstanding his office:

1. may be a party to, or otherwise interested in, any transaction or arrangement with the Company or in which the Company is otherwise interested;
2. may be a Director or other officer of, or employed by or may be a party to, or otherwise interested in, any transaction or arrangement with anybody corporate promoted by the Company or in which the Company is otherwise interested;
3. shall not, by reason of his office, be accountable to the Company for any benefit which he derives from any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate;
4. shall not infringe his duty to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or may possibly conflict, with the interests of the Company as a result of any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate;
5. shall not be required to disclose to the Company, or use in performing his duties as a Director of the Company, any confidential information relating to such office or employment if to make such a disclosure or use would result in a breach of duty or obligation of confidence owed by him in relation to or in connection with that office or employment;
6. may absent himself from discussions and exclude himself from information, which will or may relate to that office, employment, transaction, arrangement or interest; and
7. no such transaction or arrangement will be liable to be avoided because of any such interest or benefit.

For the purposes of the Articles, a general notice given to the Directors that he is to be regarded as having an interest of the nature and extent specified in the notice in any transaction or arrangement in which a specified person or class of persons is interested is deemed to be a disclosure that the Director has an interest in any such transaction of the nature and extent so specified.

An interest of which a Director has no knowledge and of which it is unreasonable to expect him to have knowledge is not treated as an interest; an interest which consists of a Director being a Director or other officer of, or employed by any subsidiary of the Company is not deemed to be a material interest; a Director need not disclose an interest if it cannot be reasonably regarded as likely to give rise to a conflict of interest; and a Director need not disclose an interest if, or to the extent that, the other Directors are already aware of it.

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

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

1. any matter which would otherwise result in a Director infringing his duty to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the Company and which may reasonably be regarded as likely to give rise to a conflict of interest (including a conflict of interest and duty or conflict of duties);
2. a Director to accept or continue in any office, employment or position in addition to his office as a Director of the Company and may authorise the manner in which a conflict of interest arising out of such office, employment or position may be dealt with, either before or at the time that such a conflict of interest arises, provided that the authorisation is only effective if:
    1. 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

2. the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

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

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

Dividend rights

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

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

Any dividend which has been unclaimed for 12 years from the date when it became due for payment shall, if the Directors so resolve, be forfeited and shall cease to be owed by the Company. The Company can cease sending dividend warrants and cheques by post or otherwise if these have been returned undelivered to, or left uncashed by, the shareholder on at least two consecutive occasions, or, if following one such occasion, reasonable enquiries have failed to establish the member's new address. No dividend shall bear interest against the Company, unless provided by the rights attached to the share.

The Directors may elect to make payments of dividends to shareholders by bank or electronic transfer only. Amounts due to shareholders who provide no, or invalid, account details may be held in an account in the Company's name until such shareholders nominate a valid account. The Company shall not be a trustee of any such monies, shall be deemed to have discharged its payment obligations by paying the relevant monies into such account and interest will not accrue for shareholders on any such monies pending payment to such persons.

Voting rights

Voting at any general meeting of shareholders is by a show of hands unless a poll is demanded. On a show of hands, every shareholder who is present in person at a general meeting has one vote regardless of the number of shares held by the shareholder.

Every proxy appointed by a shareholder and present at a general meeting has one vote, except that if the proxy has been duly appointed by more than one shareholder entitled to vote on the resolution and is instructed by one or more of those shareholders to vote for the resolution and by one or more others to vote against it, or is instructed by one or more of those shareholders to vote in one way and is given discretion as to how to vote by one or more others (and wishes to use that discretion to vote in the other way) he has one vote for and one vote against the resolution.

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

1. the Chairman of the meeting;
2. the Directors;
3. not less than five shareholders having the right to vote at the meeting;
4. a shareholder or shareholders representing not less than one-tenth of the total voting rights of all shareholders having the right to vote at the meeting (excluding any voting rights attached to treasury shares); or
5. a shareholder or shareholders holding shares which confer a right to vote on the resolution at the meeting being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all shares conferring that right (excluding any voting rights attached to treasury shares).

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

1. ordinary resolutions, which can include resolutions for the appointment, reappointment and removal of Directors, the receiving of the Annual Report, the declaration of final dividends, the appointment and reappointment of the external auditor, the authority for the Company to purchase its own shares and the grant of authority to allot shares; and
2. special resolutions, which can include resolutions amending the Company's Articles of Association and resolutions relating to certain matters concerning a winding-up of the Company.

An ordinary resolution requires the affirmative vote of a simple majority of the votes cast at a meeting at which there is a quorum in order to be passed. Special resolutions require the affirmative vote of not less than three-quarters of the votes cast at a meeting

Other statutory and regulatory information (continued)

at which there is a quorum in order to be passed. The necessary quorum for a meeting of the Company is a minimum of two shareholders present in person or by proxy or by a duly authorised representative(s) of a corporation which is a shareholder and entitled to vote.

When convening a meeting the Company may specify a time not more than 48 hours before the time of the meeting (excluding any part of a day that is not a working day) by which a person must be entered on the register of members in order to have the right to attend or vote at the meeting.

Winding-up

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

Transfer of shares

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

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

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

If the Directors refuse to register a transfer of shares, they must give the transferee notice of this refusal as soon as practicable and in any event within two months of the instrument of transfer being lodged with the Company. No fees may be charged for the registration of a transfer of shares.

Pre-emptive rights and new issues of shares

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

Alteration of share capital

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

1. consolidate and divide all or any of its shares into shares of a larger amount than its existing shares;
2. sub-divide any of its shares into shares of smaller amount than its existing shares; and
3. determine that, as between the shares resulting from such a sub-division, any of them may have any preference or advantage as compared with the others.

Subject to the provisions of the Companies Act:

1. the Company may reduce its share capital, its capital redemption reserve and any share premium account in any way; and
2. the Company may purchase its own shares, including redeemable shares, and may hold such shares as treasury shares or cancel them.

Disclosure of interests in the Company's shares

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

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

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

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

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

General meetings and notices

An AGM and all other general meetings of the Company must be called by at least 21 clear days' written notice. However, the Companies Act allows for this period of notice for meetings other than AGMs to be reduced to 14 clear days' notice provided that two conditions are met: (1) a company must allow shareholders to make proxy appointments via a website (such as that hosted by its share registrars); and (2) shareholders must pass a special resolution at the AGM every year approving that shortening of the notice period to 14 days. A special resolution enabling the Company to hold general meetings (other than AGMs) on 14 days' notice will be proposed at the AGM to be held on 25 April 2013.

Subject to the resolution being passed, the approval of the shortening of the notice period will be effective until the Company's next AGM, when it is intended that the approval be renewed. The shorter notice period would not be used as a matter of routine. Rather the Directors will consider on a case-by-case basis whether the use of the flexibility offered by the shorter notice period is merited, taking into account the circumstances, including whether the business of the meeting is time sensitive, and is thought to be to the advantage of shareholders as a whole. Further, the shorter notice period would not be used unless both of the conditions as stated above are met.

Variation of rights

If the capital of the Company is divided into different classes of shares, the rights attached to any class of shares may only be varied, either in such a manner as provided by those rights or in the absence of any provision, with the consent in writing of three-quarters in nominal value of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of holders of such shares. At any separate meeting, the necessary quorum is two persons together holding or representing by proxy at least one-third in nominal amount of the issued shares of the class (but at an adjourned meeting shall be any one person holding shares of the class or his proxy). Unless otherwise expressly provided by the rights attached to any shares, those rights shall be deemed to be varied by the reduction of the capital paid up on those shares and by the creation or issue of further shares ranking in priority for payment of a dividend or in respect of capital or which confer on the holders voting rights more favourable than those conferred by the first-mentioned shares, but shall not otherwise be deemed to be varied by the creation or issue of further shares ranking pari passu with them or subsequent to them.

Repurchase of shares

Subject to authorisation by shareholder resolution, the Company may purchase its own shares in accordance with the Companies Act. Any shares which have been bought back may be held as treasury shares or, if not so held, must be cancelled immediately upon completion of the purchase, thereby reducing the amount of the Company's issued share capital. There is no longer a requirement for public companies to have specific authorisations in their articles of association to undertake these actions.

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 2012.

Intra-Group pricing

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

On behalf of the Board

Nicola Snook
Secretary
27 February 2013

British American Tobacco p.l.c.

Registered in England and Wales No. 3407696

Responsibility of Directors

Directors' responsibilities in relation to the financial statements

The following statement sets out the responsibilities of the Directors in relation to the financial statements of both the Group and the Company. The reports of the independent auditors for the Group and the Company set out their responsibilities in relation to those financial statements.

Company law requires the Directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss of the Group and the Company for the financial year. In preparing those financial statements, the Directors are required to:

– select appropriate accounting policies and apply them consistently;
– make judgments and estimates that are reasonable and prudent;
– state whether applicable accounting standards have been followed, subject to any material departures being disclosed and explained; and
– prepare the financial statements on the going concern basis, unless they consider that to be inappropriate.

The applicable accounting standards referred to above are: (a) United Kingdom Generally Accepted Accounting Principles (UK GAAP) for the Company; and (b) International Financial Reporting Standards (IFRS) as adopted by the European Union and implemented in the UK for the Group.

The Directors are responsible for ensuring that the Company keeps sufficient accounting records to disclose with reasonable accuracy the financial position of the Company and the Group and to enable them to ensure that the Group financial statements comply with the Companies Act 2006 and Article 4 of the IAS Regulation, and that the Company financial statements and the Directors' Remuneration report comply with the Companies Act 2006. They are also responsible for taking reasonable steps to safeguard the assets of the Company and the Group and, in that context, having proper regard to the establishment of appropriate systems of internal control with a view to the prevention and detection of fraud and other irregularities.

The Directors are required to prepare financial statements and to provide the auditors with every opportunity to take whatever steps and undertake whatever inspections the auditors consider to be appropriate for the purpose of enabling them to give their audit report.

The Directors are responsible for the maintenance and integrity of the Annual Report on www.bat.com in accordance with the UK legislation governing the preparation and dissemination of financial statements. Access to the website is available from outside the UK, where comparable legislation may be different.

The Directors consider that they have pursued the actions necessary to meet their responsibilities as set out in this statement.

Directors' declaration in relation to relevant audit information

Having made enquiries of fellow Directors and of the Company's auditors, each of the Directors confirms that:

– to the best of his or her knowledge and belief, there is no relevant audit information of which the Company's auditors are unaware; and
– he or she has taken all steps that a Director might reasonably be expected to have taken in order to make himself or herself aware of relevant audit information and to establish that the Company's auditors are aware of that information.

Directors' responsibility statement

The Directors confirm to the best of their knowledge and belief that:

– the financial statements, prepared in accordance with 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 (which incorporates the Business review) includes a fair review of the development and performance of the business and the position of the Group and the Company, together with a description of the principal risks and uncertainties that they face.

The names of the Directors are listed in this Directors' report and their details appear on the Board of Directors page.

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

The responsibility statement was approved by the Board of Directors on 27 February 2013 and signed on its behalf by:

Richard Burrows
Chairman

Ben Stevens
Finance Director and CIO

Independent auditors' report

To the members of British American Tobacco p.l.c.

We have audited the Group financial statements of British American Tobacco p.l.c. for the year ended 31 December 2012 which comprise the Group Income Statement, the Group Statement of Comprehensive Income, the Group Statement of Changes in Equity, the Group Balance Sheet, the Group Cash Flow Statement, the Notes on the accounts, the Principal subsidiary undertakings, and the Principal associate undertakings. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of Directors and auditors

As explained more fully in the Directors' responsibility statement set out on page 106, the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the Group financial statements:

– give a true and fair view of the state of the Group's affairs as at 31 December 2012 and of its profit and cash flows for the year then ended;

– have been properly prepared in accordance with IFRSs as adopted by the European Union; and

– have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' report for the financial year for which the Group financial statements are prepared is consistent with the Group financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

– certain disclosures of Directors' remuneration specified by law are not made; or

– we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

– the Directors' statement, set out on page 106, in relation to going concern;

– the part of the Corporate governance statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and

– certain elements of the report to shareholders by the Board on Directors' remuneration.

Other matter

We have reported separately on the Parent Company financial statements of British American Tobacco p.l.c. for the year ended 31 December 2012 and on the information in the Remuneration report that is described as having been audited.

Paul Cragg (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom

27 February 2013

Group Income Statement
For the year ended 31 December

	Notes	2012 £m	2011 £m
Gross turnover (including duty, excise and other taxes of £30,682 million (2011: £30,724 million))		**45,872**	46,123
Revenue	2	**15,190**	15,399
Raw materials and consumables used		**(3,445)**	(3,507)
Changes in inventories of finished goods and work in progress		**133**	81
Employee benefit costs	3(a)	**(2,386)**	(2,501)
Depreciation, amortisation and impairment costs	3(b)	**(475)**	(817)
Other operating income	3(c)	**245**	233
Other operating expenses	3(d)	**(3,850)**	(4,167)
Profit from operations	2	**5,412**	4,721
Analysed as:			
– adjusted profit from operations	2	**5,681**	5,519
– restructuring and integration costs	3(e)	**(206)**	(193)
– amortisation of trademarks and similar intangibles	3(f)	**(63)**	(58)
– goodwill impairment	3(g)	**–**	(273)
– Fox River	3(h)	**–**	(274)
		5,412	4,721
Net finance costs	4	**(456)**	(460)
Finance income		**49**	117
Finance costs		**(505)**	(577)
Share of post-tax results of associates and joint ventures	5	**692**	670
Analysed as:			
– adjusted share of post-tax results of associates and joint ventures	2	**697**	659
– issue of shares and change in shareholding	5	**20**	28
– smoking cessation programme	5	**–**	(23)
– gain on disposal of business	5	**–**	22
– restructuring and integration costs	5	**(24)**	(4)
– change in post-retirement obligations	5	**24**	–
– other	5	**(25)**	(12)
		692	670
Profit before taxation		**5,648**	4,931
Taxation on ordinary activities	6	**(1,526)**	(1,556)
Profit for the year		**4,122**	3,375
Attributable to:			
Owners of the parent		**3,841**	3,095
Non-controlling interests		**281**	280
		4,122	3,375
Earnings per share			
Basic	7	**198.1p**	157.1p
Diluted	7	**197.1p**	156.2p

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

The accompanying notes are an integral part of the Group Financial Statements.

Group Statement of Comprehensive Income
For the year ended 31 December

	Notes	2012 £m	2011 £m
Profit for the year (page 108)		**4,122**	3,375
Other comprehensive income			
Differences on exchange			
– subsidiaries		**(379)**	(411)
– associates		**(145)**	(109)
Differences on exchange reclassified and reported in profit for the year		**–**	(4)
Cash flow hedges			
– net fair value losses		**(11)**	(21)
– reclassified and reported in profit for the year		**71**	38
– reclassified and reported in net assets		**12**	(5)
Available-for-sale investments			
– net fair value (losses)/gains		**(3)**	26
– reclassified and reported in profit for the year		**(1)**	(1)
Net investment hedges			
– net fair value gains		**106**	62
– differences on exchange on borrowings		**49**	(104)
Retirement benefit schemes			
– net actuarial losses in respect of subsidiaries	12	**(415)**	(462)
– surplus recognition and minimum funding obligations in respect of subsidiaries	12	**54**	2
– actuarial losses in respect of associates net of tax	11	**(55)**	(67)
Tax on items recognised directly in other comprehensive income	6(d)	**28**	20
Total other comprehensive income for the year, net of tax		**(689)**	(1,036)
Total comprehensive income for the year, net of tax		**3,433**	2,339
Attributable to:			
Owners of the parent		**3,163**	2,094
Non-controlling interests		**270**	245
		3,433	2,339

The accompanying notes are an integral part of the Group Financial Statements.

Group Statement of Changes in Equity

At 31 December

	Notes	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of parent £m	Non-controlling interests £m	Total equity £m
		Attributable to owners of the parent						
Balance at 1 January 2012		506	3,913	1,112	2,636	8,167	307	8,474
Total comprehensive income for the year (page 109)		–	–	(316)	3,479	3,163	270	3,433
Profit for the year		–	–	–	3,841	3,841	281	4,122
Other comprehensive income for the year		–	–	(316)	(362)	(678)	(11)	(689)
Employee share options								
– value of employee services		–	–	–	73	73	–	73
– proceeds from shares issued		1	3	–	1	5	–	5
Dividends and other appropriations								
– ordinary shares		–	–	–	(2,538)	(2,538)	–	(2,538)
– to non-controlling interests		–	–	–	–	–	(267)	(267)
Purchase of own shares								
– held in employee share ownership trusts		–	–	–	(121)	(121)	–	(121)
– share buy-back programme		–	–	–	(1,258)	(1,258)	–	(1,258)
Non-controlling interests – acquisitions	29	–	–	–	(21)	(21)	(3)	(24)
Other movements		–	–	–	2	2	–	2
Balance at 31 December 2012		**507**	**3,916**	**796**	**2,253**	**7,472**	**307**	**7,779**

	Notes	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of parent £m	Non-controlling interests £m	Total equity £m
		Attributable to owners of the parent						
Balance at 1 January 2011		506	3,910	1,600	3,190	9,206	342	9,548
Total comprehensive income for the year (page 109)		–	–	(488)	2,582	2,094	245	2,339
Profit for the year		–	–	–	3,095	3,095	280	3,375
Other comprehensive income for the year		–	–	(488)	(513)	(1,001)	(35)	(1,036)
Employee share options								
– value of employee services		–	–	–	76	76	–	76
– proceeds from shares issued		–	3	–	2	5	–	5
Dividends and other appropriations								
– ordinary shares		–	–	–	(2,358)	(2,358)	–	(2,358)
– to non-controlling interests		–	–	–	–	–	(279)	(279)
Purchase of own shares								
– held in employee share ownership trusts		–	–	–	(123)	(123)	–	(123)
– share buy-back programme		–	–	–	(755)	(755)	–	(755)
Non-controlling interests – acquisitions	29	–	–	–	(10)	(10)	–	(10)
Other movements		–	–	–	32	32	(1)	31
Balance at 31 December 2011		506	3,913	1,112	2,636	8,167	307	8,474

The accompanying notes are an integral part of the Group Financial Statements.

Group Balance Sheet
At 31 December

	Notes	2012 £m	2011 £m
Assets			
Non-current assets			
Intangible assets	9	**11,710**	11,992
Property, plant and equipment	10	**3,201**	3,047
Investments in associates and joint ventures	11	**2,330**	2,613
Retirement benefit assets	12	**105**	105
Deferred tax assets	13	**327**	343
Trade and other receivables	14	**224**	305
Available-for-sale investments	15	**37**	40
Derivative financial instruments	16	**207**	179
Total non-current assets		**18,141**	18,624
Current assets			
Inventories	17	**4,026**	3,498
Income tax receivable	18	**83**	127
Trade and other receivables	14	**2,741**	2,423
Available-for-sale investments	15	**26**	57
Derivative financial instruments	16	**166**	159
Cash and cash equivalents	19	**2,081**	2,194
		9,123	8,458
Assets classified as held-for-sale	26(c)	**63**	37
Total current assets		**9,186**	8,495
Total assets		**27,327**	27,119

Group Balance Sheet (continued)

	Notes	2012 £m	2011 £m
Equity			
Capital and reserves			
Share capital		**507**	506
Share premium, capital redemption and merger reserves		**3,916**	3,913
Other reserves		**796**	1,112
Retained earnings		**2,253**	2,636
Owners of the parent		**7,472**	8,167
after deducting			
– cost of treasury shares		**(2,824)**	(1,539)
Non-controlling interests		**307**	307
Total equity	20	**7,779**	8,474
Liabilities			
Non-current liabilities			
Borrowings	21	**9,083**	8,510
Retirement benefit liabilities	12	**1,152**	1,003
Deferred tax liabilities	13	**500**	556
Other provisions for liabilities and charges	22	**419**	458
Trade and other payables	23	**166**	184
Derivative financial instruments	16	**86**	87
Total non-current liabilities		**11,406**	10,798
Current liabilities			
Borrowings	21	**1,636**	1,766
Income tax payable	18	**404**	494
Other provisions for liabilities and charges	22	**210**	236
Trade and other payables	23	**5,827**	5,174
Derivative financial instruments	16	**65**	177
Total current liabilities		**8,142**	7,847
Total equity and liabilities		**27,327**	27,119

The accompanying notes are an integral part of the Group Financial Statements.

On behalf of the Board

Richard Burrows
Chairman

27 February 2013

Group Cash Flow Statement
For the year ended 31 December

	Notes	2012 £m	2011 £m
Cash flows from operating activities			
Cash generated from operations	25	**5,437**	5,537
Dividends received from associates		**486**	476
Tax paid		**(1,496)**	(1,447)
Net cash generated from operating activities		**4,427**	4,566
Cash flows from investing activities			
Interest received		**72**	79
Dividends received from investments		**2**	2
Purchases of property, plant and equipment		**(664)**	(510)
Proceeds on disposal of property, plant and equipment		**56**	45
Purchases of intangibles		**(140)**	(107)
Purchases and proceeds on disposals of investments	25	**24**	3
Proceeds from associates' share buy-backs	25	**262**	71
Purchases of subsidiaries	25	**(12)**	(295)
Net cash used in investing activities		**(400)**	(712)
Cash flows from financing activities			
Interest paid		**(564)**	(580)
Interest element of finance lease rental payments		**(1)**	–
Capital element of finance lease rental payments		**(5)**	(13)
Proceeds from issue of shares to owners of the parent		**4**	3
Proceeds from the exercise of options over own shares held in employee share ownership trusts		**1**	2
Proceeds from increases in and new borrowings	25	**2,539**	1,361
Movements relating to derivative financial instruments	25	**93**	5
Purchases of own shares		**(1,258)**	(755)
Purchases of own shares held in employee share ownership trusts		**(121)**	(123)
Purchases of non-controlling interests	25	**(24)**	(10)
Reductions in and repayments of borrowings	25	**(1,821)**	(1,304)
Dividends paid to owners of the parent	8	**(2,538)**	(2,358)
Dividends paid to non-controlling interests		**(259)**	(275)
Net cash used in financing activities		**(3,954)**	(4,047)
Net cash flows generated from/(used in) operating, investing and financing activities		**73**	(193)
Differences on exchange		**(176)**	(48)
Decrease in net cash and cash equivalents in the year		**(103)**	(241)
Net cash and cash equivalents at 1 January		**1,942**	2,183
Net cash and cash equivalents at 31 December	19	**1,839**	1,942

The accompanying notes are an integral part of the Group Financial Statements.

Notes on the accounts

1 Accounting policies

Basis of Accounting
The Group financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

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

The Group has not adopted any new and amended IFRSs and IFRIC interpretations with effect from 1 January 2012 that have had any significant effect on reported profit or equity or on the disclosures in the financial statements.

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

The most significant items include:

- the review of asset values, especially goodwill and impairment testing. The key assumptions used in respect of goodwill and impairment testing are the determination of cash-generating units, the long-term growth rate for cash flow projections and the rate used to discount the cash flow projections. These are described in note 9;
- the estimation of and accounting for retirement benefit costs. The determination of the carrying value of assets and liabilities, as well as the charge for the year, and amounts recognised in other comprehensive income, involves judgments made in conjunction with independent actuaries. These involve estimates about uncertain future events based on the environment in different countries, including life expectancy of scheme members, salary and pension increases, inflation and expected returns on assets, as well as discount rates and asset values at the year-end. The assumptions used by the Group and sensitivity analysis are described in note 12;
- the estimation of amounts to be recognised in respect of taxation and legal matters, and the estimation of other provisions for liabilities and charges are subject to uncertain future events, may extend over several years and so the amount and/or timing may differ from current assumptions. The accounting policy for taxation is explained below and the recognised deferred tax assets and liabilities, together with a note of unrecognised amounts, are shown in note 6(b) and note 13. Other provisions for liabilities and charges are as set out in note 22. The accounting policy on contingent liabilities, which are not provided for, is set out below and the contingent liabilities of the Group are explained in note 30;
- the definition of adjusting items, which are separately disclosed as memorandum information, is explained below and the impact of these on the calculation of adjusted earnings is described in note 7;
- the estimation of the fair values of acquired net assets arising in a business combination and the allocation of the purchase consideration between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair values. These estimates are prepared in conjunction with the advice of independent valuation experts where appropriate. The relevant transactions for 2012 are described in note 26; and
- the exemptions taken under IFRS 1 on the first time adoption of IFRS at 1 January 2004 and, in particular, those relating to goodwill on business combinations which are explained in the accounting policies below.

Such estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable in the circumstances and constitute management's best judgment at the date of the financial statements. In the future, actual experience may deviate from these estimates and assumptions, which could affect the financial statements as the original estimates and assumptions are modified, as appropriate, in the year in which the circumstances change.

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

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

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

The results of subsidiary undertakings acquired during the period are included from the date of acquisition of a controlling interest at which date, for the purposes of consolidation, the purchase consideration is allocated between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair value. Acquisition related costs are expensed as incurred. Similarly, the results of associates and joint ventures are included from the date of acquiring significant influence or, in the case of joint ventures, joint control.

The results of subsidiary undertakings, associates and joint ventures which have been sold during the year are included up to the date of disposal. The profit or loss on sale is calculated by reference to the net asset value at the date of disposal, adjusted for purchased goodwill previously consolidated in the balance sheet.

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

Foreign currencies
The functional currency of the Parent Company is sterling and this is also the presentation currency of the Group. The income and cash flow statements of Group undertakings expressed in currencies other than sterling are translated to sterling using exchange rates applicable to the dates of the underlying transactions. Average rates of exchange in each year are used where the average rate approximates the relevant exchange rate at the date of the underlying transactions. Assets and liabilities of Group undertakings are translated at the applicable rates of exchange at the end of each year. For hyperinflationary countries, the financial statements in local currency are adjusted to reflect the impact of local inflation prior to translation into sterling.

1 Accounting policies (continued)

The differences between retained profits of overseas subsidiary undertakings, associates and joint ventures translated at average and closing rates of exchange are taken to reserves, as are differences arising on the retranslation to sterling (using closing rates of exchange) of overseas net assets at the beginning of the year. Any differences that have arisen since 1 January 2004 are presented as a separate component of equity. As permitted under IFRS 1, any differences prior to that date are not included in this separate component of equity.

Where a disposal of an investment in a Group undertaking results in a loss of control of a subsidiary undertaking, the loss of significant influence over an associated company or the loss of joint control over a joint venture, the cumulative amount of the related foreign exchange differences deferred in the separate component of equity are recognised in the income statement when the gain or loss on disposal is recognised. These related exchange differences comprise the exchange differences on all amounts deemed to be part of the net investment in the undertaking, which are recycled to the income statement when a disposal occurs. For partial disposals of subsidiary undertakings the related exchange differences are reclassified within equity. For all other partial disposals the proportional share of the related exchange differences is recycled to the income statement.

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

Revenue

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

Retirement benefit costs

The Group operates both defined benefit and defined contribution schemes. The net deficit or surplus for each defined benefit pension scheme is calculated in accordance with IAS 19 *Employee Benefits*, based on the present value of the defined benefit obligation at the balance sheet date less the fair value of the scheme assets adjusted, where appropriate, for any surplus restrictions or the effect of minimum funding requirements.

Actuarial gains and losses, changes in unrecognised scheme surpluses and minimum funding requirements are recognised in full through other comprehensive income.

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

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

For defined benefit schemes, the actuarial cost charged to profit from operations consists of current service cost, interest cost, expected return on plan assets, past service cost and the impact of any settlements or curtailments.

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

Share-based payments

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

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

Research and development

Research expenditure is charged to income in the year in which it is incurred. Development expenditure is charged to income in the year it is incurred, unless it meets the recognition criteria of IAS 38 *Intangible Assets*.

Taxation

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

The current income tax charge is calculated on the basis of tax laws enacted or substantially enacted at the balance sheet date in the countries where the Group's subsidiaries, associates and joint ventures operate and generate taxable income.

Deferred taxation is provided in full using the liability method for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for taxation purposes. Deferred tax is provided on temporary differences arising on investments in Group undertakings, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that it will not reverse in the foreseeable future. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. As required under IAS 12 *Income Taxes*, deferred tax assets and liabilities are not discounted.

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

Notes on the accounts (continued)

1 Accounting policies (continued)

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

The Group has exposures in respect of the payment or recovery of a number of taxes. Liabilities or assets for these payments or recoveries are recognised at such time as an outcome becomes probable and when the amount can reasonably be estimated.

Goodwill

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

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

The Group's policy up to and including 1997 was to eliminate goodwill against reserves. Goodwill acquired from 1998 to 31 December 2003 was capitalised and amortised over its useful economic life.

As permitted under IFRS 1, in respect of acquisitions prior to 1 January 2004, the classification and accounting treatment of business combinations was not amended on transition to IFRS. Goodwill previously written off direct to reserves is not recycled to the income statement on the disposal of the subsidiary, associate or joint venture to which it relates.

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

Intangible assets other than goodwill

The intangible assets shown on the Group balance sheet consist mainly of trademarks and similar intangibles, including certain intellectual property, acquired by the Group's subsidiary undertakings and computer software.

Acquired trademarks and similar assets are carried at cost less accumulated amortisation and impairment. Trademarks with indefinite lives are not amortised but are reviewed annually for impairment. Intangible assets other than goodwill classified as held-for-sale are not amortised. Other trademarks and similar assets are amortised on a straight-line basis over their remaining useful lives, consistent with the pattern of economic benefits expected to be received, which do not exceed 20 years. Any impairments of trademarks are recognised in the income statement but increases in trademark values are not recognised.

Computer software is carried at cost less accumulated amortisation and impairment, and, with the exception of global software solutions, is amortised on a straight-line basis over periods ranging from three years to seven years. Global software solutions are software assets designed to be implemented on a global basis and used as a standard solution by all of the operating companies in the Group. These assets are amortised on a straight-line basis over periods not exceeding ten years.

The investments in associates and joint ventures shown in the Group balance sheet include trademarks arising from the combination of Brown & Williamson (B&W) and R J Reynolds (RJR) in 2004 to form Reynolds American Inc. (RAI), as well as those arising on the acquisition of Conwood by RAI in 2006. As the combination of B&W and RJR for the Group involved the partial disposal of B&W and an investment in RAI, fair values were assigned to trademarks formerly owned by RJR but not to those formerly owned by B&W. Most of the carrying value of the trademarks relates to trademarks which are deemed to have indefinite lives and each trademark is subject to an annual impairment test. Certain minor trademarks are being amortised over their remaining lives.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment. Depreciation is calculated on a straight-line basis to write off the assets over their useful economic life. No depreciation is provided on freehold land or assets classified as held for sale. Freehold and leasehold property are depreciated at rates between 2.5% and 4% per annum, and plant and equipment at rates between 7% and 25% per annum.

Capitalised interest

Borrowing costs which are directly attributable to the acquisition, construction or production of intangible assets or property, plant and equipment that takes a substantial period of time to get ready for its intended use or sale, and for which the commencement date for capitalisation was on or after 1 January 2009, are capitalised as part of the cost of the asset, in accordance with IAS 23 *Borrowing costs*. The Group's previous policy was to expense such borrowing costs as they were incurred.

Leased assets

Assets where the Group has substantially all the risks and rewards of ownership of the leased asset are classified as finance leases and are included as part of property, plant and equipment. Finance lease assets are initially recognised at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, then depreciated over the shorter of the lease term and their estimated useful lives. Leasing payments consist of capital and finance charge elements and the finance element is charged to the income statement.

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

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

Impairment of non-financial assets

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

1 Accounting policies (continued)

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

Impairment of financial assets

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

Inventories

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

Financial instruments

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

Financial assets and financial liabilities are initially recognised at fair value, plus directly attributable transaction costs where applicable, with subsequent measurement as set out below.

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

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

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

Cash and cash equivalents: cash and cash equivalents include cash in hand and deposits held on call, together with other short-term highly liquid investments including investments in certain money market funds. Cash equivalents normally comprise instruments with maturities of three months or less at date of acquisition. In the cash flow statement, cash and cash equivalents are shown net of bank overdrafts, which are included as current borrowings in the liabilities section on the balance sheet.

Apart from available-for-sale investments, non-derivative financial assets are stated at amortised cost using the effective interest method, subject to reduction for allowances for estimated irrecoverable amounts. These estimates for irrecoverable amounts are recognised when there is objective evidence that the full amount receivable will not be collected according to the original terms of the asset. Such evidence might include financial difficulties of the debtor, defaults of payment or significant overdue balances. For interest-bearing assets, their carrying value includes accrued interest receivable. Available-for-sale investments are stated at fair value, with changes in fair value being recognised directly in other comprehensive income. When such investments are derecognised (e.g. through disposal) or become impaired, the accumulated gains and losses, previously recognised in other comprehensive income, are reclassified to the income statement within ‘finance income’. Dividend and interest income on available-for-sale investments are included within ‘finance income’ when the Group’s right to receive payments is established.

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

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

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

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

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

Notes on the accounts (continued)

1 Accounting policies (continued)

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

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

Dividends

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

Segmental analysis

The Group is organised and managed on the basis of its geographic regions. These are the reportable segments for the Group as they form the focus of the Group's internal reporting systems and are the basis used by the chief operating decision maker, identified as the Management Board, for assessing performance and allocating resources.

The Group is primarily a single product business providing cigarettes and other tobacco products. While the Group has clearly differentiated brands, global segmentation between a wide portfolio of brands is not part of the regular internally reported financial information. The results of next-generation products are not currently material to the Group.

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

Adjusting items

Adjusting items are significant items in the profit from operations, net finance costs, taxation and the Group's share of the post-tax results of associates and joint ventures which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. While the disclosure of adjusting items is not required by IFRS, these items are separately disclosed either as memorandum information on the face of the income statement and in the segmental analyses, or in the notes to the accounts as appropriate.

The Group believes that these items are useful to users of the Group financial statements in helping them to understand the underlying business performance and are used to derive the Group's principal non-GAAP measure which is adjusted diluted earnings per share.

Provisions

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

Contingent liabilities and contingent assets

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

Contingent assets are possible assets whose existence will only be confirmed by future events not wholly within the control of the entity and are not recognised as assets until the realisation of income is virtually certain.

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

Repurchase of share capital

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

Future changes to accounting policies

Certain changes to IFRS will be applicable to the Group financial statements in future years. Set out below are those which are considered to affect the Group.

IAS 19 *Employee Benefits* has been revised and has mandatory application from 1 January 2013. The new standard does not substantially change the values of retirement benefit assets and liabilities on the balance sheet, but does change the amounts recognised in the income statement and in other comprehensive income. The expected return on plan assets and the interest cost on liabilities are replaced by a new component of the income statement charge – interest on the net retirement benefit asset/liability. In addition, past service costs will no longer be deferred and will be recognised immediately. The revised standard has retrospective application. Had the standard been applied to the 2012 results, profit for the year would have been approximately £47 million lower (2011: £54 million lower), with a compensating credit in other comprehensive income.

An amendment to IAS 1 *Presentation of Financial Statements* has been issued. This amendment changes the disclosure of items presented in other comprehensive income grouping them into items which recycle to profit and loss and items which will not. Apart from the change in disclosure, this amendment will have little impact on the Group financial statements. Mandatory application is for accounting periods beginning on or after 1 July 2012.

IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities* have been issued along with revised versions of IAS 27 *Separate Financial Statements* and IAS 28 *Associates*; additionally IAS 31 *Joint Ventures* has been withdrawn. These standards form a single package of proposals with mandatory application in the EU from 1 January 2014. The aim of these standards is to improve the quality

1 Accounting policies (continued)

of reporting in relation to the consolidation of subsidiaries, special purpose vehicles and accounting for joint arrangements. The Group intends to early adopt these new and revised standards with effect from 1 January 2013. While the requirements of IFRS 12 will potentially lengthen certain disclosures in respect of Group entities, the requirements of these standards are not expected to materially affect the Group in its present form.

IFRS 13 *Fair Value Measurement* has been issued. This standard aims to provide a single source of fair value measurement and disclosure requirements for use across IFRS. The implementation of IFRS 13 does not change where fair value is or is not applied under IFRS and will not require a restatement of historical transactions. Mandatory application is from 1 January 2013.

IFRS 9 *Financial Instruments* has been issued. This standard represented the first phase of the IASB's project to replace IAS 39 *Financial Instruments: Recognition and Measurement*, and has mandatory application for accounting periods beginning on or after 1 January 2015. In its current form, it sets out the classification and measurement criteria for financial assets and financial liabilities. It requires all financial assets, including assets currently classified under IAS 39 as available-for-sale, to be measured at fair value through profit and loss unless the assets can be classified as held at amortised cost. Qualifying equity investments held at fair value may have their fair value changes taken through other comprehensive income by election. Where the fair value option for certain financial liabilities is applied, the portion of fair value changes representing own credit risk would be recognised through other comprehensive income rather than the income statement. The Group does not use the fair value option for financial liabilities. The effect of applying the standard in its current form is not considered to have a material impact on the Group's reported profit or equity. The impact on the Group of further changes to IFRS 9 and the impact of the second and third phases of the project, covering impairment and hedge accounting respectively, will be assessed when the IASB has finalised the proposed requirements. IFRS 9 has not been endorsed by the EU and will only become applicable once that endorsement has occurred.

In addition, a number of other interpretations and revisions to existing standards have been issued which will be applicable to the Group financial statements in future years and which will have no material effect on reported profit or equity or on the disclosures in the financial statements.

Notes on the accounts (continued)

2 Segmental analyses

As the chief operating decision maker, the Management Board reviews external revenues and adjusted profit from operations to evaluate segment performance and allocate resources. Interest income, interest expense and taxation are centrally managed and accordingly such items are not presented by segment as they are excluded from the measure of segment profitability.

The four geographic regions are the reportable segments for the Group as they form the focus of the Group's internal reporting systems and are the basis used by the Management Board for assessing performance and allocating resources. The results of next-generation products are not currently material to the Group and are included within the Western Europe region.

The Management Board reviews current and prior year segmental revenue, adjusted profit from operations of subsidiaries and adjusted post-tax results of associates and joint ventures at constant rates of exchange. The constant rate comparison provided for reporting segment information is based on a retranslation, at prior year exchange rates, of the current year results of the Group's overseas entities but, other than in exceptional circumstances, does not adjust for transactional gains and losses in operations which are generated by movements in exchange rates. As a result, the 2012 segmental results were translated using the 2011 rates of exchange. The 2011 figures are also stated at the 2011 rates of exchange.

The analyses of revenue for the 12 months to 31 December 2012 and 31 December 2011, based on location of sales, are as follows:

	2012			2011
	Revenue Constant rates £m	Translation exchange £m	Revenue Current rates £m	Revenue £m
Asia-Pacific	**4,224**	**(10)**	**4,214**	4,251
Americas	**3,742**	**(282)**	**3,460**	3,558
Western Europe	**3,682**	**(240)**	**3,442**	3,600
EEMEA	**4,351**	**(277)**	**4,074**	3,990
Revenue	**15,999**	**(809)**	**15,190**	15,399

The analyses of profit from operations and the Group's share of the post-tax results of associates and joint ventures, reconciled to profit before taxation, are as follows:

	2012					2011		
	Adjusted* segment result Constant rates £m	Translation exchange £m	Adjusted* segment result Current rates £m	Adjusting items £m	Segment result Current rates £m	Adjusted* Segment Result £m	Adjusting items £m	Segment result £m
Asia-Pacific	**1,653**	**13**	**1,666**	**(80)**	**1,586**	1,539	(58)	1,481
Americas	**1,544**	**(129)**	**1,415**	**(64)**	**1,351**	1,441	(15)	1,426
Western Europe	**1,262**	**(76)**	**1,186**	**(99)**	**1,087**	1,228	(153)	1,075
EEMEA	**1,511**	**(97)**	**1,414**	**(26)**	**1,388**	1,311	(298)	1,013
	5,970	**(289)**	**5,681**	**(269)**	**5,412**	5,519	(524)	4,995
Fox River**				**–**	**–**		(274)	(274)
Profit from operations	**5,970**	**(289)**	**5,681**	**(269)**	**5,412**	5,519	(798)	4,721
Net finance costs					**(456)**			(460)
Asia-Pacific	**277**	**(32)**	**245**	**20**	**265**	225	28	253
Americas	**445**	**5**	**450**	**(25)**	**425**	432	(17)	415
EEMEA	**2**	**–**	**2**	**–**	**2**	2	–	2
Share of post-tax results of associates and joint ventures	**724**	**(27)**	**697**	**(5)**	**692**	659	11	670
Profit before taxation					**5,648**			4,931

* The adjustments to profit from operations and the Group's share of the post-tax results of associates and joint ventures are explained in notes 3(e) to 3(h) and in note 5, respectively.

** The Fox River provision made in 2011 (see note 3(h) and note 30) has not been allocated to a segment or segments as it relates to a 1998 settlement agreement. It is presented separately from the segmental reporting which is used to evaluate segment performance and to allocate resources.

2 Segmental analyses (continued)

Adjusted profit from operations at constant rates of £5,970 million (2011: £5,519 million) excludes certain depreciation, amortisation and impairment charges as explained in notes 3(b) and 3(e) to 3(g). These are excluded from segmental profit from operations at constant rates as follows:

	2012					2011		
	Adjusted depreciation and amortisation Constant rates £m	Translation exchange £m	Adjusted depreciation and amortisation Current rates £m	Adjusting items £m	Depreciation, amortisation and impairment Current rates £m	Adjusted depreciation and amortisation £m	Adjusting items £m	Depreciation, amortisation and impairment £m
Asia-Pacific	**90**	**(1)**	**89**	**22**	**111**	106	31	137
Americas	**112**	**(8)**	**104**	**25**	**129**	127	5	132
Western Europe	**98**	**(6)**	**92**	**34**	**126**	103	55	158
EEMEA	**106**	**(5)**	**101**	**8**	**109**	111	279	390
	406	**(20)**	**386**	**89**	**475**	447	370	817

External revenue and non-current assets other than financial instruments, deferred tax assets and retirement benefit assets are analysed between the UK and all foreign countries at current rates of exchange as follows:

	United Kingdom		All foreign countries		Group	
Revenue is based on location of sale	**2012 £m**	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
External revenue	**139**	124	**15,051**	15,275	**15,190**	15,399

	United Kingdom		All foreign countries		Group	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Intangible assets	**306**	173	**11,404**	11,819	**11,710**	11,992
Property, plant and equipment	**375**	188	**2,826**	2,859	**3,201**	3,047
Investments in associates and joint ventures	**–**	–	**2,330**	2,613	**2,330**	2,613

Included in the external revenue from foreign countries is £1,607 million (2011: £1,732 million) attributable to Brazil, being the only subsidiary contributing more than 10% of the Group's external revenue in 2012 and 2011. The main acquisitions comprising the goodwill balance of £10,793 million (2011: £11,120 million) in intangible assets are provided in note 9. Included in investments in associates and joint ventures are amounts of £1,496 million (2011: £1,831 million) attributable to the investment in Reynolds American Inc. and £793 million (2011: £735 million) attributable to the investment in ITC Ltd. Further information can be found in note 11.

Notes on the accounts (continued)

3 Profit from operations
(a) Employee benefit costs

	2012 £m	2011 £m
Wages and salaries	**1,907**	2,059
Social security costs	**257**	247
Other pension and retirement benefit costs (note 12)	**131**	98
Share-based payments – equity-settled (note 27)	**73**	76
Share-based payments – cash-settled (note 27)	**18**	21
	2,386	2,501

(b) Depreciation, amortisation and impairment costs

		2012 £m	2011 £m
Intangibles	– amortisation of trademarks and similar intangibles (note 3(f))	**63**	58
	– amortisation of other intangibles	**53**	92
	– impairment	**–**	273
Property, plant and equipment	– depreciation	**347**	366
	– impairment	**12**	28
		475	817

Impairment of intangibles is explained in note 3(g). Impairment in respect of certain other intangibles and property, plant and equipment is shown as part of restructuring costs (see note 3(e)).

(c) Other operating income
This represents operating income arising from the Group's activities which falls outside the definition of revenue and includes gains as a result of property disposals, service fees and other shared costs charged to third parties, manufacturing fees and trademark income.

3 Profit from operations (continued)

(d) Other operating expenses include:

	2012 £m	2011 £m
Research and development expenses (excluding employee benefit costs and depreciation)	**93**	81
Exchange differences	**50**	38
Rent of plant and equipment (operating leases)		
– minimum lease payments	**41**	42
Rent of property (operating leases)		
– minimum lease payments	**74**	85
– sublease payments	**1**	2
Fees payable for audit services pursuant to legislation:		
– fees payable to PricewaterhouseCoopers LLP for parent company and Group audit	**1.8**	1.7
– fees payable to other PricewaterhouseCoopers firms and associates for local statutory and Group reporting audits	**7.7**	8.0
Audit fees payable to PricewaterhouseCoopers firms and associates	**9.5**	9.7
Audit fees payable to other firms	**0.5**	0.4
Total audit fees payable	**10.0**	10.1
Fees payable to PricewaterhouseCoopers firms and associates for other services:		
– audit-related assurance services	**1.0**	0.2
– other assurance services	**0.2**	–
– tax advisory services	**2.5**	3.8
– tax compliance	**0.9**	1.3
– other non-audit services	**0.5**	0.6
	5.1	5.9

The total fees payable to PricewaterhouseCoopers firms and associates included above are £14.6 million (2011: £15.6 million).

Total research and development costs including employee benefit costs and depreciation were £171 million (2011: £166 million).

In 2011, other operating expenses also include the Fox River provision which was made in that year and is explained in note 30.

(e) Restructuring and integration costs

Restructuring costs reflect the costs incurred as a result of initiatives to improve the effectiveness and the efficiency of the Group as a globally integrated enterprise, including the relevant operating costs of implementing the new operating model. The new operating model includes revised organisation structures, standardised processes and shared back office services underpinned by a global single instance of SAP. The new organisation structures and processes are currently being implemented and the deployment of the new SAP system started in the third quarter of 2012 and will take around four years to fully roll out. Other initiatives include a review of the Group's manufacturing operations, supply chain, overheads and indirect costs. The costs of these initiatives together with the costs of integrating acquired businesses into existing operations, including acquisition costs, are included in profit from operations under the following headings:

	2012 £m	2011 £m
Employee benefit costs	**96**	100
Depreciation and impairment costs	**26**	39
Other operating expenses	**100**	72
Other operating income	**(16)**	(18)
	206	193

Notes on the accounts (continued)

3 Profit from operations (continued)

Restructuring and integration costs in 2012 principally relate to the implementation of the new operating model, the continuation of the factory closure and downsizing activities in Australia and the restructuring in Argentina. The costs also cover the social plan and other activities relating to the Bremen factory closure in Germany, the integration of Productora Tabacalera de Colombia, S.A.S. (Protabaco) into existing operations, as well as the write-off of non-compliant products and materials related to the implementation of plain packaging in Australia. In addition, they also include separation packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group.

Restructuring and integration costs in 2011 principally related to: factory closure and downsizing activities in Denmark and Australia respectively; a voluntary separation scheme and closure of the printing unit in Argentina; the closure of the Jawornik factory in Poland, the Tire factory in Turkey and the Lecce factory in Italy. The costs also cover the social plan and other closure activities relating to the Bremen factory closure in Germany and the integration of Productora Tabacalera de Colombia, S.A.S. (Protabaco) into existing operations, including acquisition costs, as well as other restructuring initiatives directly related to improving the efficiency and effectiveness of the Group as a globally integrated enterprise. In addition, they also include separation packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group.

Other operating income in 2012 includes gains from the sale of land and buildings in the UK and South Africa and the release of deferred income from a disposal in 2007. In 2011, other operating income also includes gains from sale of surplus land and buildings in Argentina and the release of deferred income from a disposal in 2007.

(f) Amortisation of trademarks and similar intangibles

The acquisitions of Protabaco, Bentoel, Tekel, ST and CN Creative Limited (see note 26(a)) resulted in the capitalisation of trademarks and similar intangibles which are amortised over their expected useful lives, which do not exceed 20 years. The amortisation charge of £63 million (2011: £58 million) is included in depreciation, amortisation and impairment costs in profit from operations.

(g) Goodwill impairment

In 2011, the Group impaired the remaining balance of the goodwill in respect of the Tekel acquisition in 2008, amounting to £273 million. Although cost saving initiatives in the acquisition plan have been delivered successfully, the impairment charge arose as a result of further increases in excise announced by the Turkish government effective from October 2011 and an additional increase effective from January 2013. The excise increases to date have resulted in the growth of illicit trade and a loss of volumes and market share. Turkey remains an important strategic market for the Group. The basis for determining the recoverable amounts of goodwill is explained in note 9.

(h) Fox River

In 2011, a provision of £274 million was made for a potential claim under a 1998 settlement agreement entered into by a Group subsidiary in respect of the clean up of sediment in the lower Fox River. This is explained in more detail in note 30.

4 Net finance costs

	2012 £m	2011 £m
Finance costs		
– interest payable		
– bank borrowings	**83**	82
– finance leases	**1**	1
– facility fees	**10**	8
– other	**486**	476
	580	567
– fair value changes on derivative financial instruments	**(71)**	12
– exchange differences on financial liabilities	**(4)**	(2)
	505	577
Finance income		
– interest and dividend income		
– gains in respect of available-for-sale investments	**(1)**	(1)
– dividend income in respect of available-for-sale investments	**(2)**	(2)
– other interest income	**(81)**	(79)
	(84)	(82)
– exchange differences on financial assets	**35**	(35)
	(49)	(117)
Net finance costs	**456**	460

The Group manages foreign exchange gains and losses and fair value changes on a net basis, as shown below. The derivatives that generate the fair value changes are detailed in note 16.

	2012 £m	2011 £m
Fair value changes		
– cash flow hedges transferred from equity	**35**	9
– fair value hedging instruments – exchange related movements	**3**	4
– fair value hedging instruments – net interest income	**(66)**	(62)
– fair value hedging instruments – interest related movements *(see note (i))*	**(29)**	(51)
– fair value changes on hedged items – interest related movements *(see note (i))*	**31**	39
– instruments held-for-trading *(see note (ii))*	**(45)**	73
	(71)	12
Finance costs – exchange differences on financial liabilities	**(4)**	(2)
Finance income – exchange differences on financial assets	**35**	(35)
	(40)	(25)

Notes:

(i) Hedge ineffectiveness in respect of fair value hedges is a £2 million loss (2011: £12 million gain) being the difference between the two items above.

(ii) IFRS requires derivatives which do not meet the tests for hedge accounting under IAS 39 to be classified as instruments held-for-trading with fair value changes included in the income statement. These derivatives principally consist of other derivatives shown in note 16(d) and forward foreign currency contracts which have not been designated as hedges due to their fair value changes offsetting with other components of net finance costs relating to financial assets and liabilities.

Other interest payable includes interest on the bonds and notes detailed in note 21. Facility fees principally relate to the Group's central undrawn banking facilities of £2 billion and US$150 million and the Group's €450 million term loan facility which was repaid during 2012 (2011: £2 billion and the Group's €450 million term loan facility).

Exchange differences in respect of hedged items subject to fair value hedges and cash flow hedges were a gain of £3 million (2011: £4 million gain) and a gain of £28 million (2011: £9 million gain) respectively and are included in 'Finance costs – exchange differences' in the table above.

Notes on the accounts (continued)

5 Associates and joint ventures

	2012 Total £m	2012 Group's share £m	2011 Total £m	2011 Group's share £m
Gross turnover (including duty, excise and other taxes)	**12,733**	**4,798**	12,841	4,864
Duty, excise and other taxes	**(3,927)**	**(1,488)**	(4,053)	(1,541)
Revenue	**8,806**	**3,310**	8,788	3,323
Profit from operations	**2,980**	**1,113**	2,861	1,066
Net finance costs	**(160)**	**(66)**	(149)	(62)
Profit on ordinary activities before taxation	**2,820**	**1,047**	2,712	1,004
Taxation on ordinary activities	**(936)**	**(352)**	(881)	(331)
Profit on ordinary activities after taxation	**1,884**	**695**	1,831	673
Attributable to:				
Owners of parent company		**692**		670
Non-controlling interests		**3**		3
		695		673
Analysed as:				
– adjusted share of post-tax results of associates and joint ventures		**697**		659
– issue of shares and change in shareholding	**66**	**20**	91	28
– smoking cessation programme	**–**	**–**	(55)	(23)
– gain on disposal of business	**–**	**–**	51	22
– restructuring and integration costs	**(57)**	**(24)**	(9)	(4)
– change in post-retirement obligations	**58**	**24**	–	–
– other	**(59)**	**(25)**	(28)	(12)
		692		670
Dividends				
– listed investments		**476**		479
– unlisted investments		**11**		7
		487		486

The share of post-tax results of associates and joint ventures is after the following adjusting items which are excluded from the calculation of adjusted earnings per share as set out in note 7:

In 2012, the Group's interest in ITC decreased from 31.04% to 30.72% as a result of ITC issuing ordinary shares under the company's employee stock option scheme. The issue of shares and change in the Group's share of ITC resulted in a gain of £20 million, which is treated as a deemed partial disposal and included in the income statement.

During the year, Reynolds American recognised restructuring charges of US$149 million in respect of its overall activities. The Group's share of these charges is £24 million (net of tax).

In addition, Reynolds American amended a post-retirement medical plan that resulted in a gain of US$157 million and the Group's share of this gain is £24 million (net of tax).

Reynolds American has also recognised amounts which have been combined in the table of adjusting items and reported in other. These mainly consist of a charge of US$37 million in respect of a number of Engle progeny lawsuits, the Group's share of these costs is £6 million (net of tax) and trademark amortisation and impairment of US$86 million, the Group's share of these charges amounts to £16 million (net of tax).

5 Associates and joint ventures (continued)

In 2011, the Group's interest in ITC decreased from 31.43% to 31.04% as a result of ITC issuing ordinary shares under the company's employee stock option scheme. This resulted in a gain of £28 million, which was treated as a deemed partial disposal and included in the income statement.

During 2011, Reynolds American, along with other tobacco companies, was refused by the US Supreme Court a request to revoke a 2009 order requiring them to finance a US$278 million smoking cessation programme in Louisiana (Scott case). The Group's share of this charge amounted to £23 million (net of tax).

In March 2011, Reynolds American sold Lane Limited for US$205 million in cash. The Group's share of the gain on the disposal of this business amounted to £22 million (net of tax).

In addition, during 2011, Reynolds American recognised restructuring charges of US$23 million and the Group's share of these charges amounted to £4 million (net of tax).

In the year ended 31 December 2011, Reynolds American recognised amounts which have been combined in the table of adjusting items and reported in other. These mainly consist of a charge of US$64 million in respect of four Engle progeny lawsuits that have proceeded through the appellate process in the state of Florida, the Group's share of this charge amounted to £10 million (net of tax); trademark amortisation and impairment of US$47 million, the Group's share of these charges amounted to £8 million (net of tax) and US$16 million and US$11 million of tax credits and interest, respectively, the Group's share of these credits amounted to £6 million (net of tax).

6 Taxation on ordinary activities

(a) Summary of taxation on ordinary activities

	2012 £m	2011 £m
UK corporation tax	–	–
Comprising:		
– current year tax expense	13	14
– double taxation relief	(13)	(14)
Overseas tax	1,538	1,470
Comprising:		
– current year tax expense	1,556	1,449
– adjustments in respect of prior periods	(18)	21
Total current tax	1,538	1,470
Deferred tax	(12)	86
Comprising:		
– deferred tax relating to origination and reversal of temporary differences	(12)	84
– deferred tax relating to changes in tax rates	–	2
	1,526	1,556

(b) Franked Investment Income Group Litigation Order

British American Tobacco is the principal test claimant in an action in the United Kingdom against HM Revenue and Customs in the Franked Investment Income Group Litigation Order (FII GLO). There are 25 corporate groups in the FII GLO. The case concerns the treatment for UK corporate tax purposes of profits earned overseas and distributed to the UK. The claim was filed in 2003 and the case was heard in the European Court of Justice (ECJ) in 2005 and a decision of the ECJ received in December 2006. In July 2008, the case reverted to a trial in the UK High Court for the UK Court to determine how the principles of the ECJ decision should be applied in a UK context.

The High Court judgment in November 2008 concluded, amongst many other things, that dividends received from EU subsidiaries should have been exempt from UK taxation. It also concluded that certain dividends received before 5 April 1999 from the EU and, in some limited circumstances after 1993 from outside the EU, should have been treated as franked investment income with the consequence that advance corporation tax (ACT) need not have been paid. Claims for the repayment of UK tax incurred where the dividends were from the EU were allowed back to 1973. The tentative conclusion reached by the High Court would, if upheld, produce an estimated receivable of about £1.2 billion for British American Tobacco.

Notes on the accounts (continued)

6 Taxation on ordinary activities (continued)

The case was heard by the Court of Appeal in October 2009 and the judgment handed down on 23 February 2010. The Court of Appeal determined that various questions, including which companies in the corporate tree can be included in a claim, should be referred back to the ECJ for further clarification. In addition, the Court determined that the claim should be restricted to six years and not cover claims dating back to 1973. The issue of time limits was heard by the Supreme Court in February 2012 and in May 2012 the Supreme Court decided in British American Tobacco Group's favour, that claims submitted before 8 September 2003 can go back to 1973. A hearing took place in February 2012 at the ECJ on the questions referred from the Court of Appeal.

The ECJ judgment of 13 November 2012 confirms that the UK treatment of EU dividends was discriminatory and produces the same outcome for third country dividends from 1994 in certain circumstances. The judgment also confirms that the claim can cover dividends from all indirect as well as direct EU subsidiaries and also ACT paid by a superior holding company.

The case will now revert to the UK High Court to apply the ECJ judgment and the date of the trial is awaited.

No potential receipt has been recognised in the current year or the prior year, in the results of the Group, due to the uncertainty of the amounts and eventual outcome.

(c) Factors affecting the taxation charge

The taxation charge differs from the standard 24% (2011: 26%) rate of corporation tax in the UK. The major causes of this difference are listed below:

	2012		2011	
	£m	%	£m	%
Profit before tax	**5,648**		4,931	
Less: share of post-tax results of associates and joint ventures	**(692)**		(670)	
	4,956		4,261	
Tax at 24% (2011: 26%) on the above	**1,189**	**24.0**	1,108	26.0
Factors affecting the tax rate:				
Tax at standard rates other than UK corporation tax rate	**129**	**2.6**	80	1.8
Other national tax charges	**76**	**1.5**	67	1.6
Permanent differences	**24**	**0.5**	155	3.6
Overseas withholding taxes	**172**	**3.5**	143	3.4
Double taxation relief on UK profits	**(13)**	**(0.3)**	(14)	(0.3)
Adjustments in respect of prior periods	**(18)**	**(0.3)**	21	0.5
Net deferred tax credits at other tax rates	**(33)**	**(0.7)**	(4)	(0.1)
	1,526	**30.8**	1,556	36.5

In 2012, the merger of the Group's Colombian companies led to a £11 million reduction in a deferred tax liability that was set up on the acquisition of Protabaco in 2011.

Following the goodwill impairment in Turkey in 2011 as explained in note 3(g) and the uncertainty of future taxable profits, the Group wrote off deferred tax assets of £43 million in 2011.

The above have been treated as adjusting items in the adjusted earnings per share calculation as set out in note 7.

(d) Tax on items recognised directly in other comprehensive income

	2012 £m	2011 £m
Current tax	**(2)**	15
Deferred tax	**30**	5
Credited to other comprehensive income	**28**	20

The tax relating to each component of other comprehensive income is disclosed in note 20.

7 Earnings per share

Basic earnings per share are based on profit for the year attributable to ordinary shareholders of £3,841 million (2011: £3,095 million) and 1,939 million (2011: 1,970 million) ordinary shares of 25p each, being the weighted average number of shares in issue during the year (excluding shares held as treasury shares).

For the calculation of diluted earnings per share, the weighted average number of shares in issue is increased to 1,949 million (2011: 1,982 million) to reflect the potential dilutive effect of employee share schemes.

	2012			2011		
	Earnings £m	Weighted average number of shares m	Earnings per share pence	Earnings £m	Weighted average number of shares m	Earnings per share pence
Basic earnings per share	**3,841**	**1,939**	**198.1**	3,095	1,970	157.1
Share options	**–**	**10**	**(1.0)**	–	12	(0.9)
Diluted earnings per share	**3,841**	**1,949**	**197.1**	3,095	1,982	156.2

Earnings have been affected by a number of adjusting items, which are described in notes 3, 5 and 6. To illustrate the impact of these items, an adjusted earnings per share calculation is shown below.

Adjusted earnings per share calculation

		Diluted				Basic			
		2012		2011		2012		2011	
	Notes	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence
Unadjusted earnings per share		**3,841**	**197.1**	3,095	156.2	**3,841**	**198.1**	3,095	157.1
Effect of restructuring and integration costs	3(e)	**206**	**10.6**	193	9.7	**206**	**10.6**	193	9.8
Tax and non-controlling interests on restructuring and integration costs		**(45)**	**(2.3)**	(45)	(2.3)	**(45)**	**(2.3)**	(45)	(2.3)
Effect of goodwill impairment	3(g)	**–**	**–**	273	13.8	**–**	**–**	273	13.9
Tax on goodwill impairment		**–**	**–**	(10)	(0.5)	**–**	**–**	(10)	(0.5)
Effect of deferred tax liability credit	6(c)	**(11)**	**(0.6)**	–	–	**(11)**	**(0.6)**	–	–
Effect of deferred tax asset written off	6(c)	**–**	**–**	43	2.2	**–**	**–**	43	2.2
Effect of amortisation of trademarks and similar intangibles	3(f)	**63**	**3.2**	58	2.9	**63**	**3.3**	58	2.9
Tax on amortisation of trademarks and similar intangibles		**(15)**	**(0.8)**	(13)	(0.7)	**(15)**	**(0.8)**	(13)	(0.7)
Effect of Fox River	3(h)	**–**	**–**	274	13.8	**–**	**–**	274	13.9
Effect of associates' adjusting items	5	**5**	**0.3**	(11)	(0.5)	**5**	**0.3**	(11)	(0.5)
Adjusted earnings per share		**4,044**	**207.5**	3,857	194.6	**4,044**	**208.6**	3,857	195.8

Notes on the accounts (continued)

7 Earnings per share (continued)

Headline earnings per share as required by the JSE Limited

The presentation of headline earnings per share, as an alternative measure of earnings per share, is mandated under the JSE Listing Requirements. It is calculated in accordance with Circular 3/2012 'Headline Earnings', as issued by the South African Institute of Chartered Accountants. Circular 3/2012 superceded Circular 3/2009 for periods ending on or after 31 July 2012 and requires the comparative figures to be restated. The comparative headline earnings per share for 2011, however, remains unchanged when calculated in accordance with the new Circular. Headline earnings per share are calculated as shown below:

	Diluted				Basic			
	2012		2011		**2012**		2011	
	Earnings £m	**Earnings per share pence**	Earnings £m	Earnings per share pence	**Earnings £m**	**Earnings per share pence**	Earnings £m	Earnings per share pence
Unadjusted earnings per share	**3,841**	**197.1**	3,095	156.2	**3,841**	**198.1**	3,095	157.1
Effect of impairment of intangibles, and property, plant and equipment	**12**	**0.6**	301	15.2	**12**	**0.6**	301	15.3
Tax and non-controlling interests on impairment of intangibles, and property, plant and equipment	**(4)**	**(0.2)**	(15)	(0.8)	**(4)**	**(0.2)**	(15)	(0.8)
Effect of gains on disposal of property, plant and equipment and held-for-sale assets	**(15)**	**(0.8)**	(15)	(0.8)	**(15)**	**(0.8)**	(15)	(0.8)
Tax and non-controlling interests on disposal of property, plant and equipment and held-for-sale assets	**–**	**–**	5	0.3	**–**	**–**	5	0.3
Effect of gains reclassified from the available-for-sale reserve	**(1)**	**(0.1)**	(1)	(0.1)	**(1)**	**(0.1)**	(1)	(0.1)
Share of associates' trademark and other asset impairments net of tax	**15**	**0.8**	7	0.4	**15**	**0.8**	7	0.4
Share of associates' gains on disposal of assets held-for-sale net of tax	**–**	**–**	(26)	(1.3)	**–**	**–**	(26)	(1.3)
Issue of shares and change in shareholding in associate	**(20)**	**(1.0)**	(28)	(1.4)	**(20)**	**(1.0)**	(28)	(1.4)
Headline earnings per share	**3,828**	**196.4**	3,323	167.7	**3,828**	**197.4**	3,323	168.7

An alternative measure of headline earnings per share has been presented below to take account of the effect of Fox River (note 3(h)); this measure is in addition to that mandated by the JSE Listing Requirements.

Headline earnings per share amended for Fox River	**3,828**	**196.4**	3,597	181.5	**3,828**	**197.4**	3,597	182.6

8 Dividends and other appropriations

	2012		2011	
	Pence per share	**£m**	Pence per share	£m
Ordinary shares				
Interim				
2012 paid 26 September 2012	**42.2**	**815**	–	–
2011 paid 28 September 2011	**–**	**–**	38.1	738
Final				
2011 paid 3 May 2012	**88.4**	**1,723**	–	–
2010 paid 5 May 2011	**–**	**–**	81.0	1,620
	130.6	**2,538**	119.1	2,358

The Directors have recommended to shareholders a final dividend of 92.7 pence per share for the year ended 31 December 2012. If approved, this dividend will be paid to shareholders on 8 May 2013. This dividend is subject to approval by shareholders at the Annual General Meeting and therefore, in accordance with IAS 10, it has not been included as a liability in these financial statements. The total estimated dividend to be paid is £1,789 million, which takes the total dividends declared in respect of 2012 to £2,604 million (2011: £2,461 million) representing 134.9 pence per share (2011: 126.5 pence per share).

9 Intangible assets

	Goodwill £m	Computer software £m	Trademarks and similar intangibles £m	Assets in the course of development £m	Total £m
1 January 2012					
Cost	**11,120**	**617**	**883**	**108**	**12,728**
Accumulated amortisation and impairment	**–**	**(478)**	**(258)**	**–**	**(736)**
Net book value at 1 January 2012	**11,120**	**139**	**625**	**108**	**11,992**
Differences on exchange	**(325)**	**(2)**	**(13)**	**(2)**	**(342)**
Additions					
– internal development	**–**	**1**	**–**	**116**	**117**
– acquisition of subsidiaries (note 26)	**(2)**	**–**	**40**	**–**	**38**
– separately acquired	**–**	**10**	**5**	**5**	**20**
Reallocations	**–**	**54**	**–**	**(54)**	**–**
Amortisation charge	**–**	**(52)**	**(63)**	**–**	**(115)**
31 December 2012					
Cost	**10,793**	**659**	**904**	**173**	**12,529**
Accumulated amortisation and impairment	**–**	**(509)**	**(310)**	**–**	**(819)**
Net book value at 31 December 2012	**10,793**	**150**	**594**	**173**	**11,710**
1 January 2011					
Cost	11,656	551	802	83	13,092
Accumulated amortisation and impairment	–	(417)	(217)	–	(634)
Net book value at 1 January 2011	11,656	134	585	83	12,458
Differences on exchange	(397)	(4)	(30)	(3)	(434)
Additions					
– internal development	–	13	–	97	110
– acquisition of subsidiaries (note 26)	134	–	121	–	255
– separately acquired	–	16	6	–	22
Reallocations	–	68	1	(69)	–
Amortisation charge	–	(88)	(58)	–	(146)
Impairment	(273)	–	–	–	(273)
31 December 2011					
Cost	11,120	617	883	108	12,728
Accumulated amortisation and impairment	–	(478)	(258)	–	(736)
Net book value at 31 December 2011	11,120	139	625	108	11,992

Included in computer software and assets in the course of development are internally developed assets with a carrying value of £296 million (2011: £203 million). The costs of internally developed assets include capitalised expenses of employees working full time on software development projects, third party consultants, as well as software licence fees from third-party suppliers.

Acquisitions of subsidiaries in 2012 relates to the acquisition of CN Creative Limited and in 2011 relates to the acquisition of Protabaco as explained in note 26.

Included in the net book value of trademarks and similar intangibles are trademarks relating to the acquisition of ST £322 million (2011: £367 million), Tekel £41 million (2011: £45 million), Bentoel £60 million (2011: £80 million) and Protabaco £112 million (2011: £119 million) and intellectual property of £40 million related to the acquisition of CN Creative Limited in 2012 (see note 26(a)).

Notes on the accounts (continued)

9 Intangible assets (continued)

Impairment testing for intangible assets with indefinite lives including goodwill

Goodwill of £10,793 million (2011: £11,120 million) is included in intangible assets in the balance sheet of which the following are the significant acquisitions: Rothmans Group £4,796 million (2011: £4,947 million); Imperial Tobacco Canada £2,477 million (2011: £2,533 million); ETI (Italy) £1,337 million (2011: £1,377 million) and ST (principally Scandinavia) £1,004 million (2011: £1,038 million). The principal allocations of goodwill in the Rothmans' acquisition are to the cash-generating units of Eastern Europe, Western Europe and South Africa, with the remainder mainly relating to operations in the domestic and export markets in the United Kingdom and operations in Asia-Pacific.

In 2012 goodwill was allocated for impairment testing purposes to 14 individual cash-generating units (2011: 15 individual cash-generating units) – five in Asia-Pacific, five in the Americas, two in Western Europe and two in EEMEA. In 2011, the goodwill in respect of Turkey was allocated for impairment testing purposes to a third cash-generating unit in EEMEA but was fully impaired during that year (see note 3(g)).

The carrying amounts of goodwill allocated to the cash-generating units of Canada £2,477 million (2011: £2,533 million), Western Europe (includes Rothmans and other acquisitions) £3,539 million (2011: £3,646 million), Eastern Europe (includes Rothmans and other acquisitions) £889 million (2011: £914 million), South Africa £803 million (2011: £883 million), Australia (includes Rothmans and other acquisitions) £856 million (2011: £884 million), Singapore £538 million (2011: £530 million) and Malaysia £474 million (2011: £478 million) are considered significant in comparison with the total carrying amount of goodwill.

The recoverable amount of all cash-generating units has been determined on a value-in-use basis. The key assumptions for the recoverable amount of all units are the long-term growth rate and the discount rate. The long-term growth rate used is purely for the impairment testing of goodwill under IAS 36 *Impairment of Assets* and does not reflect long-term planning assumptions used by the Group for investment proposals or for any other assessments. The discount rate is based on the Group's weighted average cost of capital, taking into account the cost of capital and borrowings, to which specific market-related premium adjustments are made. These adjustments are derived from external sources and are based on the spread between bonds (or credit default swaps, or similar indicators) issued by the US or comparable governments and by the local government, adjusted for the Group's own credit market risk. For ease of use and consistency in application, these results are periodically calibrated into bands based on internationally recognised credit ratings. These assumptions have been applied to the individual cash flows of each unit as compiled by local management in the different markets.

The valuations use cash flows based on detailed financial budgets prepared by management covering a one-year period, with growth in year 2 of 6%. Cash flows for the years 3 to 10 are extrapolated from year 2 cash flows at 5% per annum, including 2% inflation, whereafter a total growth rate of 2% per annum (including 2% inflation) has been assumed. The extrapolated growth rates are considered conservative given the Group's history of profit and cash growth, its well balanced portfolio of brands and the industry in which it operates. The long-term real growth does not exceed the expected long-term average growth rate for the combined markets in which the cash-generating units operate. In some instances, such as recent acquisitions or start-up ventures, the valuation is expanded to reflect the medium-term plan of management, spanning five years or beyond.

Pre-tax discount rates of between 7.2% and 13.9% (2011: 7.2% to 18.0%) were used, based on the Group's weighted average cost of capital, together with any premium applicable for economic and political risks.

The pre-tax discount rates used for the cash-generating units which are significant in comparison with the total carrying amount of goodwill are 8.6% for Canada (2011: 8.8%), 9.3% for Western Europe (2011: 8.6%), 8.9% for Eastern Europe (2011: 10.0%), 9.3% for South Africa (2011: 10.8%), 8.6% for Australia (2011: 8.6%), 7.2% for Singapore (2011: 7.2%) and 8.7% for Malaysia (2011: 9.3%).

If discounted cash flows for cash-generating units should fall by 10%, or the discount rate was increased at a post-tax rate of 1%, there would be no impairment.

10 Property, plant and equipment

	Freehold property £m	Leasehold property £m	Plant and equipment £m	Assets in the course of construction £m	Total £m
1 January 2012					
Cost	**1,069**	**256**	**4,588**	**380**	**6,293**
Accumulated depreciation and impairment	**(433)**	**(116)**	**(2,697)**	**–**	**(3,246)**
Net book value at 1 January 2012	**636**	**140**	**1,891**	**380**	**3,047**
Differences on exchange	**(25)**	**–**	**(64)**	**(15)**	**(104)**
Additions					
– separately acquired	**201**	**3**	**106**	**361**	**671**
Reallocations	**22**	**5**	**216**	**(243)**	**–**
Depreciation	**(25)**	**(10)**	**(304)**	**–**	**(339)**
Impairment	**(1)**	**–**	**(12)**	**–**	**(13)**
Disposals	**(3)**	**–**	**(27)**	**–**	**(30)**
Net reclassifications as held-for-sale	**(29)**	**–**	**(2)**	**–**	**(31)**
31 December 2012					
Cost	**1,138**	**261**	**4,453**	**483**	**6,335**
Accumulated depreciation and impairment	**(362)**	**(123)**	**(2,649)**	**–**	**(3,134)**
Net book value at 31 December 2012	**776**	**138**	**1,804**	**483**	**3,201**
1 January 2011					
Cost	1,144	250	4,820	369	6,583
Accumulated depreciation and impairment	(467)	(109)	(2,890)	–	(3,466)
Net book value at 1 January 2011	677	141	1,930	369	3,117
Differences on exchange	(35)	(5)	(120)	(23)	(183)
Additions					
– separately acquired	16	6	132	348	502
– acquisition of subsidiaries (note 26 (b))	22	–	32	–	54
Reallocations	16	11	287	(314)	–
Depreciation	(26)	(12)	(316)	–	(354)
Impairment	(8)	–	(19)	–	(27)
Disposals	(8)	(1)	(32)	–	(41)
Net reclassifications as held-for-sale	(18)	–	(3)	–	(21)
31 December 2011					
Cost	1,069	256	4,588	380	6,293
Accumulated depreciation and impairment	(433)	(116)	(2,697)	–	(3,246)
Net book value at 31 December 2011	636	140	1,891	380	3,047
Assets held under finance leases					
31 December 2012					
Cost			**18**		**18**
Accumulated depreciation and impairment			**(15)**		**(15)**
Net book value at 31 December 2012			**3**		**3**
31 December 2011					
Cost			35		35
Accumulated depreciation and impairment			(28)		(28)
Net book value at 31 December 2011			7		7

Notes on the accounts (continued)

10 Property, plant and equipment (continued)

The Group's finance lease arrangements relate principally to the lease of vehicles by the Group's Chilean subsidiary. Assets held under finance leases are secured under finance lease obligations included in note 21.

	2012 £m	2011 £m
Cost of freehold land within freehold property on which no depreciation is provided	**226**	84
Leasehold property comprises		
– net book value of long leasehold	**105**	106
– net book value of short leasehold	**33**	34
	138	140
Contracts placed for future expenditure	**38**	1

Bank borrowings are secured by property, plant and equipment to the value of £nil (2011: £6 million).

11 Investments in associates and joint ventures

	2012 £m	2011 £m
1 January	**2,613**	2,666
Differences on exchange	**(145)**	(109)
Differences on exchange reclassified and reported in share of profit after taxation	**–**	(4)
Share of profit after taxation (note 5)	**692**	670
Dividends (note 5)	**(487)**	(486)
Actuarial losses relating to pensions and other post-retirement benefits (note 20)	**(55)**	(67)
Share buy-backs (note 25)	**(262)**	(71)
Other equity movements	**(26)**	14
31 December	**2,330**	2,613
Non-current assets	**3,815**	4,119
Current assets	**1,957**	1,705
Non-current liabilities	**(2,090)**	(1,656)
Current liabilities	**(1,352)**	(1,555)
	2,330	2,613
Reynolds American Inc. (Group's share of market value £5,925 million (2011: £6,456 million))	**1,496**	1,831
ITC Ltd. (Group's share of market value £7,771 million (2011: £5,886 million))	**793**	735
Other listed associates (Group's share of market value £109 million (2011: £65 million))	**13**	12
Unlisted	**28**	35
	2,330	2,613

The Group's share of non-current assets above include £1,437 million (2011: £1,503 million) of goodwill and £461 million (2011: £493 million) of trademarks arising from the Reynolds American transaction in 2004. In addition, the non-current assets above include £640 million (2011: £669 million) of goodwill and £296 million (2011: £310 million) of trademarks arising from the acquisition of Conwood by Reynolds American in 2006. In 2011, as a result of the disposal of the Lane business, £17 million of goodwill arising from the Reynolds transaction in 2004 was accounted for as part of the gain on disposal reported in the income statement.

Details of the Group's contingent liabilities are set out in note 30. In addition to US litigation involving Group companies, which is covered by the R.J. Reynolds Tobacco Company (RJRT) indemnity referred to in note 30, Reynolds American Inc. (RAI) group companies are named in litigation which does not involve Group companies. While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, it is not impossible that the results of operations or cash flows of RAI, in particular quarterly or annual periods, could be materially affected by this and by the final outcome of any particular litigation. However, having regard to the contingent liability disclosures on litigation made by RAI in its public financial reports, the Directors are satisfied with the carrying value included above for RAI.

11 Investments in associates and joint ventures (continued)

The Group's share of the RAI results for the year to 31 December 2012 includes £41 million (2011: £42 million) in respect of external legal fees and other external product liability defence costs.

Additional information on associates is provided in the principal associate undertaking sections to the Annual Report.

12 Retirement benefit schemes

The Group's subsidiary undertakings operate around 180 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 and many of which are closed to new entrants. The Group also operates a number of defined contribution schemes.

The liabilities arising in the defined benefit schemes are determined in accordance with the advice of independent, professionally qualified actuaries, using the projected unit credit method. All schemes are formally valued at least every three years.

The principal pension schemes are in the UK, Germany, Canada, the Netherlands and Switzerland. Together these schemes account for over 85% of the total obligations of the Group's defined benefit schemes.

In addition, the Group operates significant schemes in Canada which provide employees with certain other retirement benefits, such as healthcare. The liabilities in respect of these benefits are also assessed by qualified independent actuaries, applying the projected unit credit method.

The amounts recognised in the balance sheet are determined as follows:

	Pension schemes		Healthcare schemes		Total	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Present value of funded scheme liabilities	**(6,196)**	(5,652)	**(21)**	(23)	**(6,217)**	(5,675)
Fair value of funded scheme assets	**5,547**	5,184	**16**	16	**5,563**	5,200
	(649)	(468)	**(5)**	(7)	**(654)**	(475)
Minimum funding obligations	**–**	(2)	**–**	–	**–**	(2)
Unrecognised funded scheme surpluses	**(15)**	(75)	**–**	–	**(15)**	(75)
	(664)	(545)	**(5)**	(7)	**(669)**	(552)
Present value of unfunded scheme liabilities	**(224)**	(197)	**(154)**	(149)	**(378)**	(346)
	(888)	(742)	**(159)**	(156)	**(1,047)**	(898)
The above net liability is recognised in the balance sheet as follows:						
– retirement benefit scheme liabilities	**(993)**	(847)	**(159)**	(156)	**(1,152)**	(1,003)
– retirement benefit scheme assets	**105**	105	**–**	–	**105**	105
	(888)	(742)	**(159)**	(156)	**(1,047)**	(898)

The total accumulated net actuarial losses taken through other comprehensive income at 31 December 2012 were £1,570 million (2011: £1,155 million) for subsidiaries, and £472 million (2011: £417 million) net of tax for associates and joint ventures.

In Jamaica, the pension schemes hold shares in Carreras Group Ltd (a Group subsidiary) with a fair value of £3 million (2011: £6 million).

Notes on the accounts (continued)

12 Retirement benefit schemes (continued)

The amounts recognised in the income statement are as follows:

	Pension schemes		Healthcare schemes		Total	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Defined benefit schemes						
– current service cost	**80**	71	**2**	1	**82**	72
– interest cost	**271**	285	**8**	11	**279**	296
– expected return on scheme assets	**(283)**	(316)	**(1)**	(2)	**(284)**	(318)
– past service cost	**13**	9	**–**	–	**13**	9
– settlements and curtailments	**2**	(3)	**–**	–	**2**	(3)
	83	46	**9**	10	**92**	56
Defined contribution schemes	**39**	42	**–**	–	**39**	42
Total amount recognised in the income statement (note 3(a))	**122**	88	**9**	10	**131**	98

The above charges are recognised within employee benefit costs in 2012 and 2011 in note 3(a) and include a charge of £14 million in 2012 (2011: £7 million charge) in respect of pension costs reported as part of the restructuring costs charged in arriving at profit from operations (see note 3(e)).

The movements in scheme liabilities are as follows:

	Pension schemes		Healthcare schemes		Total	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Present value at 1 January	**5,849**	5,512	**172**	190	**6,021**	5,702
Differences on exchange	**(120)**	(89)	**(5)**	(7)	**(125)**	(96)
Current service cost	**81**	72	**1**	1	**82**	73
Interest cost	**268**	281	**8**	10	**276**	291
Past service costs – vested	**13**	8	**–**	–	**13**	8
Contributions by scheme members	**3**	3	**–**	–	**3**	3
Benefits paid	**(339)**	(336)	**(8)**	(9)	**(347)**	(345)
Settlements and curtailments	**(3)**	(5)	**–**	–	**(3)**	(5)
Acquisition of subsidiaries	**–**	1	**–**	–	**–**	1
Actuarial losses/(gains)	**668**	402	**7**	(13)	**675**	389
Present value at 31 December	**6,420**	5,849	**175**	172	**6,595**	6,021
Funded schemes	**6,196**	5,652	**21**	23	**6,217**	5,675
Unfunded schemes	**224**	197	**154**	149	**378**	346
	6,420	5,849	**175**	172	**6,595**	6,021

The actuarial losses and gains in 2012 principally relate to changes in assumptions regarding discount rates. The actuarial losses and gains in 2011 principally relate to changes in assumptions regarding discount rates and mortality.

12 Retirement benefit schemes (continued)

The movements in funded scheme assets are as follows:

	Pension schemes		Healthcare schemes		Total	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Fair value of scheme assets at 1 January	**5,184**	5,114	**16**	20	**5,200**	5,134
Differences on exchange	**(121)**	(90)	**–**	(5)	**(121)**	(95)
Expected return on scheme assets	**279**	311	**1**	2	**280**	313
Company contributions net of reimbursements	**270**	242	**6**	7	**276**	249
Contributions by scheme members	**5**	5	**–**	–	**5**	5
Benefits paid	**(326)**	(323)	**(7)**	(8)	**(333)**	(331)
Settlements	**(4)**	(2)	**–**	–	**(4)**	(2)
Actuarial gains/(losses)	**260**	(73)	**–**	–	**260**	(73)
Fair value of scheme assets at 31 December	**5,547**	5,184	**16**	16	**5,563**	5,200

The actuarial gains and losses in both years principally relate to movements in the market value of scheme assets.

Contributions to defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes and taking into account regulatory requirements. Contributions in 2013 are expected to be £318 million for pension schemes and £8 million for healthcare schemes, compared to £296 million and £6 million, respectively, in 2012. Company contributions for 2012 in the table above are shown net of a reimbursement of £26 million from a Jamaican pension scheme in the course of being wound up. Company contributions to pension schemes include £190 million (2011: £140 million) over and above normal contributions in respect of a funding shortfall relating to the main UK pension scheme.

	Pension schemes		Healthcare schemes		Total	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Actual return on scheme assets	**539**	238	**1**	2	**540**	240

The movements in the unrecognised funded scheme surpluses are as follows:

	Pension schemes		Healthcare schemes		Total	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Unrecognised funded scheme surpluses at 1 January	**(75)**	(51)	**–**	–	**(75)**	(51)
Differences on exchange	**8**	1	**–**	–	**8**	1
Movement in year	**52**	(25)	**–**	–	**52**	(25)
Unrecognised funded scheme surpluses at 31 December	**(15)**	(75)	**–**	–	**(15)**	(75)

The movement in minimum funding obligations are as follows:

	Pension schemes		Healthcare schemes		Total	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Minimum funding obligations at 1 January	**(2)**	(29)	**–**	–	**(2)**	(29)
Movement in year	**2**	27	**–**	–	**2**	27
Minimum funding obligations at 31 December	**–**	(2)	**–**	–	**–**	(2)

Movements in unrecognised scheme surpluses and minimum funding obligations are recognised in other comprehensive income.

Notes on the accounts (continued)

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 2012					
Rate of increase in salaries	**4.4**	**2.5**	**3.3**	**2.7**	**1.5**
Rate of increase in pensions in payment	**2.9**	**2.0**	**Nil**	**1.5**	**Nil**
Rate of increase in deferred pensions	**2.4**	**Nil**	**Nil**	**1.5**	**–**
Discount rate	**4.1**	**3.2**	**3.5**	**4.1**	**2.0**
General inflation	**2.9**	**2.0**	**2.3**	**1.5**	**Nil**

For healthcare inflation in Canada, the assumption is 8.0% reducing to 5.0% by 2018. For the remaining pension schemes, typical assumptions are that real salary increases will be from 0.5% to 3.6% per annum and discount rates will be from 0% to 4.1% above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2011					
Rate of increase in salaries	4.5	2.5	3.5	3.1	1.5
Rate of increase in pensions in payment	3.0	1.7	Nil	1.5	Nil
Rate of increase in deferred pensions	2.5	Nil	Nil	1.5	–
Discount rate	4.7	5.0	4.0	4.7	3.0
General inflation	3.0	1.7	2.5	1.5	Nil

For healthcare inflation in Canada, the assumption is 8.5% reducing to 5.0% by 2018. For the remaining pension schemes, typical assumptions were that real salary increases would be from 0% to 4.5% per annum and discount rates would be from 0% to 5.25% above inflation. Pension increases, where allowed for, were generally assumed to be in line with inflation.

Discount rates in both years are determined by reference to normal yields on high quality corporate bonds at the balance sheet date. For countries where there is not a deep market in such corporate bonds, the yield on government bonds is used.

Mortality assumptions are subject to regular review. In Canada, Germany and the UK the same tables were used for both years. In Canada UP94 tables, in Germany Heubeck tables 2005G and in the UK the S1NA (year of birth) table with the Continuous Mortality Investigation (2009) model with a 1.5% long-term improvement rate, have been used. In Switzerland LPP 2010 tables (2011: EVK 2000) and in the Netherlands AG Prognosetafel 2012-2062 tables (2011: AG Prognosetafel 2010-2060) have been used.

Based on the above, the weighted average life expectancy, in years, for mortality tables used to determine benefit obligations is as follows:

	UK		Germany		Canada		Netherlands		Switzerland	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
31 December 2012										
Member age 65 (current life expectancy)	**22.7**	**24.9**	**18.6**	**22.7**	**19.7**	**22.1**	**20.3**	**24.8**	**19.7**	**22.0**
Member age 45 (life expectancy at age 65)	**24.9**	**27.3**	**21.3**	**25.3**	**21.2**	**22.9**	**22.2**	**25.0**	**22.2**	**24.5**
31 December 2011										
Member age 65 (current life expectancy)	22.5	24.7	18.5	22.6	19.7	22.1	19.9	24.6	18.9	21.4
Member age 45 (life expectancy at age 65)	24.7	27.1	21.2	25.1	21.2	22.9	21.3	24.8	21.7	23.9

12 Retirement benefit schemes (continued)

The expected rates of return on scheme assets in the following principal countries are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2012					
Equities	**6.0**	**8.0**	**8.5**	**7.0**	**5.1**
Bonds	**3.6**	**5.0**	**3.8**	**3.1**	**1.5**
Property	**–**	**5.5**	**–**	**5.7**	**4.4**
Other assets	**6.0**	**–**	**Nil**	**4.0**	**4.7**

For the remaining pension schemes, expected long-term real rates of return range from 0% to 9%.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2011					
Equities	6.0	8.0	9.0	7.2	6.5
Bonds	3.8	5.0	4.0	3.7	2.4
Property	–	5.5	–	5.6	5.4
Other assets	6.0	–	Nil	4.0	5.2

For the remaining pension schemes, expected long-term real rates of return ranged from 0% to 11%.

Expected rates of return are determined taking into account the current level of expected returns on risk-free investments, the historical level of risk premium associated with other invested assets, and the expectations for future returns on such assets.

The major categories of assets as a percentage of the total fair value of scheme assets are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %	Others %	Total %
31 December 2012							
Equities	**44.3**	**28.1**	**41.5**	**27.5**	**31.7**	**24.7**	**36.8**
Bonds	**49.5**	**28.2**	**52.0**	**63.5**	**41.4**	**59.6**	**49.5**
Property	**–**	**43.7**	**–**	**2.3**	**17.9**	**1.5**	**7.1**
Other assets	**6.2**	**–**	**6.5**	**6.7**	**9.0**	**14.2**	**6.6**
31 December 2011							
Equities	44.8	27.5	40.5	26.2	29.9	24.1	36.1
Bonds	50.9	29.0	53.3	64.6	44.2	56.2	50.1
Property	–	43.5	–	4.5	18.3	1.7	7.6
Other assets	4.3	–	6.2	4.7	7.6	18.0	6.2

The categories of equities and bonds predominately represent assets which are quoted in an active market. Property assets include investment properties, direct investments in property investment companies and real estate trusts, as well as indirect investments in real estate funds, with the majority of these investments by value quoted in an active market. Other assets include cash and other deposits, recoverable taxes, reinsurance contracts and hedge funds.

Notes on the accounts (continued)

12 Retirement benefit schemes (continued)

Valuation of post-retirement schemes involves judgments about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 December 2012 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions such as salary increases. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation, while asset values also change, and the impacts may offset to some extent.

	1 year increase £m	1 year decrease £m	0.25 percentage point increase £m	0.25 percentage point decrease £m
Average life expectancy – increase/(decrease) of scheme liabilities	**158**	**(158)**		
Rate of inflation – increase/(decrease) of scheme liabilities			**159**	**(149)**
Discount rate – (decrease)/increase of scheme liabilities			**(182)**	**193**

A one percentage point increase in healthcare inflation would increase healthcare scheme liabilities by £24 million, and a one percentage point decrease would decrease liabilities by £19 million. The income statement effect of this change in assumption is not material.

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:

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Historical information					
Scheme liabilities	**6,595**	6,021	5,702	5,532	4,895
Scheme assets	**5,563**	5,200	5,134	4,634	4,182
Scheme net deficits	**(1,032)**	(821)	(568)	(898)	(713)
Experience losses/(gains) on scheme liabilities	**23**	6	(191)	75	156
Experience (gains)/losses on scheme assets	**(260)**	73	(194)	(358)	857

Experience losses and gains on scheme liabilities are presented as part of actuarial gains and losses.

13 Deferred tax

Deferred tax assets comprise:

	Stock relief £m	Excess of depreciation over capital allowances £m	Tax losses £m	Retirement benefits £m	Fair value losses/(gains) £m	Other temporary differences £m	Total £m
At 1 January 2012	**32**	**27**	**16**	**128**	**5**	**259**	**467**
Differences on exchange	**–**	**(2)**	**(2)**	**(4)**	**–**	**(18)**	**(26)**
Credited/(charged) to the income statement	**33**	**12**	**22**	**(20)**	**9**	**(45)**	**11**
Credited/(charged) to other comprehensive income	**–**	**–**	**–**	**66**	**(10)**	**(5)**	**51**
At 31 December 2012	**65**	**37**	**36**	**170**	**4**	**191**	**503**
At 1 January 2011	31	70	42	117	4	313	577
Differences on exchange	(1)	(7)	(5)	(3)	(1)	(9)	(26)
(Charged)/credited to the income statement	1	(36)	(20)	(7)	9	(49)	(102)
Credited/(charged) to other comprehensive income	–	–	(1)	19	(7)	3	14
Subsidiaries acquired (note 26(b))	1	–	–	2	–	–	3
Other	–	–	–	–	–	1	1
At 31 December 2011	32	27	16	128	5	259	467

Deferred tax liabilities comprise:

	Stock relief £m	Excess of capital allowances over depreciation £m	Undistributed earnings of associates and subsidiaries £m	Retirement benefits £m	Fair value (losses)/gains £m	Other temporary differences £m	Total £m
At 1 January 2012	**21**	**193**	**158**	**117**	**2**	**189**	**680**
Differences on exchange	**(1)**	**(8)**	**(8)**	**(3)**	**–**	**(4)**	**(24)**
(Credited)/charged to the income statement	**(4)**	**(3)**	**18**	**3**	**3**	**(18)**	**(1)**
Charged to other comprehensive income	**–**	**–**	**–**	**2**	**19**	**–**	**21**
At 31 December 2012	**16**	**182**	**168**	**119**	**24**	**167**	**676**
At 1 January 2011	12	195	166	117	2	183	675
Differences on exchange	–	(13)	(16)	(4)	–	1	(32)
(Credited)/charged to the income statement	10	6	8	(3)	–	(37)	(16)
Charged to other comprehensive income	–	–	–	7	–	2	9
Subsidiaries acquired (note 26(b))	–	5	–	–	–	40	45
Other	(1)	–	–	–	–	–	(1)
At 31 December 2011	21	193	158	117	2	189	680

	2012 £m	2011 £m
Net deferred tax liabilities	**173**	213

Notes on the accounts (continued)

13 Deferred tax (continued)

The net deferred tax liabilities are reflected in the Group balance sheet as follows, after offsetting assets and liabilities where there is a legally enforceable right to offset current tax assets and liabilities and where the deferred income taxes relate to the same fiscal authority.

	2012 £m	2011 £m
Deferred tax assets	(327)	(343)
Deferred tax liabilities	500	556
	173	213

Deferred tax expected to be recovered within 12 months:

	2012 £m	2011 £m
Deferred tax assets	(117)	(136)
Deferred tax liabilities	169	136
	52	–

At the balance sheet date, the Group has unused tax losses of £289 million (2011: £360 million) which have no expiry date and unused tax losses of £632 million (2011: £561 million) which will expire within the next 10 years. No amount of deferred tax has been recognised in respect of these unused losses.

At the balance sheet date, the Group has not recognised a deferred tax asset in respect of deductible temporary differences of £1,221 million (2011: £1,184 million), which have no expiry date and £177 million (2011: £128 million), which will expire within the next 10 years.

At the balance sheet date, the Group has unused tax credits of £80 million (2011: £80 million) which have no expiry date. No amount of deferred tax has been recognised in respect of these unused tax credits.

At the balance sheet date, the aggregate amount of undistributed earnings of subsidiaries which would be subject to dividend withholding tax was £2 billion (2011: £2 billion). No liability has been recognised in respect of this withholding tax because the Group is in a position to control the timing of these distributions and it is probable that these distributions will not be made in the foreseeable future.

14 Trade and other receivables

	2012 £m	2011 £m
Trade receivables	2,088	1,857
Loans and other receivables	712	690
Prepayments and accrued income	165	181
	2,965	2,728
Current	2,741	2,423
Non-current	224	305
	2,965	2,728

Amounts receivable from related parties including associated undertakings are shown in note 29.

Trade and other receivables have been reported in the balance sheet net of allowances as follows:

	2012 £m	2011 £m
Gross trade and other receivables	3,017	2,777
Allowance account	(52)	(49)
Net trade and other receivables per balance sheet	2,965	2,728

14 Trade and other receivables (continued)

The movements in the allowance account are as follows:

	2012 £m	2011 £m
1 January	**49**	60
Differences on exchange	**(3)**	(5)
Provided in the year	**14**	11
Amounts reversed during the year	**(8)**	(3)
Amounts in respect of receivables written-off	**–**	(14)
31 December	**52**	49

Impairment of trade receivables, including write-offs and allowances, charged during the year is included as part of other operating expenses. For 2012, the net impairment charged was £9 million (2011: £11 million) of which £6 million (2011: £8 million), is reflected in the above table.

As at 31 December 2012, trade and other receivables of £41 million (2011: £42 million) were past their contractual payment date but not impaired. These relate to a number of external parties where there is no expectation of default. The aged analysis of these trade receivables is as follows:

	2012 £m	2011 £m
Less than three months	**36**	34
Between three and six months	**2**	3
Between six months and one year	**1**	3
Greater than one year	**2**	2

The Group holds bank guarantees, other guarantees and credit insurance in respect of some of the past due debtor balances.

Trade and other receivables are predominantly denominated in the functional currencies of subsidiary undertakings apart from the following:

	2012 £m	2011 £m
US dollar	**76**	127
UK sterling	**136**	112
Euro	**33**	32
Other currencies	**62**	36

Trade and other receivables also include certain interest bearing amounts and their effective interest rates are as follows:

	2012 £m	2011 £m	2012 %	2011 %
Euro	**5**	3	**4.0**	4.0
Other currencies	**12**	11	**5.9**	5.7

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 internationally dispersed customers.

Notes on the accounts (continued)

15 Available-for-sale investments

	2012 £m	2011 £m
1 January	**97**	87
Differences on exchange	**(4)**	(1)
Additions and advances	**1**	55
Revaluations	**–**	13
Disposals and repayments	**(31)**	(57)
31 December	**63**	97
Current	**26**	57
Non-current	**37**	40
	63	97

The classification of these investments under the IFRS 7 fair value hierarchy is given in note 24.

Investments have the following maturities:

	As per balance sheet	
	2012 £m	2011 £m
Equity investments	**37**	40
Non-equity investments		
– within one year	**24**	46
– beyond one year and within two years	**–**	10
– beyond four years and within five years	**2**	–
– beyond five years	**–**	1
	63	97

There is no material difference between the maturity profile of investments in the table above and the maturity profile on a gross contractual basis where the values in each year include the investments maturing in that year together with forecast interest receipts on all investments which are due for all or part of that year.

Investments are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	2012 £m	2011 £m
Functional currencies	**62**	82
US dollar	**1**	1
Other currencies	**–**	14
	63	97

Non-equity investments of £26 million (2011: £57 million) are principally denominated in UK sterling and have an effective interest rate of 1.1% (2011: 5.1%).

16 Derivative financial instruments

The fair values of derivatives are determined based on market data (primarily yield curves, implied volatilities and exchange rates) to calculate the present value of all estimated flows associated with each derivative at the balance sheet date. In the absence of sufficient market data, fair values would be based on the quoted market price of similar derivatives. The classification of these derivative assets and liabilities under the IFRS 7 fair value hierarchy is given in note 24.

	2012		2011	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedges				
– interest rate swaps	209	55	186	22
– cross-currency swaps	10	12	6	42
Cash flow hedges				
– cross-currency swaps	–	18	–	4
– forward foreign currency contracts	70	31	44	85
Net investment hedges				
– forward foreign currency contracts	59	12	59	34
Held-for-trading*				
– forward foreign currency contracts	25	22	34	63
– others	–	1	9	14
Total	373	151	338	264
Current	166	65	159	177
Non-current	207	86	179	87
	373	151	338	264
Derivatives				
– in respect of net debt	234	95	223	126
– other	139	56	115	138
	373	151	338	264

* As explained in note 4, some derivative financial instruments are not designated as hedges and so are required to be classified as held-for-trading.

Notes on the accounts (continued)

16 Derivative financial instruments (continued)

For cash flow hedges, including bifurcated derivatives, the timing of expected cash flows is as follows:

	2012		2011	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	49	31	41	82
Between one and two years	21	18	3	11
Between two and three years	–	–	–	4
	70	49	44	97
Less: bifurcated derivatives designated as net investment hedges	–	–	–	(8)
	70	49	44	89

The Group's cash flow hedges are principally in respect of sales or purchases of inventory and certain debt instruments. The timing of expected cash flows in respect of derivatives designated as cash flow hedges is broadly expected to be comparable to the time periods when the hedged item will affect profit or loss.

In 2011, the Group had a receive €467 million, pay DKK 3,470 million foreign exchange forward contract which was bifurcated into a receive €467 million, pay £398 million foreign exchange forward contract designated as a cash flow hedge and a receive £398 million, pay DKK 3,470 million foreign exchange forward contract designated as a net investment hedge. This structure was collapsed during 2012. The above table includes the timing of expected cash flows on the bifurcated foreign exchange forward contract designated as a cash flow hedge for 2011.

16 Derivative financial instruments (continued)

The tables below set out the maturities of the Group's derivative financial instruments on an undiscounted contractual basis, based on spot rates.

The maturity dates of all gross-settled derivative financial instruments are as follows:

	2012				2011			
	Assets		Liabilities		Assets		Liabilities	
	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m
Within one year								
– forward foreign currency contracts	**5,997**	**(5,873)**	**2,881**	**(2,956)**	4,297	(4,177)	6,626	(6,788)
– cross-currency swaps	**18**	**(11)**	**47**	**(43)**	1	–	39	(26)
– other	**–**	**–**	**–**	**–**	1,188	(1,175)	1,174	(1,189)
Between one and two years								
– forward foreign currency contracts	**503**	**(479)**	**115**	**(116)**	293	(277)	348	(358)
– cross-currency swaps	**18**	**(11)**	**158**	**(163)**	1	–	68	(56)
Between two and three years								
– forward foreign currency contracts	**–**	**–**	**–**	**–**	6	(6)	55	(54)
– cross-currency swaps	**18**	**(13)**	**18**	**(6)**	1	–	183	(177)
Between three and four years								
– cross-currency swaps	**18**	**(14)**	**343**	**(389)**	1	–	36	(27)
Between four and five years								
– cross-currency swaps	**18**	**(16)**	**–**	**–**	1	–	361	(422)
Beyond five years								
– cross-currency swaps	**575**	**(616)**	**–**	**–**	19	(15)	592	(634)
	7,165	**(7,033)**	**3,562**	**(3,673)**	5,808	(5,650)	9,482	(9,731)

The maturity dates of net-settled derivative financial instruments are as follows:

	2012		2011	
	Assets Inflow/ (Outflow) £m	Liabilities (Inflow)/ Outflow £m	Assets Inflow/ (Outflow) £m	Liabilities (Inflow)/ Outflow £m
Within one year	**64**	**12**	59	15
Between one and two years	**63**	**11**	58	10
Between two and three years	**31**	**6**	35	6
Between three and four years	**24**	**15**	14	3
Between four and five years	**20**	**12**	12	1
Beyond five years	**14**	**–**	18	(1)
	216	**56**	196	34

The above analysis of derivatives settled on a net basis primarily relates to the Group's interest rate swaps.

The fair value of derivative financial instruments is summarised as follows:

	2012		2011	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Interest rate swaps	**209**	**55**	186	22
Cross-currency swaps	**10**	**30**	6	46
Forward foreign currency contracts	**154**	**65**	137	182
Others	**–**	**1**	9	14
	373	**151**	338	264

Notes on the accounts (continued)

16 Derivative financial instruments (continued)
(a) Interest rate swaps

								2012
					Interest rate %			
	Maturity date	Principal currency	m	£m	Original	Swapped	Assets £m	Liabilities £m
Fixed to floating	**2013**	**EUR**	**400**	**324**	**5.1**	**note (a)**	**14**	**–**
	2013	**GBP**	**150**	**150**	**5.8**	**note (a)**	**6**	**–**
	2014	**GBP**	**500**	**500**	**6.0**	**note (a)**	**26**	**–**
	2014	**GBP**	**250**	**250**	**6.0**	**note (a)**	**18**	**–**
	2017	**USD**	**600**	**369**	**2.1**	**note (a)**	**4**	**–**
	2019	**GBP**	**250**	**250**	**6.4**	**note (a)**	**68**	**–**
	2020	**EUR**	**600**	**487**	**4.0**	**note (a)**	**65**	**–**
	2023	**EUR**	**750**	**608**	**2.4**	**note (a)**	**8**	**–**
Floating to fixed	**2017**	**EUR**	**600**	**487**	**note (a)**	**3.7**	**–**	**45**
	2023*	**EUR**	**750**	**608**	**note (a)**	**2.8**	**–**	**10**
							209	**55**

* The €750 million interest rate swap maturing in 2023 has a start date of 2015.

								2011
					Interest rate %			
	Maturity date	Principal currency	m	£m	Original	Swapped	Assets £m	Liabilities £m
Fixed to floating	2012	EUR	337	281	3.6	note (a)	7	–
	2013	EUR	400	334	5.1	note (a)	24	–
	2013	GBP	150	150	5.8	note (a)	10	–
	2014	GBP	500	500	6.0	note (a)	29	–
	2014	GBP	250	250	6.0	note (a)	22	–
	2019	GBP	250	250	6.4	note (a)	64	–
	2020	EUR	600	501	4.0	note (a)	30	–
Floating to fixed	2017	EUR	600	501	note (a)	3.7	–	22
							186	22

Note (a): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 67 and 268 basis points (2011: between 35 and 268 basis points).

These swaps have been used to manage the interest rate profile of external borrowings and are reflected in the repricing table in note 21.

16 Derivative financial instruments (continued)
(b) Cross-currency swaps

	Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	Assets £m	Liabilities £m
											2012
Fixed to floating	**2016**	**GBP**	**5.5**	**325**	**325**	**EUR**	**note (b)**	**473**	**384**	**–**	**12**
	2019	**EUR**	**4.6**	**20**	**16**	**USD**	**note (b)**	**22**	**13**	**7**	**–**
	2021	**EUR**	**3.6**	**600**	**487**	**GBP**	**note (b)**	**518**	**518**	**3**	**–**
Floating to fixed	**2014**	**USD**	**note (b)**	**261**	**161**	**COP**	**7.2**	**504,158**	**176**	**–**	**18**
										10	**30**

	Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	Assets £m	Liabilities £m
											2011
Fixed to floating	2016	GBP	5.5	325	325	EUR	note (b)	473	395	–	30
	2019	EUR	4.6	20	17	USD	note (b)	22	14	6	–
	2021	EUR	3.6	600	501	GBP	note (b)	518	518	–	12
Floating to fixed	2014	USD	note (b)	261	168	COP	7.2	504,158	167	–	4
										6	46

Note (b): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 82 and 250 basis points (2011: between 82 and 250 basis points).

Notes on the accounts (continued)

16 Derivative financial instruments (continued)

(c) Forward foreign currency contracts

Forward foreign currency contracts have been used to hedge both internal and external forecast transactions as well as the hedging of internal and external assets and liabilities.

	2012 Assets £m	2012 Liabilities £m	2011 Assets £m	2011 Liabilities £m
Purchase/Sell				
GBP/EUR	12	5	38	2
GBP/AUD	9	2	–	28
GBP/ZAR	2	–	19	3
GBP/CHF	10	–	12	2
GBP/USD	28	–	2	41
EUR/USD	7	–	–	7
USD/EUR	2	16	21	–
USD/GBP	–	4	9	1
USD/JPY	56	–	–	41
BRL/USD	1	–	–	11
Other	27	38	36	46
	154	65	137	182

Certain of these contracts were used to manage the currency profile of external borrowings and are reflected in the currency table in note 21. The nominal values of these contracts are as follows:

	2012 Purchase £m	2012 Sell £m	2011 Purchase £m	2011 Sell £m
Purchase/Sell				
GBP/CHF	(221)	221	(89)	86
GBP/CAD	(292)	287	(290)	294
GBP/AUD	–	–	(1,092)	1,121
GBP/USD	–	–	(268)	272
GBP/EUR	(362)	362	–	–
EUR/DKK	(344)	344	(390)	390
EUR/SEK	(131)	131	(126)	130
EUR/NOK	(166)	166	(160)	162
EUR/GBP	–	–	(75)	77

(d) Others

	2012 Assets £m	2012 Liabilities £m	2011 Assets £m	2011 Liabilities £m
Others: Bund forwards *(see note (i))*	–	–	9	11
Interest derivative *(see note (ii))*	–	1	–	3
	–	1	9	14

Notes:

(i) Forward contracts to purchase and sell German government securities with a nominal value of nil (2011: €1.4 billion) taken out to manage internal financing arrangements.

(ii) Remaining impact of an interest derivative with a nominal value of €1 billion maturing in 2013.

17 Inventories

	2012 £m	2011 £m
Raw materials and consumables	**1,725**	1,797
Finished goods and work in progress	**2,079**	1,477
Goods purchased for resale	**222**	224
	4,026	3,498

Inventories pledged as security for liabilities amount to £8 million (2011: £13 million). Write-offs taken to other operating expenses in the Group income statement comprise £57 million (2011: £38 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 2012 and 2011.

19 Cash and cash equivalents

	2012 £m	2011 £m
Cash and bank balances	**977**	970
Cash equivalents	**1,104**	1,224
	2,081	2,194

Cash equivalents mainly comprise short-term deposits and investments in money market funds with an original maturity of three months or less. The carrying value of cash and cash equivalents approximates their fair value.

Cash and cash equivalents are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	2012 £m	2011 £m
Functional currency	**1,383**	1,404
US dollar	**532**	678
UK sterling	**5**	14
Euro	**63**	30
Other currencies	**98**	68
	2,081	2,194

At 31 December 2012, cash and cash equivalents of £1 million (2011: £1 million) were pledged as collateral.

In the Group cash flow statement, net cash and cash equivalents are shown after deducting bank overdrafts and accrued interest where applicable, as follows:

	2012 £m	2011 £m
Cash and cash equivalents as above	**2,081**	2,194
Less overdrafts	**(242)**	(252)
Net cash and cash equivalents	**1,839**	1,942

Cash and cash equivalents include restricted amounts of £151 million (2011: £146 million), principally due to exchange control regulations in certain countries.

Notes on the accounts (continued)

20 Capital and reserves – reconciliation of movement in total equity

	Attributable to owners of the parent						
	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of the parent £m	Non-controlling interests £m	Total equity £m
1 January 2012	**506**	**3,913**	**1,112**	**2,636**	**8,167**	**307**	**8,474**
Comprehensive income and expense							
Profit for the year	–	–	–	3,841	3,841	281	4,122
Differences on exchange							
– subsidiaries	–	–	(355)	–	(355)	(24)	(379)
– associates	–	–	(145)	–	(145)	–	(145)
Cash flow hedges							
– net fair value (losses)/gains	–	–	(14)	–	(14)	3	(11)
– reclassified and reported in profit for the year	–	–	71	–	71	–	71
– reclassified and reported in net assets	–	–	12	–	12	–	12
Available-for-sale investments							
– net fair value losses	–	–	(3)	–	(3)	–	(3)
– reclassified and reported in profit for the year	–	–	(1)	–	(1)	–	(1)
Net investment hedges							
– net fair value gains	–	–	106	–	106	–	106
– differences on exchange on borrowings	–	–	49	–	49	–	49
Retirement benefit schemes							
– actuarial losses in respect of subsidiaries (note 12)	–	–	–	(410)	(410)	(5)	(415)
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	–	–	–	35	35	19	54
– actuarial losses in respect of associates net of tax (note 11)	–	–	–	(55)	(55)	–	(55)
Tax on other items recognised directly in other comprehensive income (note 6(d))	–	–	(36)	68	32	(4)	28
Other changes in equity							
Employee share options							
– value of employee services	–	–	–	73	73	–	73
– proceeds from shares issued	1	3	–	1	5	–	5
Dividends and other appropriations							
– ordinary shares	–	–	–	(2,538)	(2,538)	–	(2,538)
– to non-controlling interests	–	–	–	–	–	(267)	(267)
Purchase of own shares							
– held in employee share ownership trusts	–	–	–	(121)	(121)	–	(121)
– share buy-back programme	–	–	–	(1,258)	(1,258)	–	(1,258)
Non-controlling interests – acquisitions (note 29)	–	–	–	(21)	(21)	(3)	(24)
Other movements	–	–	–	2	2	–	2
31 December 2012	**507**	**3,916**	**796**	**2,253**	**7,472**	**307**	**7,779**

20 Capital and reserves – reconciliation of movement in total equity (continued)

	Attributable to owners of the parent						
	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of the parent £m	Non-controlling interests £m	Total equity £m
1 January 2011	506	3,910	1,600	3,190	9,206	342	9,548
Comprehensive income and expense							
Profit for the year	–	–	–	3,095	3,095	280	3,375
Differences on exchange							
– subsidiaries	–	–	(377)	–	(377)	(34)	(411)
– associates	–	–	(109)	–	(109)	–	(109)
Differences on exchange reclassified and reported in profit for the year	–	–	(4)	–	(4)	–	(4)
Cash flow hedges							
– net fair value losses	–	–	(19)	–	(19)	(2)	(21)
– reclassified and reported in profit for the year	–	–	38	–	38	–	38
– reclassified and reported in net assets	–	–	(5)	–	(5)	–	(5)
Available-for-sale investments							
– net fair value gains	–	–	26	–	26	–	26
– reclassified and reported in profit for the year	–	–	(1)	–	(1)	–	(1)
Net investment hedges							
– net fair value gains	–	–	62	–	62	–	62
– differences on exchange on borrowings	–	–	(104)	–	(104)	–	(104)
Retirement benefit schemes							
– actuarial losses in respect of subsidiaries (note 12)	–	–	–	(461)	(461)	(1)	(462)
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	–	–	–	3	3	(1)	2
– actuarial losses in respect of associates net of tax (note 11)	–	–	–	(67)	(67)	–	(67)
Tax on other items recognised directly in other comprehensive income (note 6(d))	–	–	5	12	17	3	20
Other changes in equity							
Employee share options							
– value of employee services	–	–	–	76	76	–	76
– proceeds from shares issued	–	3	–	2	5	–	5
Dividends and other appropriations							
– ordinary shares	–	–	–	(2,358)	(2,358)	–	(2,358)
– to non-controlling interests	–	–	–	–	–	(279)	(279)
Purchase of own shares							
– held in employee share ownership trusts	–	–	–	(123)	(123)	–	(123)
– share buy-back programme	–	–	–	(755)	(755)	–	(755)
Non-controlling interests – acquisitions (note 29)	–	–	–	(10)	(10)	–	(10)
Other movements	–	–	–	32	32	(1)	31
31 December 2011	506	3,913	1,112	2,636	8,167	307	8,474

Details relating to the allotted share capital, and movements therein, are included in note 4 of the Parent Company Financial Statements.

Notes on the accounts (continued)

20 Capital and reserves – reconciliation of movement in total equity (continued)

Share premium account, capital redemption reserves and merger reserves comprise:

	Share premium account £m	Capital redemption reserves £m	Merger reserves £m	Total £m
1 January 2011	61	101	3,748	3,910
31 December 2011	64	101	3,748	3,913
31 December 2012	**67**	**101**	**3,748**	**3,916**

The share premium account includes the difference between the value of shares issued and their nominal value. The increase of £3 million (2011: £3 million) relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the remuneration report.

On the purchase of own shares as part of the share buy-back programme for shares which are cancelled, a transfer is made from retained earnings to the capital redemption reserve equivalent to the nominal value of shares purchased. Purchased shares which are not cancelled are classified as treasury shares and presented as a deduction from total equity.

Total equity attributable to owners of the parent is stated after deducting the cost of treasury shares which include £2,536 million (2011: £1,278 million) for shares repurchased and not cancelled and £288 million (2011: £261 million) in respect of the cost of own shares held in employee share ownership trusts.

During 2012, 39 million shares were bought back at a cost of £1,250 million (2011: 28 million shares at a cost of £750 million) excluding transaction costs of £8 million (2011: £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.

20 Capital and reserves – reconciliation of movement in total equity (continued)

Movements in other reserves and retained earnings (which is after deducting treasury shares) shown above comprise:

	Translation reserve £m	Hedging reserve £m	Available-for-sale reserve £m	Revaluation reserve £m	Other £m	Total other reserves £m	Retained earnings: Treasury shares £m	Retained earnings: Other £m
1 January 2012	**349**	**(29)**	**40**	**179**	**573**	**1,112**	**(1,539)**	**4,175**
Comprehensive income and expense								
Profit for the year	–	–	–	–	–	–	–	3,841
Differences on exchange								
– subsidiaries	(355)	–	–	–	–	(355)	–	–
– associates	(145)	–	–	–	–	(145)	–	–
Cash flow hedges								
– net fair value losses	–	(14)	–	–	–	(14)	–	–
– reclassified and reported in profit for the year	–	71	–	–	–	71	–	–
– reclassified and reported in net assets	–	12	–	–	–	12	–	–
Available-for-sale investments								
– net fair value losses	–	–	(3)	–	–	(3)	–	–
– reclassified and reported in profit for the year	–	–	(1)	–	–	(1)	–	–
Net investment hedges								
– net fair value gains	106	–	–	–	–	106	–	–
– differences on exchange on borrowings	49	–	–	–	–	49	–	–
Retirement benefit schemes								
– actuarial losses in respect of subsidiaries (note 12)	–	–	–	–	–	–	–	(410)
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	–	–	–	–	–	–	–	35
– actuarial losses in respect of associates net of tax (note 11)	–	–	–	–	–	–	–	(55)
Tax on items recognised directly in other comprehensive income (note 6(d))	(7)	(29)	–	–	–	(36)	–	68
Other changes in equity								
Employee share options								
– value of employee services	–	–	–	–	–	–	–	73
– proceeds from shares issued	–	–	–	–	–	–	1	–
Dividends and other appropriations								
– ordinary shares	–	–	–	–	–	–	–	(2,538)
Purchase of own shares								
– held in employee share ownership trusts	–	–	–	–	–	–	(121)	–
– share buy-back programme	–	–	–	–	–	–	(1,258)	–
Non-controlling interests – acquisitions (note 29)	–	–	–	–	–	–	–	(21)
Other movements	–	–	–	–	–	–	93	(91)
31 December 2012	**(3)**	**11**	**36**	**179**	**573**	**796**	**(2,824)**	**5,077**

Notes on the accounts (continued)

20 Capital and reserves – reconciliation of movement in total equity (continued)

	Translation reserve £m	Hedging reserve £m	Available-for-sale reserve £m	Revaluation reserve £m	Other £m	Total other reserves £m	Retained earnings: Treasury shares £m	Retained earnings: Other £m
1 January 2011	868	(35)	15	179	573	1,600	(750)	3,940
Comprehensive income and expense								
Profit for the year	–	–	–	–	–	–	–	3,095
Differences on exchange								
– subsidiaries	(377)	–	–	–	–	(377)	–	–
– associates	(109)	–	–	–	–	(109)	–	–
Differences on exchange reclassified and reported in profit for the year	(4)	–	–	–	–	(4)	–	–
Cash flow hedges								
– net fair value losses	–	(19)	–	–	–	(19)	–	–
– reclassified and reported in profit for the year	–	38	–	–	–	38	–	–
– reclassified and reported in net assets	–	(5)	–	–	–	(5)	–	–
Available-for-sale investments								
– net fair value gains	–	–	26	–	–	26	–	–
– reclassified and reported in profit for the year	–	–	(1)	–	–	(1)	–	–
Net investment hedges								
– net fair value gains	62	–	–	–	–	62	–	–
– differences on exchange on borrowings	(104)	–	–	–	–	(104)	–	–
Retirement benefit schemes								
– actuarial losses in respect of subsidiaries (note 12)	–	–	–	–	–	–	–	(461)
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	–	–	–	–	–	–	–	3
– actuarial losses in respect of associates net of tax (note 11)	–	–	–	–	–	–	–	(67)
Tax on items recognised directly in other comprehensive income (note 6(d))	13	(8)	–	–	–	5	–	12
Other changes in equity								
Employee share options								
– value of employee services	–	–	–	–	–	–	–	76
– proceeds from shares issued	–	–	–	–	–	–	2	–
Dividends and other appropriations								
– ordinary shares	–	–	–	–	–	–	–	(2,358)
Purchase of own shares								
– held in employee share ownership trusts	–	–	–	–	–	–	(123)	–
– share buy-back programme	–	–	–	–	–	–	(755)	–
Non-controlling interests – acquisitions (note 29)	–	–	–	–	–	–	–	(10)
Other movements	–	–	–	–	–	–	87	(55)
31 December 2011	349	(29)	40	179	573	1,112	(1,539)	4,175

The translation reserve is as explained in the accounting policy on foreign currencies in note 1.

The hedging reserve and the available-for-sale reserve are as explained in the accounting policy on financial instruments in note 1.

The revaluation reserve relates to the acquisition of the cigarette and snus business of ST in 2008.

Of the amounts released from the hedging reserve during the year, losses of £5 million (2011: £5 million) and losses of £26 million (2011: £26 million) were reported within revenue and raw materials and consumables respectively, together with a loss of £5 million (2011: £2 million gain) reported in other operating expenses and a loss of £35 million (2011: £9 million) reported within net finance costs.

20 Capital and reserves – reconciliation of movement in total equity (continued)

Other reserves comprise:

(a) £483 million which arose in 1998 from merger accounting in a Scheme of Arrangement and Reconstruction whereby British American Tobacco p.l.c. acquired the entire share capital of B.A.T Industries p.l.c. and the share capital of that company's principal financial services subsidiaries was distributed, so effectively demerging them; and

(b) In the Rothmans transaction, convertible redeemable preference shares were issued as part of the consideration. The discount on these shares was amortised by crediting other reserves and charging retained earnings. The £90 million balance in other reserves comprises the accumulated balance in respect of the preference shares converted during 2004.

The tax attributable to components of other comprehensive income is as follows:

	2012 £m	2011 £m
Translation reserve		
Differences on exchange	**(2)**	7
Net investment hedges		
– difference on exchange on borrowings	**(5)**	6
	(7)	13
Hedging reserve		
Cash flow hedges		
– net fair value (gains)/losses	**(17)**	8
– reclassified and reported in profit for the year	**(12)**	(16)
	(29)	(8)
Retained earnings		
– actuarial gains in respect of subsidiaries	**76**	13
– surplus recognition and minimum funding obligations in respect of subsidiaries	**(8)**	(1)
	68	12
Owners of the parent	**32**	17
Non-controlling interests	**(4)**	3
Total tax recognised in other comprehensive income for the period (note 6(d))	**28**	20

Notes on the accounts (continued)

21 Borrowings

	Currency	Maturity dates	Interest rates	2012 £m	2011 £m
Eurobonds	Euro	2012 to 2023	2.4% to 5.9%	**5,208**	4,985
	UK sterling	2013 to 2040	5.5% to 7.3%	**2,670**	2,675
Bonds issued pursuant to Rule 144A and RegS under the US Securities Act (as amended)	US dollar	2013 to 2022	1.4% to 9.5%	**1,840**	643
Other notes	Malaysian ringgit	2012 to 2014	4.1% to 4.5%	**51**	134
	Indonesian rupiah	2012	10.5%	**–**	96
	Other currencies	–	–	**25**	26
Syndicated bank loans	US dollar	2012	floating rate	**–**	444
	Euro	2013	floating rate	**–**	374
Commercial paper				**–**	85
Bank loans				**543**	497
Other loans				**135**	57
Finance leases				**5**	8
Overdrafts				**242**	252
				10,719	10,276

The floating interest rates referred to in the table above are based on EURIBOR or USD LIBOR plus a margin ranging between 28 and 105 basis points (2011: 28 and 105 basis points).

	2012 £m	2011 £m
Current	**1,636**	1,766
Non-current	**9,083**	8,510
	10,719	10,276

Current borrowings include interest payable of £222 million at 31 December 2012 (2011: £230 million). Included within borrowings are £3,731 million (2011: £3,066 million) of borrowings subject to fair value hedges where their amortised cost has been increased by £220 million (2011: £189 million) in the table above.

The fair value of borrowings is estimated to be £12,041 million (2011: £11,263 million) and has been determined using quoted market prices or discounted cash flow analysis.

	2012 £m	2011 £m
Amounts secured on Group assets	**13**	27

In both years amounts secured on Group assets include finance leases of £5 million (2011: £8 million) and amounts secured on certain inventory of the Group (see note 17). In 2011 certain borrowings were also secured on property of the Group (see note 10).

Borrowings are repayable as follows:

	Per balance sheet		Contractual gross maturities	
	2012 £m	2011 £m	2012 £m	2011 £m
Within one year	**1,636**	1,766	**1,783**	1,922
Between one and two years	**666**	1,228	**1,099**	1,602
Between two and three years	**1,319**	665	**1,730**	1,086
Between three and four years	**369**	1,042	**672**	1,417
Between four and five years	**1,508**	454	**1,862**	767
Beyond five years	**5,221**	5,121	**6,874**	6,978
	10,719	10,276	**14,020**	13,772

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 2012								
Total borrowings	**5,710**	**1,962**	**329**	**2,688**	**–**	**–**	**30**	**10,719**
Effect of derivative financial instruments								
– cross-currency swaps	**1,078**	**(148)**	**(325)**	**(503)**	**–**	**–**	**–**	**102**
– forward foreign currency contracts	**(875)**	**–**	**–**	**(279)**	**287**	**–**	**862**	**(5)**
	5,913	**1,814**	**4**	**1,906**	**287**	**–**	**892**	**10,816**
31 December 2011								
Total borrowings	5,213	1,264	329	3,431	1	–	38	10,276
Effect of derivative financial instruments								
– cross-currency swaps	1,080	(154)	(325)	(518)	–	–	–	83
– forward foreign currency contracts	(1,662)	272	–	(751)	294	1,121	768	42
	4,631	1,382	4	2,162	295	1,121	806	10,401

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 2012							
Total borrowings	**1,667**	**665**	**1,318**	**368**	**1,508**	**5,193**	**10,719**
Effect of derivative financial instruments							
– interest rate swaps	**1,977**	**(750)**	**(608)**	**–**	**118**	**(737)**	**–**
– cross-currency swaps	**781**	**149**	**–**	**(325)**	**–**	**(503)**	**102**
	4,425	**64**	**710**	**43**	**1,626**	**3,953**	**10,821**
31 December 2011							
Total borrowings	2,373	848	598	1,042	324	5,091	10,276
Effect of derivative financial instruments							
– interest rate swaps	1,484	(484)	(750)	–	–	(250)	–
– cross-currency swaps	759	–	167	–	(325)	(518)	83
	4,616	364	15	1,042	(1)	4,323	10,359

Details of the derivative financial instruments included in these tables are given 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:

	2012 Total £m	2011 Total £m
Within one year	**2**	4
Between one and two years	**2**	1
Between two and three years	**1**	1
Between three and four years	**–**	1
Between four and five years	**–**	1
	5	8

There is no material difference between the repayable principal and the total gross cash flows shown above.

Borrowings facilities – undrawn committed facilities expire as follows:

	2012 £m	2011 £m
Within one year	**131**	194
Between one and two years	**–**	10
Between two and three years	**2,000**	–
Between three and four years	**–**	2,000
Between four and five years	**92**	–
	2,223	2,204

The Group defines net debt as follows:

	2012 £m	2011 £m
Borrowings (note 21)	**10,719**	10,276
Derivatives in respect of net debt:		
– assets (note 16)	**(234)**	(223)
– liabilities (note 16)	**95**	126
Cash and cash equivalents (note 19)	**(2,081)**	(2,194)
Current available-for-sale investments (note 15)	**(26)**	(57)
	8,473	7,928

22 Other provisions for liabilities and charges

	Restructuring of existing businesses £m	Employee related benefits £m	Fox River £m	Other provisions £m	Total £m
1 January 2012	149	50	274	221	694
Differences on exchange	(6)	(2)	–	(19)	(27)
Provided in respect of the year	6	9	–	71	86
Utilised during the year	(57)	(12)	(3)	(52)	(124)
31 December 2012	92	45	271	221	629
Analysed on the balance sheet as					
– current	47	17	–	146	210
– non-current	45	28	271	75	419
	92	45	271	221	629

The restructuring provisions relate to the restructuring and integration costs incurred and reported as adjusting items in the income statement. The principal restructuring activities in 2012 and 2011 are as described in note 3(e). While some elements of the non-current provisions of £45 million will unwind over several years, as termination payments are made over extended periods in some countries, it is estimated that approximately 44% will unwind in 2014 and over 91% within five years.

Employee related benefits mainly relate to long-term employee benefits other than post-retirement benefits. As the principal components of these provisions are long-service awards and 'jubilee' payments due after a certain service period, they will unwind over several years. It is estimated that approximately 39% of the non-current provisions of £28 million will unwind within five years.

A provision of £274 million was made in 2011 for a potential claim under a 1998 settlement agreement entered into by a Group subsidiary in respect of the clean-up of sediment in the lower Fox River. This is explained in more detail in note 30.

Other provisions comprise balances set up in the ordinary course of general business that cannot be classified within the other categories, such as sales returns, onerous contracts, together with amounts in respect of supplier, excise and other disputes. The nature of the amounts provided in respect of disputes is such that the extent and timing of cash flows is difficult to estimate, and the ultimate liability may vary from the amounts provided.

Amounts provided above are shown net of reversals of unused provisions which include £13 million for restructuring of existing businesses, £1 million for employee benefits and £52 million for other provisions.

Notes on the accounts (continued)

23 Trade and other payables

	2012 £m	2011 £m
Trade payables	**679**	668
Duty, excise and other taxes	**3,736**	3,085
Accrued charges and deferred income	**1,156**	1,168
Social security and other taxation	**15**	8
Sundry payables	**407**	429
	5,993	5,358
Current	**5,827**	5,174
Non-current	**166**	184
	5,993	5,358

Accrued charges and deferred income include £5 million (2011: £8 million) in respect of interest payable. Amounts payable to related parties including associated undertakings are shown in note 29.

There is no material difference between the above amounts for trade and other payables and their fair value due to the short-term duration of the majority of trade and other payables.

Trade and other payables are predominantly denominated in the functional currencies of subsidiary undertakings with less than 3% in other currencies (2011: 5%).

24 Financial instruments and risk management

Management of financial risks

One of the principal responsibilities of Treasury is to manage the financial risks arising from the Group's underlying operations. Specifically, Treasury manages, within an overall policy framework set by the Group's Main Board and Corporate Finance Committee (CFC), the Group's exposure to funding and liquidity, interest rate, foreign exchange and counterparty risks. The Group's treasury position is monitored by the CFC which meets regularly throughout the year and is chaired by the Group Finance Director. The approach is one of risk reduction within an overall framework of delivering total shareholder return.

The Group defines capital as net debt (see note 21) and equity (see note 20). The only externally imposed capital requirement for the Group is interest cover as described under Interest rate risk below. The Group assesses its financial capacity by reference to cash flow, net debt and interest cover. Group policies include a set of financing principles and key performance indicators including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital base is managed and, in particular, the policies on dividends (as a percentage of long-term sustainable earnings) and share buy-back are decided. The key objective of the financing principles is to appropriately balance the interests of equity and debt holders in driving an efficient financing mix for the Group.

The Group manages its financial risks in line with the classification of its financial assets and liabilities in the Group's balance sheet and related notes.

The Group's management of specific risks is dealt with as follows:

Liquidity risk

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group has a target average centrally managed debt maturity of at least five years with no more than 20% of centrally managed debt maturing in a single rolling year. As at 31 December 2012, the average centrally managed debt maturity was 7.2 years (2011: 7.0 years) and the highest proportion of centrally managed debt maturing in a single rolling year was 19.3% (2011: 18.3%).

In November 2012, the Group issued a new €750 million bond with a maturity of January 2023.

In July 2012, the Group prepaid and cancelled a €450 million syndicated facility due October 2013. This repayment was financed from Group cash balances.

In June 2012, the Group repaid a €337 million bond due in June 2012, and prepaid and cancelled a US$690 million syndicated facility due October 2012, a Mexican Peso 1,444 million borrowing due September 2014 and a Mexican Peso 1,025 million borrowing due November 2014. These payments were financed from Group cash balances.

In June 2012, the Group issued new US$2 billion bonds; US$500 million with a maturity of June 2015, US$600 million with a maturity of June 2017 and US$900 million with a maturity of June 2022.

In June 2011, the Group established an US$2 billion commercial paper programme. It is Group policy that short-term sources of funds (including drawings under both the US$ programme and the existing Group £1 billion euro commercial paper (ECP) programme) are backed by undrawn committed lines of credit and cash. At 31 December 2012 no commercial paper was outstanding (2011: £85 million).

24 Financial instruments and risk management (continued)

In November 2011, the Group issued a new €600 million bond with a maturity of November 2021.

In September 2011, the Group repaid a Mexican Peso 1,444 million borrowing which was due in September 2011 with a new Mexican Peso 1,444 million borrowing due 2014.

In August 2011, the Group extended the maturity date of a US$200 million facility from 2011 to 2016, and simultaneously increased the size of the facility to US$240 million. This facility is drawable in Chilean peso and was drawn to the value of US$225 million at 31 December 2012 (31 December 2011: US$225 million). The undrawn element of US$15 million is available for drawing until February 2013.

In June 2011, the Group repaid a €530 million bond with the repayment financed from Group cash balances.

During the year, the Group's subsidiary in Brazil received proceeds of £356 million (2011: £401 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £350 million (2011: £519 million).

During the year the Group's subsidiary in Japan entered into an agreement with an affiliate of Sumitomo Mitsui Banking Corporation to assign part of its monthly trade receivables, without recourse, in return for cash. Since the bank has acquired the risks associated with the assigned receivables, in accordance with IAS 39 this portion of the receivables has been derecognised from trade and other receivables, leading to an increase of £75 million in cash generated from operations.

The Group utilises cash pooling and zero balancing bank account structures in addition to inter-company loans and borrowings to ensure that there is the maximum mobilisation of cash within the Group. The key objectives of Treasury in respect of cash and cash equivalents are to protect the principal value of cash and cash equivalents, to concentrate cash at the centre to minimise the required long-term debt issuance, and to optimise the yield earned. The amount of debt issued by the Group is determined by forecasting the net debt requirement after the mobilisation of cash.

The Group continues to target investment-grade credit ratings; as at 31 December 2012 the ratings from Moody's and S&P were Baa1 (positive outlook) / A- (stable outlook) (2011: Baa1/BBB+). The S&P rating was upgraded from BBB+ to A- on 9 November 2012. The strength of the ratings has underpinned the debt issuance during 2012 and 2011 and, despite the impact of the turbulence in financial markets, the Group is confident of its ability to successfully access the debt capital markets, as demonstrated with the issue of bonds in the euro, US dollar and sterling markets in 2012 and 2011.

As part of its short-term cash management, the Group invests in a range of cash and cash equivalents, including money market funds, which are regarded as highly liquid and are not exposed to significant changes in fair value. These are kept under continuous review as described in the credit risk section below. At 31 December 2012, cash and cash equivalents include £434 million invested in money market funds (2011: £558 million).

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

Currency risk

The Group is subject to exposure on the translation of the net assets of foreign currency subsidiaries and associates into its reporting currency, sterling. The Group's primary balance sheet translation exposures are to the US dollar, Canadian dollar, euro, Danish krone, Swiss franc, South African rand, Russian rouble, Brazilian real, Australian dollar, Malaysian ringgit and Singapore dollar. These exposures are kept under continuous review. The Group's policy on borrowings is to broadly match the currency of these borrowings with the currency of cash flows arising from the Group's underlying operations. Within this overall policy, the Group aims to minimise all balance sheet translation exposure where it is practicable and cost-effective to do so through matching currency assets with currency borrowings. The main objective of these policies is to protect shareholder value by increasing certainty and minimising volatility in earnings per share. At 31 December 2012, the currency profile of the Group's gross debt, after taking into account derivative contracts, was 17% (2011: 14%) US dollar, 45% (2011: 43%) euro, 3% (2011: 3%) Canadian dollar, 18% (2011: 12%) sterling, nil (2011: 11%) Australian dollar and 17% (2011: 17%) other currencies.

The Group faces currency exposures arising from the translation of profits earned in foreign currency subsidiaries and associates and joint ventures; these exposures are not normally hedged. Exposures also arise from:

(i) foreign currency denominated trading transactions undertaken by subsidiaries. These exposures comprise committed and highly probable forecast sales and purchases, which are offset wherever possible. The remaining exposures are hedged within the Treasury policies and procedures with forward foreign exchange contracts and options, which are designated as hedges of the foreign exchange risk of the identified future transactions; and

(ii) forecast dividend flows from subsidiaries to the centre. To ensure cash flow certainty, the Group hedges such flows using forward foreign exchange contracts designated as net investment hedges of the foreign exchange risk arising from the investments in these subsidiaries.

IFRS 7 requires a sensitivity analysis that shows the impact on the income statement and on items recognised directly in other comprehensive income of hypothetical changes of exchange rates in respect of non-functional currency financial assets and liabilities held across the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. Financial assets and liabilities held in the functional currency of the Group's subsidiaries, as well as non-financial assets and liabilities and translation risk, are not included in the analysis. The Group considers a 10% strengthening or weakening of the functional currency against the non-functional currency of its subsidiaries as a reasonably possible change. The impact is calculated with reference to the financial asset or liability held as at the year-end, unless this is unrepresentative of the position during the year.

Notes on the accounts (continued)

24 Financial instruments and risk management (continued)

A 10% strengthening of functional currencies against non-functional currencies would result in pre-tax profit being £1 million higher (2011: £16 million higher) and items recognised directly in other comprehensive income being £5 million lower (2011: £227 million higher). A 10% weakening of functional currencies against non-functional currencies would result in pre-tax profit being £1 million lower (2011: £23 million lower) and items recognised directly in other comprehensive income being £5 million higher (2011: £277 million lower).

The exchange sensitivities on items recognised directly in other comprehensive income relate to hedging of certain net asset currency positions in the Group as well as on cash flow hedges in respect of future transactions, but does not include sensitivities in respect of exchange on non-financial assets or liabilities.

Interest rate risk

The objectives of the Group's interest rate risk management policy are to lessen the impact of adverse interest rate movements on the earnings, cash flow and economic value of the Group and to safeguard against any possible breach of its financial covenants. Additional objectives are to minimise the cost of hedging and the associated counterparty risk.

The Group targets an interest cover ratio, as calculated under its key central banking facilities, of greater than 5 and for 2012 it is 12.6 times (2011: 12.5 times). The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of 4.5.

In order to manage its interest rate risk, the Group maintains both floating rate and fixed rate debt. The Group sets targets (within overall guidelines) for the desired ratio of floating to fixed rate debt on both a gross and net basis (at least 50% fixed on a net basis in the short to the medium-term) as a result of regular reviews of market conditions and strategy by the Corporate Finance Committee and the board of the main central finance company. At 31 December 2012, the relevant ratios of floating to fixed rate borrowings were 35:65 (2011: 38:62) on a gross basis and 16:84 (2011: 17:83) on a net basis. Underlying borrowings are arranged on both a fixed rate and a floating rate basis and, where appropriate, the Group uses derivatives, primarily interest rate swaps, to vary the fixed and floating mix. The interest rate profile of liquid assets is taken into account in determining the net interest rate exposure.

IFRS 7 requires a sensitivity analysis that shows the impact on the income statement and on items recognised directly in other comprehensive income of hypothetical changes of interest rates in respect of financial assets and liabilities of the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. For the purposes of this sensitivity analysis, financial assets and liabilities with fixed interest rates are not included. The Group considers a 100 basis point change in interest rates a reasonably possible change except where rates are less than 100 basis points. In these instances it is assumed that the interest rates increase by 100 basis points and decrease to zero for the purpose of performing the sensitivity analysis. The impact is calculated with reference to the financial asset or liability held as at the year-end, unless this is unrepresentative of the position during the year.

A 100 basis point increase in interest rates would result in pre-tax profit being £16 million lower (2011: £18 million lower). A 100 basis point decrease in interest rates, or less where applicable, would result in pre-tax profit being £1 million higher (2011: £21 million higher). The effect of these interest rate changes on items recognised directly in other comprehensive income is not material in either year.

Credit risk

The Group has no significant concentrations of customer credit risk. Subsidiaries have policies in place requiring appropriate credit checks on potential customers before sales commence. The process for monitoring and managing credit risk once sales to customers have been made varies depending on local practice in the countries concerned.

Certain territories have bank guarantees, other guarantees and credit insurance provided in the Group's favour in respect of Group trade receivables, the issuance and terms of which are dependent on local practices in the countries concerned.

All derivatives are subject to ISDA agreements or equivalent documentation.

Cash deposits and other financial instruments give rise to credit risk on the amounts due from the related counterparties. Generally the Group targets a long-term counterparty credit rating of at least A/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 and for this, the Group identifies specific counterparties with a minimum short-term rating of A1/P1.

Counterparty credit risk is managed on a global basis by limiting the aggregate amount and duration of exposure to any one counterparty, taking into account its credit rating. The credit ratings of all counterparties are reviewed regularly.

The Group ensures that it has sufficient counterparty credit capacity of requisite quality to undertake all anticipated transactions throughout its geographic footprint, while at the same time ensuring that there is no geographic concentration in the location of counterparties.

The maximum exposure to the credit risk of financial assets at the balance sheet date is reflected by the carrying values included in the Group's balance sheet. In addition, the Group has issued guarantees to third parties, part of which has been recognised on the balance sheet in accordance with IAS 39. The unrecognised portion of these guarantees amounts to £26 million (2011: £28 million).

24 Financial instruments and risk management (continued)

Price risk
The Group is exposed to equity price risk on equity investments held by the Group, which are included in available-for-sale investments on the consolidated balance sheet, but the quantum of such is not material.

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

Fair value estimation
The fair values of financial assets and liabilities with maturities of less than one year, other than derivatives, are assumed to approximate their book values. For other financial instruments which are measured at fair value in the balance sheet, the basis for fair values is described below.

Fair value hierarchy
The following table presents the Group's financial assets and liabilities that are measured at fair value in accordance with the IFRS 7 classification hierarchy:

				2012
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets at fair value				
Available-for-sale investments (note 15)	26	–	37	63
Derivatives relating to				
– interest rate swaps (note 16)	–	209	–	209
– cross-currency swaps (note 16)	–	10	–	10
– forward foreign currency contracts (note 16)	–	154	–	154
Assets at fair value	26	373	37	436
Liabilities at fair value				
Derivatives relating to				
– interest rate swaps (note 16)	–	55	–	55
– cross-currency swaps (note 16)	–	30	–	30
– forward foreign currency contracts (note 16)	–	65	–	65
– others (note 16)	–	1	–	1
Liabilities at fair value	–	151	–	151

Notes on the accounts (continued)

24 Financial instruments and risk management (continued)

				2011
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets at fair value				
Available-for-sale investments (note 15)	17	42	38	97
Derivatives relating to				
– interest rate swaps (note 16)	–	186	–	186
– cross-currency swaps (note 16)	–	6	–	6
– forward foreign currency contracts (note 16)	–	137	–	137
– others (note 16)	–	9	–	9
Assets at fair value	17	380	38	435
Liabilities at fair value				
Derivatives relating to				
– interest rate swaps (note 16)	–	22	–	22
– cross-currency swaps (note 16)	–	46	–	46
– forward foreign currency contracts (note 16)	–	182	–	182
– others (note 16)	–	14	–	14
Liabilities at fair value	–	264	–	264

Level 1 financial instruments are traded in an active market and fair value is based on quoted prices at the year-end. This category includes listed equity shares of £nil (2011: £2 million).

Level 2 financial instruments are not traded in an active market, but the fair values are based on quoted market prices, broker/dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The Group's level 2 financial instruments include certain money market securities and most OTC derivatives.

The fair values of level 3 financial instruments have been determined using a valuation technique where at least one input (which could have a significant effect on the instrument's valuation) is not based on observable market data. The Group's level 3 financial instruments primarily consist of an equity investment in an unquoted entity which is valued using the discounted cash flows of estimated future dividends. The valuation assumes the following:

- future dividends grow by 2.0% (2011: 1.7%) and a 100 basis points decrease in the growth rate would result in the valuation being £7 million lower (2011: £6 million lower); and
- discount rate of 6.5% (2011: 7.0%) and a 100 basis points decrease in the discount rate would result in the valuation being £11 million higher (2011: £9 million higher).

The following table presents the changes in level 3 financial instruments:

	2012	2011
	Available-for-sale investments £m	Available-for-sale investments £m
1 January	**38**	26
Gains included in other comprehensive income	**–**	13
Differences on exchange	**(1)**	(1)
31 December	**37**	38

25 Cash flow
Cash generated from operations

	2012 £m	2011 £m
Profit from operations	**5,412**	4,721
Adjustments for		
– amortisation and impairment of trademarks	**63**	58
– amortisation and impairment of intangible assets	**53**	365
– depreciation and impairment of property, plant and equipment	**359**	394
– increase in inventories	**(755)**	(47)
– increase in trade and other receivables	**(329)**	(87)
– increase in trade and other payables	**840**	46
– decrease in net retirement benefit liabilities	**(200)**	(208)
– (decrease)/increase in provisions for liabilities and charges	**(45)**	232
– other non-cash items	**39**	63
Cash generated from operations	**5,437**	5,537

Profit from operations includes charges in respect of Group restructuring and integration costs referred to in note 3(e). These are also reflected in the movements in depreciation, amortisation, impairment, inventories, receivables, payables and provisions above and in the proceeds on disposal of property, plant and equipment shown in the Group cash flow statement. The net cash outflow in respect of the Group's restructuring costs was £201 million (2011: £207 million), of which £228 million (2011: £217 million) is included in cash generated from operations above.

Cash flows from investing activities
(a) Purchases and proceeds on disposals of investments
The purchases and disposals of investments (which comprise available-for-sale investments and loans and receivables) comprises a net cash inflow in respect of current investments of £24 million (2011: £3 million inflow).

(b) Property, plant and equipment
Purchases of property, plant and equipment include £195 million in respect of the Group's acquisition of the freehold interest in Globe House (the Group's headquarters in London). The Group had leased the property on a 25-year lease which was due to expire in 2024. The purchase price has been allocated to Freehold property in note 10.

(c) Proceeds from associates' share buy-backs
The proceeds from associates' share buy-backs reflect proceeds of £262 million (2011: £71 million) in respect of the Group's participation in the share buy-back programme conducted by Reynolds American Inc.

(d) Purchases of subsidiaries
In 2012, the cash outflow relates to the cash consideration paid on the purchase of CN Creative Limited of £14 million offset by a £2 million inflow relating to the adjustment of the purchase price for Protabaco.

In 2011, net cash outflows of £295 million arose on the purchase of Protabaco reflecting the settlement of the original purchase consideration of £298 million less the acquired net cash and cash equivalents of £3 million.

Cash flows from financing activities
(a) Cash flows from borrowings
In November 2012, the Group issued a new €750 million bond with a maturity of January 2023.

In July 2012, the Group prepaid and cancelled a €450 million syndicated facility due October 2013. This repayment was financed from Group cash balances.

In June 2012, the Group repaid a €337 million bond due in June 2012 and prepaid and cancelled a US$690 million syndicated facility due October 2012, a Mexican Peso 1,444 million borrowing due September 2014 and a Mexican Peso 1,025 million borrowing due November 2014. These payments were financed from Group cash balances.

In June 2012, the Group issued new US$2 billion bonds; US$500 million with a maturity of June 2015, US$600 million with a maturity of June 2017 and US$900 million with a maturity of June 2022.

During the year the Group's subsidiary in Brazil received proceeds of £356 million (2011: £401 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £350 million (2011: £519 million).

In June 2011, the Group established an US$2 billion commercial paper programme. It is Group policy that short-term sources of funds (including drawings under both the US$ programme and the existing Group £1 billion euro commercial paper (ECP) programme) are backed by undrawn committed lines of credit and cash. At 31 December 2012 no commercial paper was outstanding (2011: £85 million).

In November 2011, the Group issued a new €600 million bond with a maturity of November 2021.

Notes on the accounts (continued)

25 Cash flow (continued)

In September 2011, the Group repaid a Mexican Peso 1,444 million borrowing which was due in September 2011 with a new Mexican Peso 1,444 million borrowing due 2014.

In June 2011, the Group repaid a €530 million bond. The repayment was financed from Group cash balances.

(b) Movements relating to derivative financial instruments

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

(c) Purchases of non-controlling interests

In 2012, the purchase of non-controlling interest of £24 million relates to the acquisition of part of the non-controlling interests in British American Tobacco Bangladesh. For 2011, the cash outflow of £10 million relates to the acquisition of non-controlling interests in Chile.

26 Business combinations and disposals

(a) CN Creative Limited

On 18 December 2012, the Group acquired CN Creative Limited, a UK-based company specialising in the development of e-cigarette technologies intended to offer smokers a less risky alternative to cigarettes. The company's entire share capital was acquired from private investors for £40 million, of which £14 million has been paid. The company, which has its own research and development facilities, currently has several e-cigarette products on the market as well as new, innovative e-cigarette technologies in the development pipeline. The acquisition of CN Creative Limited is a natural extension of the Group's approach to tobacco harm reduction that has been evolving over a number of years.

The only material asset acquired was the company's intellectual property. There was no difference between the book value and fair value of the assets acquired.

Part of the consideration payable is contingent upon the achievement of certain post-acquisition events. The Group regards the successful outcome of these events as being more likely than not and anticipates making full payment within two years of the acquisition.

The impact of the acquired business upon actual results for 2012 was immaterial. Had the acquisition taken place on 1 January 2012 it is estimated that Group revenue would have been £15,192 million and the Group profit from operations would have been £5,398 million for the 12 months to 31 December 2012, after charging £13 million for the amortisation of acquired intangibles.

(b) Productora Tabacalera de Colombia, S.A.S. (Protabaco)

On 11 October 2011, the Group acquired from Flentex Holdings Limited and Trioumvir Enterprises Limited, both private investor shareholders, a 100% stake in Productora Tabacalera de Colombia, S.A.S. (Protabaco). The purchase price was subject to the final agreement of adjustments for working capital and net debt with the vendors. This was finalised in July 2012 with a reduction of £2 million to the previously reported purchase price and goodwill.

The goodwill of £132 million on the acquisition of the cigarette business of Protabaco, stated at the exchange rates ruling at the date of the transaction, arises as follows:

	Final fair value £m
Net assets acquired	164
Goodwill	132
Total consideration (US$458 million)	**296**

The goodwill of £132 million on the acquisition of the business represents a strategic premium to strengthen the Group's position in Latin America's fourth largest market, building on the Group's existing business and anticipated synergies, that will arise from combining the businesses in Colombia, post-acquisition.

(c) Items classified as held-for-sale

At 31 December 2012, held-for-sale assets comprise mainly land and buildings in Russia and Denmark which are being actively marketed for sale. At 31 December 2011, the held-for-sale assets included an amount of £6 million which has been reclassified to property, plant and equipment during the current year.

(d) Termination of distributor arrangement

With effect from 1 July 2011, the arrangement by which the Group acted as a distributor for a third party in Norway, was terminated. This arrangement contributed £24 million to revenue and less than £1 million to profit from operations in the Western Europe region in the six months ended 30 June 2011.

Notes on the accounts (continued)

27 Share-based payments

The Group operates a number of share-based payment arrangements of which the two principal ones are:

Long-Term Incentive Plan (LTIP)

Nil-cost options exercisable after three years from date of grant with a contractual life of ten years. Payout is subject to performance conditions based on earnings per share relative to inflation (50% of grant) and total shareholder return, combining the share price and dividend performance of the Company by reference to two comparator groups (50% of grant). Participants are not entitled to dividends prior to the exercise of the options. A cash equivalent dividend accrues through the vesting period and is paid on vesting. Both equity and cash-settled LTIPs are granted in March each year. In 2011 the Management Board LTIP award was made in May.

Deferred Share Bonus Scheme (DSBS)

Free ordinary shares released three years from date of grant and may be subject to forfeit if participant leaves employment before the end of the three-year holding period. Participants receive a separate payment equivalent to a proportion of the dividend payment during the holding period. Both equity and cash-settled grants are granted in March each year.

The Group also has a number of other arrangements which are not material for the Group and these are as follows:

Share Option Scheme (ESOS)

Options exercisable three years from date of grant with a contractual life of ten years, subject to earnings per share performance condition relative to inflation. Participants are not entitled to receive dividends in the period prior to the exercise of the options.

The granting of options under this scheme ceased with the last grant made in March 2004 and final outstanding awards must be exercised by March 2014. The awards were both equity and cash-settled.

Sharesave Scheme (SAYE)

Options granted in March each year from 2011 onwards (previously November until 2009 and no options were granted during 2010) by invitation at a 20% discount to the market price. Options to this equity-settled scheme are exercisable at the end of a three-year or five-year savings contract. Participants are not entitled to dividends prior to the exercise of the options. The maximum amount that can be saved by a participant in this way is £3,000 in any tax year.

Share Reward Scheme (SRS) and International Share Reward Scheme (ISRS)

Free shares granted in April each year (maximum £3,000 in any year) under the equity-settled scheme are subject to a three-year holding period. Participants receive dividends during the holding period which are reinvested to buy further shares.

Partnership Share Scheme

Open to all eligible employees, where employees can allocate part of their pre-tax salary to purchase shares in British American Tobacco p.l.c. The maximum amount that can be allocated in this way to any individual is £1,500 in any tax year. The shares purchased are held in a UK-based trust and are normally capable of transfer to participants tax free after a five-year holding period.

Further details on the operation of share-based payment arrangements can be found in the remuneration report.

Share-based payment expense

The amounts recognised in the income statement in respect of share-based payments were as follows:

	2012		2011	
	Equity-settled £m	**Cash-settled £m**	Equity-settled £m	Cash-settled £m
LTIP (note (a))	**22**	**5**	28	9
DSBS (note (b))	**46**	**13**	43	12
SAYE (note (c))	**1**	**–**	1	–
SRS (note (c))	**4**	**–**	4	–
Total recognised in the income statement (note 3(a))	**73**	**18**	76	21

27 Share-based payments (continued)

Share-based payment liability

The Group issues to certain employees cash-settled share-based payments that require the Group to pay the intrinsic value of these share-based payments to the employee at the date of exercise. The Group has recorded liabilities in respect of vested and unvested grants at the end of 2012 and 2011:

	2012		2011	
	Vested £m	Unvested £m	Vested £m	Unvested £m
LTIP	3.0	8.6	3.7	11.4
DSBS	0.1	14.6	–	17.1
ESOS	0.2	–	0.6	–
Total liability	3.3	23.2	4.3	28.5

(a) Long-Term Incentive Plan

Details of the movements for the equity and cash-settled LTIP scheme during the years ended 31 December 2012 and 31 December 2011, were as follows:

	2012		2011	
	Equity-settled Number of options in thousands	Cash-settled Number of options in thousands	Equity-settled Number of options in thousands	Cash-settled Number of options in thousands
Outstanding at start of year	6,589	829	7,292	960
Granted during the period	1,834	303	2,256	252
Exercised during the period	(2,129)	(317)	(2,335)	(299)
Forfeited during the period	(345)	(36)	(624)	(84)
Outstanding at end of year	5,949	779	6,589	829
Exercisable at end of year	751	102	374	135

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the period was £31.96 (2011: £25.52) for equity-settled and £31.88 (2011: £25.86) for cash-settled options.

The outstanding shares for the year ended 31 December 2012 had a weighted average contractual life of 8.0 years (2011: 8.0 years) for the equity-settled scheme, and 7.9 years (2011: 7.5 years) for the cash-settled share-based payment arrangements.

Notes on the accounts (continued)

27 Share-based payments (continued)

(b) Deferred Share Bonus Scheme

Details of the movements for the equity and cash-settled DSBS scheme during the years ended 31 December 2012 and 31 December 2011, were as follows:

	2012		2011	
	Equity-settled Number of options in thousands	Cash-settled Number of options in thousands	Equity-settled Number of options in thousands	Cash-settled Number of options in thousands
Outstanding at start of year	6,109	954	5,482	911
Granted during the period	2,025	368	2,474	388
Exercised during the period	(2,667)	(431)	(1,780)	(295)
Forfeited during the period	(99)	(13)	(67)	(50)
Outstanding at end of year	5,368	878	6,109	954
Exercisable at end of year	45	2	3	–

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the period was £32.02 (2011: £25.08) for equity-settled and £32.01 (2011: £25.65) for cash-settled options.

The outstanding shares for the year ended 31 December 2012 had a weighted average contractual life of 1.3 years (2011: 1.3 years) for the equity-settled scheme, and 1.3 years (2011: 1.2 years) for the cash-settled scheme.

(c) Other schemes

ESOS

The number of outstanding equity-settled options at the end of the year were 204,002 (2011: 385,451) and cash-settled options were 9,150 (2011: 24,870).

SAYE

The number of outstanding options at the end of the year for the three-year scheme were 280,383 (2011: 317,484) and for the five-year scheme were 526,023 (2011: 564,484).

SRS and ISRS

The number of outstanding shares at the end of the year for the Share Reward Scheme were 565,312 (2011: 591,204) and for the International Share Reward Scheme were 49,318 (2011: 76,213).

Valuation assumptions

Assumptions used in the Black-Scholes models to determine the fair value of share options at grant date were as follows:

	2012		2011	
	LTIP	DSBS	LTIP	DSBS
Expected volatility (%)	26	26	25	25
Average expected term to exercise (years)	3.5	3.0	3.5	3.0
Risk-free rate (%)*	0.7	0.6	2.0/1.6	1.8
Expected dividend yield (%)*	3.9	3.9	4.8/4.2	4.8
Share price at date of grant (£)*	32.08	32.08	23.77/27.15	23.77
Fair value at grant date (£)*	21.79/21.68	28.50	15.60/18.60	20.58

* Where two figures have been quoted for the Long-Term Incentive Plan, the first number represents the awards made to employees below Management Board level and the second number to awards made to the members of the Management Board as at the date of award.

Market condition features were incorporated into the Monte-Carlo models for the total shareholder return elements of the LTIP, in determining fair value at grant date. Assumptions used in these models were as follows:

	2012 %	2011 %
Average share price volatility FTSE 100 comparator group*	39	40/39
Average share price volatility FMCG comparator group*	26	26/26
Average correlation FTSE 100 comparator group*	38	39/21
Average correlation FMCG comparator group*	36	35/35

* Where two figures have been quoted for the Long-Term Incentive Plan, the first number represents the awards made to employees below Management Board level and the second number to awards made to the members of the Management Board as at the date of award.

27 Share-based payments (continued)

Fair values determined from the Black-Scholes and Monte-Carlo models use assumptions revised at the end of each reporting period for cash-settled share-based payment arrangements.

The expected British American Tobacco p.l.c. share price volatility was determined taking account of the return index (the share price index plus the dividend reinvested) over a five-year period. The respective FMCG and FTSE 100 share price volatility and correlations were also determined over the same periods. The average expected term to exercise used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural conditions, forfeiture and historical experience.

The risk-free rate has been determined from market yield curves for government gilts with outstanding terms equal to the average expected term to exercise for each relevant grant. The expected dividend yield was determined by calculating the yield from the last two declared dividends divided by the grant share price.

In addition to these valuation assumptions, LTIP awards contain earnings per share performance conditions. As these are non-market performance conditions they are not included in the determination of fair value of share options at the grant date, however they are used to estimate the number of awards expected to vest. This payout calculation is based on expectations published in analysts' forecasts.

28 Group employees

The average number of persons employed by the Group and its associates during the year, including Directors, was 87,485 (2011: 87,813).

	2012 Number	2011 Number
Asia-Pacific	**15,307**	15,351
Americas	**17,336**	16,661
Western Europe	**11,703**	12,138
EEMEA	**12,017**	12,115
Subsidiary undertakings	**56,363**	56,265
Associates	**31,122**	31,548
	87,485	87,813

Details of Directors' remuneration, share options and retirement benefits are given in the remuneration report.

Included within the employee numbers for Western Europe are certain employees in the UK in respect of central functions. Some of the costs of these employees are allocated or charged to the various regions and markets in the Group.

Notes on the accounts (continued)

29 Related party disclosures

The Group has a number of transactions and relationships with related parties, as defined in IAS 24 *Related Party Disclosures*, all of which are undertaken in the normal course of business.

Transactions and balances with associates relate mainly to the sale and purchase of cigarettes and tobacco leaf. Amounts receivable from associates in respect of dividends included in the table below were £84 million (2011: £87 million). The Group's share of dividends from associates, included in other net income in the table below, was £487 million (2011: £486 million).

	2012 £m	2011 £m
Transactions		
– revenue	**32**	28
– purchases	**(330)**	(342)
– other net income	**481**	487
Amounts receivable at 31 December	**92**	97
Amounts payable at 31 December	**(34)**	(40)

On 17 December 2012, a wholly owned subsidiary of the Group, BATUS Japan Inc. (BATUSJ), entered into an Amendment and Extension Agreement (referred to as the Amendment) with a wholly owned subsidiary of Reynolds American, R.J. Reynolds Tobacco Company (referred to as RJRTC). The Amendment modifies the American blend Cigarette Manufacturing Agreement (referred to as the 2010 Agreement), effective as of 1 January 2010.

Prior to the Amendment, the term of the 2010 Agreement was scheduled to expire on 31 December 2014, subject to early termination and extension provisions. Pursuant to the Amendment, the Manufacturing Agreement will remain in effect beyond 31 December 2014, provided that either RJRTC or BATUSJ may terminate the Manufacturing Agreement by furnishing three years' notice to the other party, with any such notice to be given no earlier than 1 January 2016.

In 2012, the Group acquired non-controlling interests of shareholders in British American Tobacco Bangladesh for £24 million. This transaction is shown as a £21 million reduction to reserves attributable to the owners of the parent and a £3 million reduction in reserves attributable to non-controlling interests in note 20. In 2011, the Group acquired non-controlling interests of shareholders in Chile for £10 million. This transaction is shown as a £10 million reduction to reserves attributable to the owners of the parent in note 20.

During the year, the Group received proceeds of £262 million (2011: £71 million) in respect of its participation in the share buy-back programme conducted by Reynolds American Inc.

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.

	2012 £m	2011 £m
The total compensation for key management personnel, including Directors, was:		
– salaries and other short-term employee benefits	**22**	21
– post-employment benefits	**3**	3
– share-based payments	**10**	8
	35	32

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.

30 Contingent liabilities and financial commitments

The Group is subject to contingencies pursuant to requirements that it complies with relevant laws, regulations and standards.

Failure to comply could result in restrictions in operations, damages, fines, increased tax, increased cost of compliance, interest charges, reputational damage or other sanctions. These matters are inherently difficult to quantify. In cases where the Group has an obligation as a result of a past event existing at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and the amount of the obligation can be reliably estimated, a provision will 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 have been made.

General litigation

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 in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

US 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% equity ownership interest in Reynolds American Inc.

As a result of the Business Combination, RJRT assumed all liabilities of B&W (except liabilities to the extent relating to businesses and assets not contributed by B&W to RJRT and other limited categories of liabilities) and contributed subsidiaries or otherwise to the extent related to B&W's tobacco business as conducted in the United States on or prior to 30 July 2004. In addition, RJRT agreed to indemnify B&W and each of its associates (other than Reynolds American Inc. and its subsidiaries) against, among other matters, all losses, 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.

Included in the US Litigation section below are all significant cases where B&W and/or a UK company is named as a defendant and all cases where RJRT is named as a defendant as a successor to B&W (the *"RJRT Successor Cases"*). The RJRT Successor Cases are covered by the RJRT Indemnification. Of the RJRT Successor Cases, the section below includes details of all cases where there has been an adverse judgment and also notes favourable judgments.

US litigation

The total number of US product liability cases pending at 31 December 2012 naming B&W was approximately 7,918 (2011: approximately 8,688). Of these, 4,837 cases are RJRT Successor Cases. For all of these cases, British American Tobacco Group companies have the protection of the RJRT Indemnification. British American Tobacco (Investments) Limited ("**Investments**") has been served as a co-defendant in one of those cases (2011: three). No other UK based Group company has been served as a co-defendant in any US product liability case pending as at 31 December 2012. Since many of these pending cases seek unspecified damages, it is not possible to quantify the total amounts being claimed, but the aggregate amounts involved in such litigation are significant, possibly totalling billions of US dollars. The cases fall into three broad categories: medical reimbursement cases; class actions; and individual cases.

(a) Medical reimbursement cases

These civil actions seek to recover amounts spent by government entities and other third-party providers on healthcare and welfare costs claimed to result from illnesses associated with smoking.

At 31 December 2012, one US medical reimbursement suit was pending against B&W (2011: one). This suit has been brought by an Indian tribe in the Indian Tribal Court in South Dakota. No other suits are pending against B&W by county or other political subdivisions of the states.

(b) Class actions

At 31 December 2012, B&W was named as a defendant in some six (2011: eight) separate actions attempting to assert claims on behalf of classes of persons allegedly injured or financially impacted through smoking or where classes of tobacco claimants have been certified. If the classes are or remain certified and the possibility of class-based liability is eventually established, it is likely that individual trials will be necessary to resolve any claims by individual plaintiffs. Class action suits have been filed in a number of states against individual cigarette manufacturers and their parent corporations, alleging that the use of the terms 'lights' and 'ultralights' constitutes unfair and deceptive trade practices.

The Cleary putative class action complaint was filed in state court in Chicago, Illinois on 3 June 1998 against several defendants, alleging that all defendants fraudulently concealed facts regarding the addictive nature of nicotine, and that defendant Philip Morris fraudulently marketed Marlboro Lights cigarettes, and sought

Notes on the accounts (continued)

30 Contingent liabilities and financial commitments (continued)

Fourth Amended Complaint was granted on 22 June 2010 and later affirmed by the Seventh Circuit. The plaintiffs' petition for rehearing was denied by the Seventh Circuit and the time for plaintiffs to seek further review to the US Supreme Court expired in February 2012. As no review was sought, the case is now over.

In a medical monitoring class action brought on behalf of Louisiana smokers (*Scott*) the jury returned a verdict on 28 July 2003 in favour of the defendants on the plaintiffs' claim for medical monitoring and found that cigarettes were not defectively designed. However, the jury also made certain findings against the defendants on 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, requiring the defendants to fund a cessation programme to help eligible class members stop smoking. After the intermediate court of appeal's decision affirming in part the judgment below, the trial court entered an amended judgment in the case. This was later amended but largely affirmed by the Louisiana Court of Appeals. Pursuant to the judgment, the defendants were required to deposit US$242 million with the court, with interest from 21 July 2008 until paid. The defendants' application for *writ of certiorari* by the Supreme Court of Louisiana along with the defendants' motion to stay execution of the judgment was denied, as was defendants' subsequent petition for *writ of certiorari* in the US Supreme Court. In August 2011, RJRT paid US$139 million (the portion of the judgment allocated to RJRT and B&W) into the trust for the funding of the programme. On 10 May 2012, the parties entered into an agreement wherein the plaintiffs will request attorneys' fees and costs of approximately US$114 million be paid from the monies deposited in the trust, the plaintiffs will release their claims that the defendants were liable to pay their attorneys' fees and costs, and the defendants will waive the right to assert claims to 50% of any unspent or surplus money in the trust at the termination of the ten-year smoking cessation programme.

Black is a 'lights' class action filed in November 2000 in the Circuit Court, City of St. Louis, Missouri. B&W removed the case to the US District Court for the Eastern District of Missouri on 23 September 2005. On 25 October 2005, the plaintiffs filed a motion to remand, which was granted on 17 March 2006. On 16 April 2008, the court stayed the case pending US Supreme Court review in *Good v. Altria Group, Inc.* On 28 June 2011, the court issued an order removing the case from the trial docket. A status conference is currently scheduled for 3 February 2014.

Brown is a case filed in June 1997 in the Superior Court, San Diego County, California. On 11 April 2001, the court granted in part the plaintiffs' motion for certification of a class composed of California residents who smoked at least one of the defendants' cigarettes from 10 June 1993 through 23 April 2001, and who were exposed to the defendants' marketing and advertising activities in California. On 7 March 2005, the court granted the defendants' motion to decertify the class, but this decision was later reversed by the California Supreme Court to the extent that it was based upon the conclusion that all class members were required to demonstrate standing, and remanded the case. The defendants filed a motion on 9 January 2012 with the California Superior Court requesting that the class be decertified. On 23 May 2012, the court issued a "Tentative Ruling" that, among other things, denied the defendants' motion to decertify the class and, as a result, the case will go forward as a "lights" class action. At the plaintiffs' request, the court entered an order on 26 September 2012, dismissing with prejudice from the case defendants B&W, RJRT, Lorillard Tobacco Company, Liggett Group and Liggett & Meyers. Philip Morris USA Inc. is the sole defendant remaining in the case.

Howard is a 'lights' class action filed in February 2000 in the Circuit Court, Madison County, Illinois. A judge certified a class on 18 December 2001. On 6 June 2003, the trial judge issued an order staying all proceedings pending resolution of *Price v. Philip Morris, Inc.*, a 'lights' class action against Philip Morris, Inc. in the Illinois state court. The plaintiffs appealed this stay order to the Illinois Fifth District Court of Appeals, which affirmed the Circuit Court's stay order on 19 August 2005. There is currently no activity in the case.

Jones is a case filed in December 1998 in the Circuit Court, Jackson County, Missouri. The defendants removed the case to the US District Court for the Western District of Missouri on 16 February 1999. The action was brought by tobacco product users and purchasers on behalf of all similarly situated Missouri consumers. The plaintiffs allege that their use of the defendants' tobacco products has caused them to become addicted to nicotine. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. The case was remanded to the Circuit Court on 17 February 1999. There has been limited activity in this case.

Parsons is a case filed in February 1998 in the Circuit Court, Ohio County, West Virginia. The plaintiff sued asbestos manufacturers and US cigarette manufacturers, including B&W, seeking compensatory and punitive damages (US$1 million individually and an unspecified sum for the class) for alleged personal injuries arising from their exposure to respirable asbestos fibres and cigarette smoke. The case has been stayed pending a final resolution of the plaintiffs' motion to refer tobacco litigation to the judicial panel on multidistrict litigation filed in *In Re: Tobacco Litigation* in the Supreme Court of Appeals of West Virginia. Moreover, *Parsons* has been stayed pursuant to the Bankruptcy Code because three defendants filed bankruptcy petitions on 26 December 2000.

Young is a case filed in November 1997 in the Circuit Court, Orleans Parish, Louisiana. The plaintiffs brought an Environmental Tobacco Smoke ("ETS") class action on behalf of all residents of Louisiana who, though not themselves cigarette smokers, have been exposed to second-hand smoke from cigarettes which were manufactured by the defendants, and who allegedly suffered injury as a result of that exposure. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. On 13 October 2004, the trial court stayed this case pending the outcome of appellate review in the Scott class action in Louisiana (discussed above).

In *Engle* (a case in Florida), a jury awarded a total of US$12.7 million to three class representatives, and in a later stage of the three-phase trial procedure adopted in this case, a jury assessed US$17.6 billion in punitive damages against B&W. On 21 May 2003, the intermediate appellate court reversed the trial court's

30 Contingent liabilities and financial commitments (continued)

judgment and remanded the case to the trial court with instructions to de-certify the class – this was upheld on 6 July 2006. Further, the Florida Supreme Court permitted the judgments entered for two of the three *Engle* class representatives to stand, but dismissed the judgment entered in favour of the third *Engle* class representative. Finally, the Florida Supreme Court permitted putative *Engle* class members to file individual lawsuits against the *Engle* defendants within one year of the court's decision (subsequently extended to 11 January 2008).

Engle progeny cases, as at 31 December 2012:

	Engle progeny cases in which B&W has been served (both state and federal courts in Florida)	Engle progeny cases in which RJRT is named as a successor to B&W
Number of cases	42	4,821
Number of plaintiffs	76	5,714

Phase three trials of individual Engle class members, as at 31 December 2012:

	Additional Phase 3 Engle Trials naming RJRT as successor to B&W proceeding to verdict
Total number of trials	37
Number of trials resulting in plaintiffs' verdicts	22
Total damages awarded in final judgments against RJRT as successor to B&W (approximately)	US$73,248,732
Amount of overall damages comprising 'compensatory damages' (approximately)	US$48,150,000 (of overall US$73,248,732)
Amount of overall damages comprising 'punitive damages' (approximately)	US$150,000 (of overall US$248,732)
Number of adverse judgments appealed by RJRT	17*
Number of adverse judgments (not yet appealed), in which RJRT still has time to file an appeal	5

* In one of the appeals that was decided, the Florida intermediate appellate court affirmed the liability finding but vacated the damages award and remanded the matter to the trial court. In three of the appeals that were decided, the Florida intermediate appellate courts affirmed final judgments in favour of plaintiffs. In the other two appeals that were decided, the Florida intermediate appellate courts reversed the final judgment and remanded the matter to the trial court for a new trial on all issues. One of these remanded cases has since been retried, and resulted in a plaintiff's verdict. The time to file an appeal from this adverse judgment has not yet expired.

In June 2009, the Florida legislature amended its existing bond cap statute by adding a US$200 million bond cap that applies to all phase three *Engle* progeny cases in the aggregate and establishing individual bond caps for individual cases in amounts that vary depending on the number of judgments in effect at a given time. In May 2011, Florida removed the provision in this legislation that would have permitted this bond cap to expire on 31 December 2012. Plaintiffs in several *Engle* progeny cases have unsuccessfully challenged the constitutionality of the bond cap. One of these appellate courts has since certified to the Florida Supreme Court the question of whether the bond cap violates the Florida Constitution. The Florida Supreme Court accepted jurisdiction over the issue of the constitutionality of the bond cap on 23 January 2012. On 31 August 2012, the Florida Supreme Court entered an order dismissing this case. Plaintiff subsequently moved for a rehearing, but this was denied. Plaintiff had until 10 January 2013 to file a petition for *writ of certiorari* to the United States Supreme Court. Plaintiff did not file a petition for *writ of certiorari*.

Notes on the accounts (continued)

30 Contingent liabilities and financial commitments (continued)

Individual actions

	As at:	Total number of cases		
Cases pending against B&W which were filed by or on behalf of individuals and in which it is contended that diseases or deaths have been caused by cigarette smoking or by exposure to ETS	31 December 2011	3,091		
	31 December 2012	3,074	2,574	ETS cases brought by flight attendants who were members of a class action (*"Broin"*) that was settled on terms that allow compensatory but not punitive damages claims by class members.
			396	Cases brought in consolidated proceedings in West Virginia, where the first phase of the trial began on 19 October 2011 but ended in a mistrial on 8 November 2011 (trial is scheduled for 15 April 2013).
			42	*Engle* progeny cases that have been filed directly against B&W (please see earlier table on page 177).
			62	Cases filed by other individuals.

In addition, there are 16 cases filed by other individuals naming RJRT as successor to B&W. These cases are subject to the RJRT Indemnification and are not detailed here.

Of the individual cases that remain pending as of 31 December 2012, two resulted in verdicts against B&W: In December 2003, a New York jury (*in Frankson*) awarded US$350,000 in compensatory damages against B&W and two industry organisations. In January 2004, the same jury awarded US$20 million in punitive damages. On 22 June 2004, the trial judge granted a new trial unless the parties agreed to an increase in compensatory damages to US$500,000 and a decrease in punitive damages to US$5 million, of which US$4 million would be awarded against B&W. The plaintiff agreed to a decrease in punitive damages but B&W did not agree to an increase in compensatory damages. On 25 January 2005, B&W appealed to an intermediate New York State appellate court, which affirmed the judgment on 5 July 2006, except insofar as it dismissed the plaintiff's design defect claims. The court denied B&W's motion for leave to reargue, or in the alternative, for leave to appeal to the New York Court of Appeals on 5 October 2006. On 8 December 2006, the trial judge granted the plaintiff's application for entry of judgment in the amounts of US$5 million in punitive damages and US$175,000 in compensatory damages. The trial court also granted the plaintiff's motion to vacate that part of the 2004 order granting a new trial unless the parties agreed to an increase in compensatory damages to US$500,000. RJRT posted a bond in the approximate amount of US$8 million on 3 July 2007. Following B&W's appeal, the intermediate appellate court modified the final judgment on 29 September 2009 by reversing the award of punitive damages, and remanding the case for a new punitive damages trial. On 15 January 2010, the appellate court denied the plaintiff's motion for additional time to seek leave to appeal to the New York Court of Appeals, but granted the plaintiff more time to file a motion for leave to reargue to the appellate court, which was denied on 12 March 2010. On 17 July 2012, defendants filed a motion for summary judgment dismissing plaintiff's claims for punitive damages. The motion was fully briefed, and oral argument was held on 28 August 2012. A decision remains pending.

In February 2005, a Missouri jury (*in Lincoln Smith*) awarded US$500,000 in compensatory damages and US$20 million in punitive damages against B&W. Following B&W's appeal, on 31 July 2007, an intermediate appellate court affirmed the compensatory damages award and reversed the punitive damages award, reasoning that the plaintiffs failed to produce sufficient evidence to justify the verdict. Following a transfer to the Missouri Supreme Court and a subsequent remand by that court, the intermediate appellate court on 16 December 2008 again upheld the award of compensatory damages, reversed the jury's award of US$20 million in punitive damages, and ordered a new trial on punitive damages. On 20 August 2009, a Missouri jury awarded US$1.5 million in punitive damages against B&W. On 24 September 2009, B&W filed a motion for a new trial and a motion for judgment notwithstanding the verdict. On the same date, the plaintiffs filed a motion to increase the punitive damages award to US$20 million, and a motion to vacate, modify or set aside judgment, or in the alternative, for a new trial. On 21 December 2009, the court denied the plaintiffs' and B&W's post-trial motions. After an initial oral argument on both parties' appeals in September 2011, the intermediate appellate court ordered the parties to reargue the case *en banc*. On 2 October 2012, the intermediate appellate court reversed the jury's award of punitive damages on the grounds that the trial court's conduct in the 2009 trial had exceeded the scope of its mandate, and remanded for a new trial solely to determine the amount of punitive damages. On 30 October 2012, the intermediate appellate court denied B&W's application for transfer to the Missouri Supreme Court, and overruled B&W's motion for rehearing. B&W filed in the Missouri Supreme Court an application for transfer to that court on 14 November 2012, and plaintiffs filed opposition on 26 November 2012. On 18 December 2012, the Missouri Supreme Court granted B&W's application for transfer.

30 Contingent liabilities and financial commitments (continued)

UK-based Group companies
Investments has been served in the following US cases pending as of 31 December 2012: one class action alleging violations of Kansas antitrust and consumer protection laws, the *Daric Smith* case mentioned below: and one individual action (*"Perry"*). The Company and Investments have been served in one individual action alleging misappropriation of novel ideas and breach of contract (*Gero*), although on 7 November 2011, the trial court dismissed the Company and Investments from the case, which orders the plaintiff appealed on 7 December 2011. Appeals remain pending.

Conduct-based claims
In the *Daric Smith* case, purchasers of cigarettes in the state of Kansas brought a class action in the Kansas State Court against B&W, Investments and certain other tobacco companies seeking injunctive relief, treble damages, interest and costs. The allegations are that the defendants participated in a conspiracy to fix or maintain the price of cigarettes sold in the US, including in the state of Kansas, in violation of the Kansas Restraint of Trade Act.

After the close of discovery, all defendants, including Investments, moved for summary judgment in late October and early November 2010. On 13 May 2011, Investments supplemented its summary judgment motion on the basis of its de minimis market share and the inapplicability of the Kansas Restraint of Trade Act to a non-resident (such as Investments) that did not purchase, sell or manufacture goods in the state of Kansas.

On 26 March 2012, the court entered an order granting all of the defendants' summary judgment motions and dismissing the plaintiff's first amended petition with prejudice. On 18 July 2012, plaintiff filed a notice of appeal on various points. On or about 1 August 2012, all defendants filed notices of cross-appeal, with Investments filing its own separate notice of cross-appeal to address, amongst other issues, various orders denying the defendants' claims of privilege over certain categories of documents during discovery. Plaintiff-appellant's moving brief is currently due no later than 25 January 2013.

Product liability outside the United States
As at 31 December 2012, active claims against the Group's companies existed in 17 markets outside the US (2011:17). The only markets with more than five claims were Argentina, Brazil, Canada, Italy, and Nigeria. There are medical reimbursement actions in Canada, Argentina, Brazil, Nigeria, and Spain.

(a) Medical reimbursement cases

Argentina
In 2007, the Argentina Tort Law Association ("ATLA"), a non-governmental organization, filed a reimbursement action against Nobleza Piccardo S.A.I.C.y.F. (**"Nobleza"**) and Massalín Particulares. Nobleza filed its defence on 1 October 2009. Preliminary objections from Nobleza and the federal government (a third party) were considered by the Civil Court in late 2009 and, on 23 December 2009, the Civil Court declared its lack of jurisdiction to hear the claim. On 11 March 2010, the case was sent to the Contentious-Administrative Court, which determined that it had jurisdiction over the case. On 24 June 2011, the Contentious-Administrative Court issued an Order stating that it would decide defendants' outstanding procedural objections together with the merits of the case. The case will now enter the evidentiary stage.

Brazil
In August 2007, the São Paulo Public Prosecutor's office filed a medical reimbursement claim on behalf of all states against Souza Cruz S.A. An identical claim was filed against Philip Morris. Souza Cruz's motion to consolidate the two claims was rejected and the two cases were ordered to progress independently. On 4 October 2011, the court dismissed the action against Souza Cruz, with judgment on the merits. The plaintiff filed an appeal on 9 January 2012 and Souza Cruz filed its counter arguments on 17 February 2012. The case records were remitted to the São Paulo Court of Appeals in September 2012.

Canada
In Canada there are nine active statutory actions for recovery of healthcare costs arising from the treatment of smoking and health-related diseases. These proceedings name various Group companies as defendants, including the Company, Investments, B.A.T Industries p.l.c (*"Industries"*), Carreras Rothmans Limited (collectively the *"UK Companies"*) and Imperial Tobacco Canada Limited (*"Imperial"*), the Group's operating company in Canada. Legislation enabling provincial governments to recover the healthcare costs has been enacted in all 10 provinces and two of three territories in Canada and has been proclaimed in force in nine provinces. The Acts have received Royal Assent in Nova Scotia, Northwest Territories and Nunavut but have yet to be proclaimed into force. Actions have begun against various Group companies, including Imperial, in British Columbia, New Brunswick, Newfoundland and Labrador, Ontario, Quebec, Manitoba, Alberta, Saskatchewan and Prince Edward Island (*"PEI"*). In Quebec, three Canadian manufacturers, including Imperial, are challenging the enabling legislation; the Quebec government has commended an action.

Notes on the accounts (continued)

30 Contingent liabilities and financial commitments (continued)

Canadian province	Act pursuant to which claim was brought	Companies named as defendants and date served	Current stage
British Columbia	Tobacco Damages and Health Care Costs Recovery Act 2000	Imperial Investments Industries Other former Rothmans Group companies	This case remains at a preliminary case management stage. The next step will be hearings on discovery motions relating to the plaintiff's damages model in July, 2013. Damages have not been quantified. No trial date has been set.
New Brunswick	Tobacco Damages and Health Care Costs Recovery Act 2006	The UK Companies have all been named as defendants. Imperial and the UK Companies have all been served.	Both Imperial and the UK Companies have now filed their defences and document production is underway. A motion to set a case schedule is set for May 2013. Damages have been quantified at CAD$19 billion. No trial date has been set.
Ontario	Tobacco Damages and Health Care Costs Recovery Act 2009	The UK Companies have all been named as defendants. Imperial and the UK Companies have all been served.	On 5-7 November 2012, appeals by the BAT defendants of both the jurisdictional and costs orders were heard by the Court of Appeal and taken under advisement. Imperial filed a third-party notice against several native manufacturers claiming contribution and indemnity as well as damages in the amount of CAD$1.5 billion. Imperial also filed a third-party claim against the Federal government claiming malfeasance in public office due to the government's failure to enforce the law against illicit manufacturers. The Attorney General has indicated its intention to file a Motion to Strike the Claim, but no date has been set for this preliminary motion. Pending the outcome of the Court of Appeal's decision on jurisdiction, the case will then be under case management. Damages have been quantified at CAD$50 billion. No trial date has been set.
Newfoundland and Labrador	Tobacco Health Care Costs Recovery Act 2006	The UK Companies have all been named as defendants. Imperial and the UK Companies have all been served.	The UK Companies have filed jurisdictional motions but as yet there is no scheduled date for the motions to be heard due to a pending issue on the admissibility of the plaintiff's evidence for the jurisdictional motions. Damages have not been quantified by the province. No trial date has been set.
Saskatchewan	Tobacco Damages and Health Care Costs Recovery Act 2012	The UK Companies have all been named as defendants. Imperial and the UK Companies have all been served.	This case is at a preliminary case management stage. The UK Companies have filed jurisdictional motions, and the hearing on these motions is scheduled to commence 29 April 2013. A case management judge has been appointed. Damages have not been quantified by the province. No trial date has been set. Imperial has served a motion to defer filing defences until pending jurisdictional challenges have been resolved. There are no discovery motions to date in this jurisdiction.

30 Contingent liabilities and financial commitments (continued)

Canadian province	Act pursuant to which claim was brought	Companies named as defendants and date served	Current stage
Manitoba	Tobacco Damages Health Care Costs Recovery Act 2006	Imperial Investments Industries Other former Rothmans Group companies	Imperial has served a motion to defer filing defences until pending jurisdictional challenges have been resolved. The province has not quantified damages. No trial date has been set.
Alberta	Crown's Right of Recovery Act 2009	Imperial and the UK Companies have all been named as defendants.	On 8 August, 2012, Imperial was served with the Alberta Medicaid suit. Damages have been quantified at CAD$10 billion. This case is at a preliminary stage. No trial date has been set.
Quebec	Tobacco Related Damages and Health Care Costs Recovery Act 2005	Investments, Industries, and Carreras Rothmans Limited have been named as defendants. Imperial and the UK Companies have been served.	On 25 August 2009, Imperial and the other Canadian manufacturers filed a constitutional challenge of the Quebec Medicaid Legislation. The Quebec Attorney-General (AG) filed a motion to dismiss the constitutional challenge and following a hearing, the Quebec Superior Court dismissed the motion. On 28 January 2011, the Court of Appeal denied the AG's leave application, permitting Imperial's challenge to proceed. On 8 June, 2012, the Quebec Medicaid suit was served upon Imperial. The government is seeking CAD$60 billion. On 14 December 2012, Imperial's Motion to stay the Medicaid suit pending the resolution of the constitutional challenge, was heard by the Court and taken under advisement. A case management judge has been appointed, a motion to stay pending the constitutional challenge was dismissed but otherwise no further steps will be required by Imperial pending a resolution of certain jurisdictional challenges by other defendants including other group companies. No trial date has been set.
Prince Edward Island	Tobacco Damages and Health Care Costs Recovery Act 2009	Imperial and the UK Companies	On 15 November, 2012, Imperial was served with the PEI Medicaid suit. This case is at a preliminary case management stage. Damages have not been quantified by the province. A case management judge has been appointed and the defendants must file jurisdictional motions by 15 March 2013. No trial date has been set.

Nigeria

As of 31 December 2012, six medical reimbursement actions filed by the federal government and five Nigerian states (Lagos, Kano, Gombe, Oyo, Ogun) were pending in the Nigerian courts. British American Tobacco (Nigeria) Limited, the Company and Investments have been named as defendants in each of the cases. The plaintiffs in the six cases seek a total of approximately £44.8 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief. On 13 and 25 May 2010, respectively, the plaintiffs in the Kano and Ogun state cases filed motions for preliminary injunctive relief, seeking, inter alia, orders to restrain the defendants from various alleged marketing and distribution practices including the sale of tobacco products within 1,000 meters of any public places that are predominantly locations for minors.

The Company and Investments have filed preliminary objections challenging the jurisdiction of the Nigerian courts over them. On 22 June 2010, the Oyo High Court partially granted the Company's and Investments' preliminary objections and set aside the service of the writ of summons. The Company and Investments appealed the court's order insofar as it denied the remainder of the relief

Notes on the accounts (continued)

30 Contingent liabilities and financial commitments (continued)

requested, and the Court of Appeal has yet to set a date for hearing of the appeals. In the federal government's action, the Federal High Court has yet to hear the preliminary objections filed by the Company and Investments, which remain pending as of 31 December 2012.

The High Courts of Lagos, Kano, Gombe and Ogun states denied the preliminary objections filed by the Company and Investments, and the companies have appealed. High Court proceedings in the Lagos and Kano state cases have been stayed pending the appeals filed by the Company and Investments. In the Gombe and Ogun cases, the High Courts have adjourned proceedings without date. As of 31 December 2012, the appeals filed by the Company and Investments remain pending in the Lagos, Kano, Gombe, and Ogun cases, and have yet to be heard by the Court of Appeal. A hearing before the Court of Appeal is currently scheduled for 25 February 2013 in the Ogun appeals filed by the Company, Investments and British American Tobacco (Nigeria) Limited.

Spain

In early 2006, the Junta de Andalucia (the *"Junta"*), in Spain, filed a medical reimbursement action against the State and tobacco companies (including BAT España S.A.) before the contentious-administrative courts. The State filed preliminary objections to the Junta's claim, with tobacco companies filing supporting briefs. The court upheld these preliminary objections and dismissed the claim in November 2007. The Junta's appeal of this ruling to the Supreme Court was dismissed in September 2009. However, in May 2009, the Junta filed a new contentious-administrative claim with similar allegations. The defendants filed procedural objections, which were rejected by the court. The next procedural step is for the court to provide the defendants with copies of the exhibits to the claim which were not attached to the claim when originally filed. Once the defendants receive copies of the exhibits, the term to file their answers (20 business days) will resume.

(b) Class actions

Brazil

There are currently three class actions being brought in Brazil. One is also a medical reimbursement claim (São Paulo Public Prosecutor's Office), and is therefore discussed above. A fourth class action recently ended in the affirmance on appeal of a defence judgment, as described below.

In 1995, the Associação de Defesa da Saúde do Fumante (*"ADESF"*) class action was filed against Souza Cruz and Philip Morris in the São Paulo Lower Civil Court alleging that the defendants are liable to a class of smokers and former smokers for failing to warn of cigarette addiction. The case was stayed in 2004 pending the defendants' appeal from a decision issued by the lower civil court that held that the defendants had not met their burden of proving that cigarette smoking was not addictive or harmful to health, notwithstanding an earlier interlocutory order that the São Paulo Court of Appeals had issued, which directed the trial court to allow more evidence to be taken before rendering its decision.

On 12 November 2008, the São Paulo Court of Appeals overturned the lower court's unfavourable decision of 2004, finding that the lower court had failed to provide the defendants with an opportunity to produce evidence. The case was returned to the Lower Civil Court on 19 March 2009, who ordered designation of court-appointed medical and advertising experts. The parties submitted questions to these court-appointed experts who subsequently delivered their reports. Each party also provided expert reports commenting on the court-appointed experts' conclusions. On 16 May 2011, the court granted Souza Cruz's motion to dismiss the action in its entirety on the merits. Plaintiffs filed an appeal of the dismissal on 22 July 2011. Souza Cruz filed its response on 5 October 2011. On 10 November 2011, the case records were sent to the Public Prosecutor's Office. On 20 December 2011, the Public Prosecutor's Office presented a non-binding, advisory opinion that rejected most of Souza Cruz's legal defence arguments. The case records were sent to the São Paulo State Court of Appeals and were immediately sent to the Public Prosecutor's office for General Public and Collective Interest. On 1 March 2012, the case files returned with an unfavourable opinion given by the Public Prosecutor, who advised that the Court should find in favour of the appeal brought by ADESF and thereby fully reverse the appealed judgment. On 6 September 2012, the case was assigned to a new temporary Reporting Justice in the 7th Chamber of Private Law of the São Paulo Court of Appeals, pending reference to a permanent Reporting Justice of the case.

The Brazilian Association for the Defense of Consumers' Health (*"Saudecon"*) filed a class action against Souza Cruz and Philip Morris in the City of Porto Alegre, Brazil on 3 November 2008. The plaintiff purports to represent all Brazilian smokers whom, it alleges, are unable to quit smoking and lack access to cessation treatments. The plaintiff is seeking an order requiring the named defendants to fund, according to their market share, the purchase of cessation treatments for these smokers over a minimum period of two years. Souza Cruz was served with this complaint on 19 November 2008. On 18 May 2009, the case was dismissed with judgment on the merits. The plaintiffs appealed in August 2009 and Souza Cruz and Philip Morris both responded. On 22 July 2011, the Public Prosecutor's Office issued a non-binding opinion saying that the favourable first instance ruling should be vacated based on procedural issues. On 25 August 2011, the reporting justice of the appellate court rejected the Public Prosecutor's Office's opinion, finding that the trial court ruling should not be nullified. On 1 November 2011, the 9th Chamber of the Rio Grande do Sul State Court of Appeals granted the Public Prosecutor's Office special appeal, ordering the remittance of the case records in the first instance to complete proper notification to the Public Prosecutor's Office of the sentence. On 14 December 2011, the Public Prosecutor's Office filed a special appeal. Souza Cruz's counter arguments were submitted on 10 February 2012. On 28 March 2012, the Rio Grande do Sul State Court of Appeals recognized the applicability of the special appeal and ordered it sent up to the Superior Court of Justice. On 26 September 2012, a new Reporting Justice of the Superior Court of Justice was designated for the case. The parties await judgment of the special appeal at the Superior Court of Justice.

30 Contingent liabilities and financial commitments (continued)

In 2004, the State of Sergipe instigated a class action seeking compensation for smokers in Sergipe State who purportedly tried to quit smoking. The lower court denied the plaintiffs' request for early relief and determined ANVISA (a federal government health agency) be ordered to join the case as co-defendants. As ANVISA is a federal agency, the case was removed to the federal court where ANVISA successfully argued that it lacked standing to be sued. The claim against ANVISA was dismissed and the federal court sent the case back to the lower state court for proceedings to continue. However, the action was stayed on 18 December 2009 pending a decision by the Superior Court on which court has jurisdiction. On 26 March 2010 the Superior Court determined that the civil court had jurisdiction of the matter. On 19 October 2011, the court dismissed the action with judgment on the merits. The plaintiff filed an appeal on 9 January 2012. Souza Cruz's counter-arguments were submitted on 9 February 2012. The case records were sent to the 1st Chamber of the Sergipe State Court of Appeals, as well as to the Public Prosecutor's Office for it to consider an advisory opinion. On 9 July 2012, the 1st Chamber of the Sergipe State Court of Appeals by unanimous decision upheld the lower court ruling that dismissed the case. Plaintiffs did not file a Special Appeal from this judgment and the case is now closed.

Canada

There are 10 class actions being brought in Canada against Group companies.

Knight is a 'lights' class action in which the plaintiff alleges that the marketing of light and mild cigarettes is deceptive because it conveys a false and misleading message that those cigarettes are less harmful than regular cigarettes. Although the claim arises from health concerns, it does not seek compensation for personal injury but for amounts spent on 'light and mild' products and a disgorgement of profits from Imperial. The Supreme Court of British Columbia certified a class of all consumers of cigarettes bearing 'light' or 'mild' descriptors since 1974 manufactured in British Columbia by Imperial. Imperial filed an appeal against the certification which was heard in February 2006. The appellate court confirmed the certification of the class but has limited any financial liability, if proven, to the period from 1997.

The federal government's motion to strike out the third-party notice issued against it by Imperial was upheld by the Supreme Court which dismissed the third-party claim on the basis that the federal government's impugned conduct constituted valid policy benefiting public health and is therefore not subject to civil liability.

In 2009, Imperial was served with a class action filed by Ontario tobacco farmers and the Ontario Flue-Cured Tobacco Growers' Marketing Board (**"Growers' claim"**). The plaintiffs allege that Imperial improperly paid lower prices for tobacco leaf destined for duty-free products that was smuggled back into Canada and sold in the domestic market, as opposed to the higher domestic leaf price. Imperial deposited the amount owing to the government of Ontario pursuant to the Comprehensive Agreement (the "CA") into an escrow account, claiming that the Growers Claim was a Released Claim under the CA and the CA permitted Imperial to set-off that amount against costs incurred as a result of the claim (including damages, if any). In response, the Ontario government commenced an action against Imperial, seeking the release of the funds and a declaration that the Growers' Claim is not a Released Claim (**"Ontario claim"**). Imperial successfully argued its preliminary motion in the Ontario claim in July 2010 and the court ordered that the claim be stayed in favour of the arbitration provisions stipulated in the CA and raised by Imperial in its Notice of Arbitration. The Court of Appeal denied the Ontario government's appeal in July 2011, and also ruled that the question of whether the Growers' Claim constitutes a 'Released Claim' under the CA must be determined by the courts, thereby splitting the issues.

Imperial was recently served with certification materials in the underlying Growers' claim. On 25 January 2012, the case management judge ruled that Imperial's prescription challenge will proceed prior to certification hearings in the class action. The judge also ruled that the question of whether or not the Growers' claim is a "Released Claim" under the CA should proceed as part of the Ontario claim rather than the class action Growers' Claim, and should proceed as the first order of business. The Released Claim challenge was heard on 19 September 2012 and dismissed on 2 January 2013. Imperial has appealed that decision. The date for the appeal has not yet been set.

There are currently two class actions in Quebec. On 21 February 2005, the Quebec Superior Court granted certification in two class actions against Imperial and two other domestic manufacturers, which have a combined value of CAD$27 billion plus interest and costs. The court certified two classes, which include residents of Quebec who suffered from lung, throat and laryngeal cancer or emphysema as of November 1998 or developed these diseases thereafter and who smoked a minimum of fifteen cigarettes a day for at least five years, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. In Quebec, there is no right of appeal for a defendant upon certification. The plaintiffs have served a Statement of Claim. The trial in this matter commenced on 12 March 2012 and remains ongoing.

In June 2009, four new smoking and health class actions were filed in Nova Scotia, Manitoba, Saskatchewan and Alberta, against Canadian manufacturers and foreign companies, including the UK Companies and Imperial. In Saskatchewan, a number of the UK companies have been released from the action. No date has been set for the certification motion hearing. In Nova Scotia the proceedings have not progressed. There are service issues in relation to the UK Companies in Alberta and Manitoba. A suit *identical in content and parties* was filed in June 2012 in Ontario, and the UK Companies and Imperial have been served in this action.

In July 2010, two further smoking and health class actions in British Columbia were served on Imperial and the UK companies. The Bourassa claim is allegedly on behalf of all individuals who have suffered chronic respiratory disease and the *McDermid* claim proposes a class based on heart disease. Both claims state that they have been brought on behalf of those who have "smoked a minimum of 25,000 cigarettes." The UK Companies and Imperial objected to jurisdiction. Subsequently a number of the UK Companies were released from the action. No certification motion hearing date has been set.

Notes on the accounts (continued)

30 Contingent liabilities and financial commitments (continued)

Italy

In or about June 2010, British American Tobacco Italia S.p.A (*"BAT Italia"*) was served with a class action filed in the Civil Court of Rome by the consumer association, Codacons, and three class representatives. Plaintiffs primarily asserted addiction-related claims. The class action lawsuit was rejected at the first instance (Civil Court of Rome) and appellate (Rome Court of Appeal) court levels. In July 2012, Codacons filed an appeal before the Italian Supreme Court. BAT Italia's response brief, which for the most part addressed procedural issues, was filed on 13 November 2012. The Supreme Court has yet to set a date for hearing of the appeal.

Venezuela

The Venezuelan Federation of Associations of Users and Consumers filed a class action against the Venezuelan government seeking regulatory controls on tobacco and recovery of medical expenses for future expenses of treating smoking-related illnesses in Venezuela. On 19 January 2009, C.A Cigarrera Bigott Sucs. (**"Cigarrera Bigott"**) notified the court of its intention to appear as a third party. The court adjourned a public hearing scheduled for July 2009 in which Cigarrera Bigott's status as a third party would be determined and parties would make submissions. On 12 April 2011, the Constitutional Chamber of the Supreme Court of Justice issued decision number 494, which established the rules for class action procedures. On 5 December 2012 Cigarrera Bigott was admitted as third party, and defenses are due on 28 February 2013.

(c) Individual personal injury claims

Aside from the United States, there were approximately 329 (2011: 353) individual smoking cases pending world-wide as of 31 December 2012 against Group companies. Approximately three-quarters of these cases are in Brazil and are not detailed here.

As at 31 December 2012, in Italy there were 28 (2011: 30) smoking and health cases filed against BAT Italia by or on behalf of individuals in which it is contended that diseases or deaths have been caused by cigarette smoking, including nine (2011: 10) cases pending appeal and two labour cases for alleged occupational exposure pending before the first instance labour courts. In addition, there were three (2011: three) individual 'lights' cases pending before justices of the peace and 28 (2011: 26) 'lights' cases on appeal.

On 23 June 2003, an individual action was brought in the Danish High Court against House of Prince A/S and Skandinavisk Tobakskompagni A/S seeking DKK485,450 for alleged smoking-related diseases and loss of earnings. On 8 December 2011, the Court issued judgment in favour of the defendants and ordered costs against the plaintiff. On 31 January 2012, the plaintiff filed an appeal to the Supreme Court. The appeal is ongoing.

Other Non-Tobacco Related Claims

Flintkote

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) in 2000. Soon after this acquisition, and as part of the acquisition plan, Genstar Corporation began to sell most of its assets, including the non-asbestos related operations and subsidiaries of Flintkote. The liquidation of Flintkote assets produced cash proceeds and, having obtained advice from the law firm of Sullivan & Cromwell LLP (*"S&C"*) and other consultants that sufficient assets would remain to satisfy reasonably foreseeable liabilities, Flintkote's Board of Directors authorised the payment of a dividend of US$170.2 million in 1986 and a further dividend of US$355 million in 1987. In 2003, Imperial divested Flintkote and then, in 2004, Flintkote filed for bankruptcy in the United States Bankruptcy Court for the District of Delaware. In 2006, Flintkote, representatives of both the present and future asbestos claimants, and individual asbestos claimants were permitted by the bankruptcy court to file a complaint in California state court against Imperial and numerous other defendants including S&C, for the recovery of the dividends and other compensation under various legal and equitable theories.

The California case remains in the discovery phase, but the court has resolved multiple issues that will narrow the case. Firstly, following a multi-day bench trial, the court issued a preliminary decision dismissing S&C. Flintkote then settled with S&C for a nominal sum before the decision was made final. All claims and cross claims in the litigation asserted by or against S&C have now been dismissed. Secondly, after a series of bench trials, on 5 October 2011, the court issued preliminary orders deciding multiple preliminary issues regarding Flintkote's claims to recover the dividends and Flintkote's claim that Imperial is its "alter ego" for purposes of asbestos liabilities. Among other things, the court has concluded that Flintkote is barred from seeking to recover, under any theory, transfers that occurred after 31 December 1986. This ruling should preclude Flintkote's efforts to recover the 1987 dividend of US$355 million. The court also concluded that Flintkote has no standing to pursue its claim that Imperial is its alter ego for purposes of asbestos liability, holding that any such claims must instead be pursued by individual asbestos plaintiffs. These rulings were made final on 6 January 2012. The remaining preliminary issue pending is whether Flintkote is estopped from pursuing certain fraudulent conveyance remedies as a result of contrary statements it made early in the litigation.

Discovery is ongoing and will likely continue through mid to late 2013. The Court has not set a trial date, but a trial could occur in late 2013 or in 2014. The alter ego claims of the individual asbestos claimants (known in this lawsuit as the "Hopkins Plaintiffs") will not proceed to trial until after the Flintkote claims are concluded.

Fox River

In Wisconsin, the authorities have identified potentially responsible parties (*"PRPs"*) to fund the clean-up of river sediments in the lower Fox River. The pollution was caused by discharges of Polychlorinated Biphenyls (*"PCBs"*) from paper mills and other facilities operating close to the river. The cost of the clean-up work has been estimated to be in excess of US$900 million. Among the PRPs is NCR Corporation (*"NCR"*) which is liable for the clean-up costs in a large portion of the river under the terms of a consent decree and a unilateral administrative order issued by the United States Environmental Protection Agency.

30 Contingent liabilities and financial commitments (continued)

In 1978, a subsidiary of Industries, later known as Appleton Papers Inc. (*"Appleton"*), 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 via a Demerger Agreement with Wiggins Teape Appleton p.l.c., now known as Windward Prospects Ltd (*"Windward"*), and Wiggins Teape Appleton (Holdings) p.l.c., now known as Arjo Wiggins US Holdings Ltd (collectively, the *"AWA Entities"*), obtaining what Industries believes were full indemnities from the AWA Entities and Appleton for past and future environmental claims.

Disputes between NCR, Appleton, and Industries as to the indemnities given and received under the original purchase agreement in 1978 have been the subject of litigation that was commenced in 1995, a settlement agreement executed in 1998 (the *"Settlement Agreement"*), and an arbitration award in 2005. Under the terms of the Settlement Agreement and the arbitration award, Industries and Appleton generally have an obligation to share the costs of Fox River 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 the non NCR (60%) share of the clean-up costs to date, and the authorities have not identified Industries or BATUS as PRPs. Windward also separately, and indirectly, indemnified Appleton in respect of the clean-up costs.

A trial took place in Wisconsin in February 2012 to determine whether NCR is liable for the clean-up costs in the upper portion of the Fox River. This trial addressed issues as to whether NCR is liable as a result of the sale, by a predecessor of NCR's Appleton Papers Division, of scrap paper, or "broke", to other PRPs which, in turn, discharged PCBs into the river in the course of recycling the broke. A judgment issued in July 2012 found NCR was not liable on this basis. It is envisaged that the other PRPs may seek to appeal this decision in the future.

As regards the mid and lower portions of the Fox River, in March 2012, the US Government filed a motion in Wisconsin for a preliminary injunction against NCR and Appleton, seeking to establish the scope of the clean-up operations to be carried out on the Fox River in 2012. In light of a subsequent ruling by the same court that Appleton is not a PRP, the injunction was granted against NCR alone on 27 April 2012. NCR appealed this decision and it was affirmed on 3 August 2012. Full trial of the merits of the US Government's action took place in December 2012, and a decision is awaited.

Subsequent to the injunction, and by letters dated 3 May 2012, NCR made demands on both Appleton and Industries for payment of the sum of US$6.6 million, and stated to be due on a joint and several basis pursuant to the terms of the Settlement Agreement. Appleton refused to pay this sum, whereupon NCR filed a motion in Wisconsin in order to enforce the terms of the Settlement Agreement and arbitration award against Appleton. In a ruling handed down in September 2012 the court declined to do so, holding that the amount of which Appleton is liable to pay 60% must be ascertained via the dispute resolution provisions of the Settlement Agreement. As a result, Industries understands that NCR has now invoked the dispute resolution provisions contained in the Settlement Agreement as against Appleton. NCR has also made further demands on Appleton.

Industries has become aware that Windward settled the majority of Appleton's insurance claims (over which it had control) at what Industries believes constituted a significant discount, and has made dividend payments to its former and current shareholders of approximately US$810 million, leaving it holding, according to its latest accounts, approximately US$70 million of net assets. Accordingly, there may be a greater risk that the assets of Windward are insufficient to meet its obligations under the indemnities Industries believes it has been granted. Appleton's own accounts indicate limited financial resources.

In December 2011, Windward asserted that it did not indemnify Industries pursuant to the terms of the 1990 Demerger Agreement in respect of Industries' obligations under the Settlement Agreement. Industries disputes Windward's position and has commenced proceedings against both Windward and Appleton (which has also denied owing Industries an indemnity).

While Industries believes it may have defences to claims by NCR against it under the Settlement Agreement and arbitration award and remains hopeful that Appleton and the AWA Entities will satisfy their obligations with respect to the Fox River clean-up, taking into account court decisions and the possibility of appeals, sums paid to date on the clean-up and other available information, Industries believes it may have an exposure of some £271 million in clean-up related costs. Accordingly, Industries has made a provision for that amount, which was treated as an adjusting item in the 2011 income statement. The previously recognised provision was £274 million, with £3 million utilised in respect of legal costs. This figure is necessarily subject to uncertainty.

Industries has become aware that NCR is also being pursued by Georgia-Pacific LLC (**"Georgia-Pacific"**), the owner of a facility on the Kalamazoo River in South-West Michigan which released PCBs into that river. Georgia-Pacific has been designated as a PRP in respect of the river. Georgia-Pacific contends that NCR is responsible for, or should contribute to, the clean-up costs, because (i) a predecessor to NCR's Appleton Paper Division sold "broke" containing PCBs to Georgia Pacific or others for recycling; (ii) NCR itself sold paper containing PCBs to Georgia Pacific or others for recycling; and/or (iii) NCR is liable for sales to Georgia Pacific or others of PCB containing broke by Mead Corporation, which, like the predecessor to NCR's Appleton Papers Division, coated paper with the PCB containing emulsion manufactured by NCR. A full trial on liability is scheduled to take place in February 2013. Industries understands that NCR does not believe that NCR has any liability in relation to the Kalamazoo River and that it will vigorously contest Georgia-Pacific's claim. Industries itself believes that Industries only has potential exposure under the Settlement Agreement or arbitration award if NCR is unsuccessful in its defence of the claim and it is found that PCB contamination of the Kalamazoo River is due to "broke" supplied by a predecessor of NCR's Appleton Papers Division.

Notes on the accounts (continued)

30 Contingent liabilities and financial commitments (continued)

Industries is taking active steps to protect its interests, including seeking to confirm its indemnities and to procure the repayment of the Windward dividends, with a view to restoring value to Windward and, accordingly, the indemnities it believes were granted to Industries.

General litigation 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 in any case, an appeal will be made. Such appeals could require the appellants to post appeal bonds or substitute security in amounts which could in some cases equal or exceed the amount of the judgment. In any event, with regard to US litigation, the Group has the benefit of the RJRT Indemnification. At least in the aggregate, and despite the quality of defences available to the Group, it is not impossible that the Group's results of operations or cash flows in any particular period could be materially affected by this and by the final outcome of any particular litigation.

Having regard to all these matters, with the exception of Fox River, the Group (i) does not consider it appropriate to make any provision in respect of any pending litigation as set out in this note and (ii) does not believe that the ultimate outcome of this litigation will significantly impair the Group's financial condition.

Tax litigation

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.

30 Contingent liabilities and financial commitments (continued)

Operating leases

Total future minimum lease payments under non-cancellable operating leases comprise leases where payments fall due:

	2012 £m	2011 £m
Property		
Within one year	**56**	70
Between one and five years	**126**	183
Beyond five years	**49**	129
	231	382
Plant and equipment		
Within one year	**26**	31
Between one and five years	**37**	47
	63	78

Five-Year Summary

For the years ended 31 December	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Income statement					
Gross turnover (including duty, excise and other taxes)	**45,872**	46,123	43,855	40,713	33,921
Revenue (after deducting duty, excise and other taxes)	**15,190**	15,399	14,883	14,208	12,122
Profit from operations	**5,412**	4,721	4,318	4,101	3,572
Adjusted profit from operations	**5,681**	5,519	4,984	4,461	3,717
Profit before taxation	**5,648**	4,931	4,388	4,080	3,684
Profit for the year	**4,122**	3,375	3,140	2,956	2,659

	2012 pence	2011 pence	2010 pence	2009 pence	2008 pence
Earnings per share					
– basic unadjusted	**198.1**	157.1	145.2	137.0	123.3
– diluted unadjusted	**197.1**	156.2	144.4	136.3	122.5
– diluted adjusted	**207.5**	194.6	175.7	153.0	128.8
Dividends declared per share	**134.9**	126.5	114.2	99.5	83.7

At 31 December	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Balance sheet					
Non-current assets	**18,141**	18,624	19,203	18,508	18,812
Current assets	**9,186**	8,495	8,657	8,106	8,739
Total assets	**27,327**	27,119	27,860	26,614	27,551
Owners of the parent	**7,472**	8,167	9,206	7,613	6,944
Non-controlling interests	**307**	307	342	299	271
Total equity	**7,779**	8,474	9,548	7,912	7,215
Non-current liabilities	**11,406**	10,798	10,667	11,786	11,458
Current liabilities	**8,142**	7,847	7,645	6,916	8,878
Total liabilities	**19,548**	18,645	18,312	18,702	20,336
Total equity and liabilities	**27,327**	27,119	27,860	26,614	27,551

Half-Yearly Analysis of Profit

The figures shown below have been produced using average rates of exchange on a half-yearly basis since the beginning of the year. Thus the discrete half year to 30 June has not been restated for subsequent movements in foreign exchange rates during the year, which are reflected in the results for the subsequent half year to 31 December.

	6 months to		Year to
	30 Jun 2012 £m	31 Dec 2012 £m	31 Dec 2012 £m
Profit from operations	**2,740**	**2,672**	**5,412**
Analysed as:			
– adjusted profit from operations	**2,839**	**2,842**	**5,681**
– restructuring and integration costs	**(68)**	**(138)**	**(206)**
– amortisation of trademarks	**(31)**	**(32)**	**(63)**
	2,740	**2,672**	**5,412**
Net finance costs	**(211)**	**(245)**	**(456)**
Share of post-tax results of associates and joint ventures	**344**	**348**	**692**
Analysed as:			
– adjusted share of post-tax results of associates and joint ventures	**347**	**350**	**697**
– issue of shares and change in shareholding	**24**	**(4)**	**20**
– restructuring and integration costs	**(25)**	**1**	**(24)**
– change in post-retirement obligations	**–**	**24**	**24**
– other	**(2)**	**(23)**	**(25)**
	344	**348**	**692**
Profit before taxation	**2,873**	**2,775**	**5,648**
Earnings per share			
Basic	**98.9p**	**99.2p**	**198.1p**
Adjusted diluted	**102.4p**	**105.1p**	**207.5p**

	6 months to		Year to
	30 Jun 2011 £m	31 Dec 2011 £m	31 Dec 2011 £m
Profit from operations	2,691	2,030	4,721
Analysed as:			
– adjusted profit from operations	2,760	2,759	5,519
– restructuring and integration costs	(40)	(153)	(193)
– amortisation of trademarks	(29)	(29)	(58)
– goodwill impairment	–	(273)	(273)
– Fox River	–	(274)	(274)
	2,691	2,030	4,721
Net finance costs	(233)	(227)	(460)
Share of post-tax results of associates and joint ventures	329	341	670
Analysed as:			
– adjusted share of post-tax results of associates and joint ventures	315	344	659
– issue of shares and change in shareholding	34	(6)	28
– smoking cessation programme	(23)	–	(23)
– gain on disposal of business	–	22	22
– restructuring and integration costs	(2)	(2)	(4)
– change in post-retirement obligations	–	–	–
– other	5	(17)	(12)
	329	341	670
Profit before taxation	2,787	2,144	4,931
Earnings per share			
Basic	94.5p	62.6p	157.1p
Adjusted diluted	96.1p	98.5p	194.6p

Principal subsidiary undertakings

The Company has taken advantage of the exemption under Section 410 (2) of the Companies Act 2006 by providing information only in relation to subsidiary undertakings whose results or financial position, in the opinion of the Directors, principally affected the financial statements. The subsidiary undertakings listed below are therefore the main corporate entities in those countries which, in aggregate, contributed over 80% of Group revenue and operating profit.

	% equity shares held
Centre Corporate Companies	
B.A.T (U.K. and Export) Ltd.	100
B.A.T Capital Corporation	100*
(incorporated in the United States of America)	
B.A.T. International Finance p.l.c.	100*
BATMark Ltd.	100*
British-American Tobacco (Holdings) Ltd.	100
British American Tobacco Holdings	100
(The Netherlands) B.V.	
(incorporated in The Netherlands)	
British American Tobacco International Ltd.	100
(incorporated in Switzerland)	
British American Tobacco (Brands) Inc.	100
(incorporated in the United States of America)	
British American Tobacco (Brands) Ltd.	100
British American Tobacco (GLP) Ltd.	100
British American Tobacco (Investments) Ltd.	100
Asia-Pacific	
Australia	
British American Tobacco Australia Ltd.	100
Bangladesh	
British American Tobacco Bangladesh Company Ltd.	72
Indonesia	
PT Bentoel Internasional Investama Tbk	85#
Japan	
British American Tobacco Japan, Ltd.	100
Malaysia	
British American Tobacco (Malaysia) Berhad	50
New Zealand	
British American Tobacco (New Zealand) Ltd.	100
Pakistan	
Pakistan Tobacco Co. Ltd.	94
South Korea	
British American Tobacco Korea Ltd.	100
British American Tobacco Korea Manufacturing Ltd.	100
Taiwan	
B.A.T Services Ltd.	100
(incorporated in the United Kingdom)	
Vietnam	
British-American Tobacco Marketing (Singapore)	100
Private Limited	
(incorporated in Singapore)	
Americas	
Argentina	
Nobleza-Piccardo S.A.I.C.y F.	99

	% equity shares held
Brazil	
Souza Cruz, S.A.	75
Canada	
Imperial Tobacco Canada Ltd.	100
Chile	
British American Tobacco Chile Operaciones, S.A.	98
Colombia	
British American Tobacco Colombia S.A.S.	100
Mexico	
British American Tobacco Mexico, S.A. de C.V.	100
Venezuela	
C.A. Cigarrera Bigott Sucs.	100
Western Europe	
Belgium	
British American Tobacco Belgium S.A.	100
Czech Republic	
British American Tobacco (Czech Republic), s.r.o.	100
Denmark	
British American Tobacco Denmark A/S	100
(House of Prince A/S)	
France	
British American Tobacco France SAS	100
Germany	
British-American Tobacco (Germany) GmbH	100
British American Tobacco (Industrie) GmbH	100
Hungary	
BAT Pecsi Dohnygyr Kft.	100
Italy	
British American Tobacco Italia S.p.A.	100
Netherlands	
British American Tobacco Nederland B.V.	100
British American Tobacco Western Europe Region B.V.	100
Poland	
British-American Tobacco Polska S.A.	100
British American Tobacco Polska Trading sp. zo.o.	100
Romania	
British-American Tobacco (Romania) Trading SRL	100
Spain	
British American Tobacco España, S.A.	100
Sweden	
British American Tobacco Sweden AB	100
Fiedler & Lundgren AB	100
Switzerland	
British American Tobacco Switzerland S.A.	100
United Kingdom	
British American Tobacco UK Ltd.	100

Eastern Europe, Middle East and Africa	% equity shares held
Algeria	
British American Tobacco (Algérie) S.P.A.	51
Egypt	
British American Tobacco Egypt LLC	100
Iran	
B.A.T. Pars Company (Private Joint Stock)	100
Kazakhstan	
British American Tobacco Kazakhstan Trading LLP	100
Morocco	
British American Tobacco Exports B.V. (incorporated in the Netherlands)	100
Nigeria	
British American Tobacco (Nigeria) Ltd.	100

	% equity shares held
Russia	
OJSC British American Tobacco – STF	100
OJSC British American Tobacco – Yava	99†
CJSC British American Tobacco – SPb	100†
CJSC "International Tobacco Marketing Services"	100
South Africa	
British American Tobacco Holdings South Africa (Pty) Ltd.	100
Turkey	
British American Tobacco Tütün Mamulleri Sanayi ve Ticaret A.S.	100
Ukraine	
A/T B.A.T. – Prilucky Tobacco Co.	99

Those subsidiary undertakings listed above which are held directly by British American Tobacco p.l.c. are indicated thus *; all others are held by sub-holding companies. Unless otherwise stated, Centre Corporate Companies are subsidiary undertakings incorporated in the United Kingdom and the country of incorporation and operation of regional subsidiary undertakings is that under which the company is listed. All identified subsidiary undertakings are involved in activities related to the manufacture, distribution or sale of tobacco products. All companies' shares are ordinary shares or common stock except for those indicated thus †, which include preference shares.

During 2011, the Group sold 984 million shares, representing approximately 14% of PT Bentoel Internasional Investama Tbk's share capital, for the purposes of fulfilling certain obligations pursuant to Bapepam LK (Indonesia) takeover regulations. The Group simultaneously entered into a total return swap on 971 million of the shares. As a consequence of this and for the duration of the swap, while the Group does not have legal ownership of these shares, it retains the risks and rewards which results in the Group continuing to recognise an effective interest in 99% of PT Bentoel Internasional Investama Tbk's net assets and results.

A complete list of Group subsidiary and associate undertakings will be attached to the next British American Tobacco p.l.c. annual return to the Registrar of Companies. A broader description of the Group's operations and sphere of activities can be found online at www.bat.com

Principal associate undertakings

		Latest published information	Total issued capital £m	% shares held
Americas				
United States of America				
Reynolds American Inc.	▼Common Stock	31.12.12	*	42.0
tobacco	▼Preferred Stock		**	
Asia-Pacific				
India				
ITC Ltd.	▼Ordinary	31.12.12	88	30.7
FMCG including tobacco				
agri-business				
paperboard, paper and packaging				
hotels				

▼ Listed overseas.

* As at 31 December 2012, Reynolds American Inc. had issued 552,940,767 shares (US$0.0001 Common Stock), of which the Group held 232,480,049.

** As at 31 December 2012, Reynolds American Inc. had issued 1,000,000 shares (US$0.01 Preferred Stock), in which the Group held no interest.

Independent auditors' report
To the members of British American Tobacco p.l.c.

We have audited the Parent Company financial statements of British American Tobacco p.l.c. for the year ended 31 December 2012 which comprise the Parent Company Balance Sheet, and the Notes on the accounts. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of Directors and auditors
As explained more fully in the Directors' responsibility statement set out on page 106, the Directors are responsible for the preparation of the Parent Company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Parent Company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements
In our opinion the Parent Company financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2012;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006
In our opinion:

- the part of the Remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' report for the financial year for which the Parent Company financial statements are prepared is consistent with the Parent Company financial statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements and the part of the Remuneration report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter
We have reported separately on the Group financial statements of British American Tobacco p.l.c. for the year ended 31 December 2012.

Paul Cragg (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom

27 February 2013

Balance Sheet – British American Tobacco p.l.c.
At 31 December

	Notes	2012 £m	2011 £m
Assets			
Fixed assets			
Investments in Group companies	2	**4,333**	4,305
		4,333	4,305
Current assets			
Debtors	3	**8,042**	7,894
		8,042	7,894
Total assets		**12,375**	12,199
Equity			
Capital and reserves			
Called up share capital		**507**	506
Share premium account		**67**	64
Capital redemption reserves		**101**	101
Other reserves		**90**	90
Profit and loss account		**7,575**	6,669
after deducting			
– cost of treasury shares		**(2,810)**	(1,527)
Shareholders' funds	4	**8,340**	7,430
Liabilities			
Creditors	5	**4,035**	4,769
Total equity and liabilities		**12,375**	12,199

The accompanying notes are an integral part of the Parent Company Financial Statements.

On behalf of the Board

Richard Burrows
Chairman

27 February 2013

Notes on the accounts

1 Accounting policies

Basis of accounting
The Parent Company financial statements have been prepared on the going concern basis under the historical cost convention except as described in the accounting policy below on financial instruments and in accordance with the Companies Act 2006 and UK Generally Accepted Accounting Principles.

The Company is a public limited company which is listed on the London Stock Exchange and the Johannesburg Stock Exchange and is incorporated and domiciled in the UK.

Cash Flow Statement
The cash flows of the Company are included in the consolidated cash flow statement of British American Tobacco p.l.c. which is included in this Annual Report. Consequently, the Company is exempt under the terms of FRS 1 (Revised) from publishing a cash flow statement.

Foreign currencies
Transactions arising in currencies other than sterling are translated at the rate of exchange ruling on the date of the transaction. Assets and liabilities expressed in currencies other than sterling are translated at rates of exchange ruling at the end of the financial year. All exchange differences are taken to the profit and loss account in the year.

Accounting for income
Income is included in the profit and loss account when all contractual or other applicable conditions for recognition have been met. Provisions are made for bad and doubtful debts, as appropriate.

Taxation
Taxation provided is that chargeable on the profits of the year, together with deferred taxation. Deferred taxation is provided in full on timing differences between the recognition of gains and losses in the financial statements and their recognition in tax computations. However, the Company does not discount deferred tax assets and liabilities.

Fixed asset investments
Fixed asset investments are stated at cost, together with subsequent capital contributions, less provisions for any impairment in value.

Dividends
Final dividend distributions to the Company's shareholders are recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders, while the interim dividend distributions are recognised in the period in which the dividends are declared and paid.

Similarly, dividend income is recognised at the same time as the paying company recognises the liability to pay a dividend.

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

Related parties
The Company has taken advantage of the exemption under paragraph 3(c) of FRS 8 from disclosing transactions with related parties that are wholly owned subsidiaries of British American Tobacco p.l.c. Group.

Financial instruments
The financial instrument disclosures of the Company are included in the Group financial statements which are included in this Annual Report. Consequently, the Company is exempt under paragraph 2D (b) of FRS 29 from publishing these financial instruments disclosures.

Financial guarantees are initially recorded at fair value, and subsequently carried at this fair value less accumulated amortisation.

Future changes to accounting policies
On 22 November 2012, the Financial Reporting Council issued FRS 100 *Application of Financial Reporting Requirements* and FRS 101 *Reduced Disclosure Framework*. These standards will be applicable to all companies and entities in the UK and Republic of Ireland, other than listed groups, effective from 1 January 2015. Early adoption is permissible.

FRS 100 sets out the overall financial reporting framework whereas FRS 101 applies to the individual financial statements of subsidiaries and ultimate parents, allowing them to apply the same accounting policies as in their listed group accounts, but with fewer disclosures.

The Company is evaluating the impact of these requirements.

2 Investments in Group companies

The Company's directly wholly owned subsidiaries are British American Tobacco (1998) Limited, B.A.T. International Finance p.l.c., B.A.T. Capital Corporation and BATMark Limited.

The Directors are of the opinion that the individual investments in the subsidiary undertakings have a value not less than the amount at which they are shown in the balance sheet.

	2012 £m	2011 £m
1 January	**4,305**	4,302
Additions	**28**	3
31 December	**4,333**	4,305

3 Debtors

	2012 £m	2011 £m
Amounts due from Group undertakings	**8,042**	7,894

Included within amounts due from Group undertakings is an amount of £7,750 million (2011: £6,348 million) which is unsecured, interest bearing and repayable on demand. The interest rate is based on LIBOR.

Amounts totalling £216 million (2011: £1,485 million) due from Group undertakings are unsecured, interest free and repayable on demand.

Included in debtors are amounts of £76 million (2011: £61 million) falling due after one year, all of which is unsecured and interest free.

4 Shareholders' funds

	Share capital £m	Share premium account £m	Capital redemption reserves £m	Other reserves £m	Profit and loss account £m	Total £m
1 January 2012	**506**	**64**	**101**	**90**	**6,669**	**7,430**
Increase in share capital – share options	**1**	**3**	**–**	**–**	**–**	**4**
Profit for the year	**–**	**–**	**–**	**–**	**4,727**	**4,727**
Dividends and other appropriations ordinary shares	**–**	**–**	**–**	**–**	**(2,538)**	**(2,538)**
Consideration paid for share buy-back programme	**–**	**–**	**–**	**–**	**(1,258)**	**(1,258)**
Consideration paid for purchase of own shares held in employee share ownership trusts	**–**	**–**	**–**	**–**	**(118)**	**(118)**
Consideration received on the exercise of options over own shares held in employee share ownership trusts	**–**	**–**	**–**	**–**	**1**	**1**
Other movements	**–**	**–**	**–**	**–**	**92**	**92**
31 December 2012	**507**	**67**	**101**	**90**	**7,575**	**8,340**

Dividends paid are recognised in the year in which they are approved by shareholders, and dividends received are recognised in the year in which they are received. The final dividend which has been declared for the year ended 31 December 2012 is shown in note 8 to the Group financial statements and will be recognised in the financial statements for the year ended 31 December 2013.

As permitted by Section 408 of the Companies Act 2006, the profit and loss of the Company has not been presented in these financial statements. The profit for the year ended 31 December 2012 was £4,727 million (2011: £6,167 million).

Details of Directors' remuneration, share options and retirement benefits are given in the remuneration report. Details of key management compensation are included in note 29 of the Group financial statements. The Company had three employees at 31 December 2012 (2011: three). The cost of these employees are borne by another Group company.

Shareholders' funds are stated after deducting the cost of treasury shares which include £2,536 million (2011: £1,278 million) for shares repurchased and not cancelled and £274 million (2011: £249 million) in respect of the cost of own shares held in employee share ownership trusts.

During 2012, 39 million shares were bought back at a cost of £1,250 million (2011: 28 million shares at a cost of £750 million), excluding transaction costs of £8 million (2011: £5 million). As at 31 December 2012 treasury shares include 10,520,098 of shares held in trust and 95,892,487 of shares repurchased and not cancelled as part of the Company's share buy-back programme.

Notes on the accounts (continued)

4 Shareholders' funds (continued)

Called up share capital	Ordinary shares of 25p each Number of shares	£m
Allotted and fully paid		
1 January 2012	**2,025,986,670**	**506.50**
Changes during the year		
– share option schemes	**280,953**	**0.07**
31 December 2012	**2,026,267,623**	**506.57**

Called up share capital	Ordinary shares of 25p each Number of shares	£m
Allotted and fully paid		
1 January 2011	2,025,756,358	506.44
Changes during the year		
– share option schemes	230,312	0.06
31 December 2011	2,025,986,670	506.50

Share premium

The increase of £3 million (2011: £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

	2012 £m	2011 £m
Amounts due to Group undertakings	**250**	991
Loans due to Group undertakings	**3,617**	3,617
Sundry creditors	**168**	161
	4,035	4,769

Amounts due to Group undertakings of £250 million (2011: £991 million) are unsecured, interest free and repayable on demand.

Loans due to Group undertakings of £3,617 million (2011: £3,617 million) are unsecured, bear interest at rates between 1.87% and 2.14% (2011: 1.42% and 2.23%) and are repayable in 2017.

Included in sundry creditors is an amount of £41 million (2011: £54 million) which is unsecured, interest free and due within one year and the remaining balance of £127 million (2011: £107 million) is unsecured, interest free and due after one year.

6 Audit fees

	2012	2011
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 £9.6 billion (2011: £9.3 billion) and total borrowing facilities of £17.4 billion (2011: £17.7 billion).

There are contingent liabilities in respect of litigation in various countries (note 30 to the Group financial statements). In addition, the Company has cross-guaranteed the liabilities of the British American Tobacco UK Pension Fund which had a deficit according to the last formal tri-annual actuarial valuation in March 2011 of £516 million and which had a deficit on an IAS 19 basis at 31 December 2012 of £341 million (2011: £400 million).

Shareholder and contact information

Listings and shareholder services

Premium listing
London Stock Exchange (Share Code: BATS; ISIN: GB0002875804)

United Kingdom Registrar
Computershare Investor Services PLC
The Pavilions, Bridgwater Road, Bristol BS99 6ZZ
tel: 0800 408 0094; +44 870 889 3159
web-based enquiries: www.investorcentre.co.uk/contactus

www.computershare.com/uk/investor/bri
Access the web-based enquiry service of Computershare Investor Services PLC for holders of shares on the UK share register; view details of your British American Tobacco shareholding and recent dividend payments and register for shareholder electronic communications to receive notification of British American Tobacco shareholder mailings by email.

www.computershare.com/dealing/uk
Go online or telephone 0870 703 0084 (UK) to buy or sell British American Tobacco shares traded on the London Stock Exchange. The internet share dealing service is only available to shareholders resident in countries in the European Economic Area.

Secondary listing
JSE (Share Code: BTI)

Shares are traded in electronic form only and transactions settled electronically through Strate.

South Africa Registrar
Computershare Investor Services (Pty) Ltd
PO Box 61051, Marshalltown 2107, South Africa
tel: 0861 100 925; +27 11 870 8222
email enquiries: web.queries@computershare.co.za

American Depositary Receipts
NYSE MKT (Symbol: BTI; CUSIP No. 110448107)

British American Tobacco sponsors an American Depositary Receipt (ADR) programme in the United States. Each ADR represents two of the Company's ordinary shares.

Enquiries regarding ADR holder accounts and payment of dividends should be directed to:

Citibank Shareholder Services
P.O. Box 43077, Providence, Rhode Island 02940-3077, USA
tel: 1-888 985-2055 (toll-free) or +1 781 575 4555
email enquiries: citibank@shareholders-online.com
website: www.citi.com/dr

Publications
Copies of current and past Annual Reports are available on request. Copies of the Group corporate descriptive booklet About Us are also available. Highlights from these publications can be produced in alternative formats such as Braille, audio tape and large print. Contact:

British American Tobacco Publications
Unit 80, London Industrial Park, Roding Road, London E6 6LS
tel: +44 20 7511 7797; facsimile: +44 20 7540 4326
email: bat@team365.co.uk

Holders of shares held on the South Africa register can contact Computershare Investor Services (Pty) Ltd using the contact details shown above.

Our website – www.bat.com
Access comprehensive information about British American Tobacco and download shareholder publications at the corporate website; visit the Investor Centre for valuation and charting tools and dividend and share price data and subscribe to the email and SMS alert services for key financial events in the British American Tobacco financial calendar; download the new British American Tobacco Investor Relations iPad app via the iTunes store to access all the latest financial information.

Dividend Reinvestment Plan
Available to the majority of shareholders on the UK register, this is a straightforward and economic way of utilising your dividends to build up your shareholding in British American Tobacco. Contact Computershare Investor Services PLC in the UK for details.

Individual Savings Accounts (ISAs)
A British American Tobacco sponsored ISA.

Contact:
The Share Centre
PO Box 2000, Aylesbury, Bucks HP21 8ZB
tel: 0800 800 008; +44 1296 414 141
email enquiries: service@share.co.uk
website: www.share.co.uk

(The tax advantages of ISAs depend on your individual circumstances and the benefits of ISAs could change in the future. You should note that investments, their value and the income they provide can go down as well as up and you might not get back what you originally invested.)

Capital gains tax
Fact sheet for British American Tobacco historical UK capital gains tax information; contact the British American Tobacco Company Secretarial Department, tel: +44 20 7845 1000 or access the Investor Centre at www.bat.com/investorcentre/cgt.

Shareholder and contact information (continued)

Final dividend 2012 – dates in 2013

Please see 'Other statutory and regulatory information' for further details.

28 February	Dividend announced (including amount of dividend per share in both sterling and rand, applicable exchange rate and conversion date – 26 February 2013; plus additional applicable information as required in respect of South African Dividend Tax)
28 February to 15 March	From the commencement of trading on 28 February to 15 March 2013 (inclusive), no removal requests in either direction between the UK main register and the South Africa branch register will be permitted
8 March	Last day to trade (JSE)
11 March to 15 March	No transfers between the UK main register and the South Africa branch register; no shares may be dematerialised or rematerialised
11 March	Ex-dividend date (JSE)
13 March	Ex-dividend date (LSE)
15 March	Record date (LSE and JSE)
8 May	Payment date (sterling and rand)

Financial calendar 2013

25 April	Interim Management Statement
25 April	Annual General Meeting The Banqueting House, Whitehall, London SW1A 2ER
31 July	Half-Yearly Report
23 October	Interim Management Statement

Analyses of shareholders

The high and low prices at which the Company's shares are recorded as having traded during the year on each of the LSE and the JSE are as follows:

	High	Low
LSE	£34.88	£28.975
JSE	R473.00	R356.35

At 31 December 2012 there was a total of 2,026,267,623 ordinary shares in issue held by 113,809 shareholders. These shareholdings are analysed as follows:

(a) by listing as at 31 December 2012:

Register	Total number of shares	Percentage of issued share capital	Number of holders
UK	1,755,459,022	86.64	50,128
South Africa	270,808,601	13.36	63,681

(b) by category of shareholder and size of shareholding as at 31 December 2012 (UK register) and 28 December 2012 (South Africa register), being the latest practicable dates on which equivalent information was available on both registers:

UK Register

Category of UK shareholder	Number of UK holders	Percentage of total UK holders	Number of UK ordinary shares	Percentage of UK ordinary share capital
Individuals	41,210	82.21	48,703,192	2.77
Financial institutions/ Pension funds	286	0.57	11,444,495	0.65
Nominee companies	8,314	16.59	1,589,149,127	90.53
Other corporate holders	317	0.63	10,269,721	0.59
Treasury Shares (UK)	1	<0.01	95,892,487	5.46

South Africa Register

Category of SA shareholder	Number of SA holders	Percentage of total SA holders	Number of SA ordinary shares	Percentage of SA ordinary share capital
Individuals	46,436	72.92	29,022,416	10.72
Financial institutions/ Pension funds	1,634	2.56	192,952,724	71.25
Nominee companies	12,970	20.37	35,027,097	12.93
Other corporate holders	2,641	4.15	13,806,364	5.10

Combined Registers

Category of shareholder	Number of holders	Percentage of total holders	Number of ordinary shares	Percentage of issued ordinary share capital
Individuals	87,646	77.01	77,725,608	3.83
Financial institutions/ Pension funds	1,920	1.69	204,397,219	10.09
Nominee companies	21,284	18.70	1,624,176,224	80.16
Other corporate holders	2,958	2.60	24,076,085	1.19
Treasury Shares (UK)	1	<0.01	95,892,487	4.73

UK Register

	Number of holders	Percentage of UK ordinary share capital
1 – 1,999	41,668	1.16
2,000 – 9,999	6,487	1.39
10,000 – 199,999	1,437	3.76
200,000 – 499,999	216	3.90
500,000 and over	319	84.33
Treasury shares (UK)	1	5.46

South Africa Register

	Number of holders	Percentage of SA ordinary share capital
1 – 1,999	56,824	7.31
2,000 – 9,999	5,005	7.37
10,000 – 199,999	1,687	23.93
200,000 – 499,999	95	10.63
500,000 and over	70	50.76

Combined Registers

	Number of holders	Percentage of issued ordinary share capital
1 – 1,999	98,492	1.99
2,000 – 9,999	11,492	2.19
10,000 – 199,999	3,124	6.45
200,000 – 499,999	311	4.80
500,000 and over	389	79.84
Treasury shares (UK)	1	4.73

Registered office
Globe House, 4 Temple Place, London WC2R 2PG
tel: +44 20 7845 1000, facsimile: +44 20 7240 0555

Incorporated in England and Wales No. 3407696

Representative Office in South Africa
34 Alexander Street, Stellenbosch 7600, South Africa
PO Box 631, Cape Town 8000, South Africa
tel: +27 21 883 3722

Secretary
Nicola Snook

General Counsel
Neil Withington

Investor relations
Enquiries should be directed to Mike Nightingale or Rachael Brierley
tel: +44 20 7845 1180

Press office
Enquiries should be directed to Will Hill or Jem Maidment
tel: +44 20 7845 2888
email: press_office@bat.com

Auditors
PricewaterhouseCoopers LLP
1 Embankment Place, London WC2N 6RH

Read the online Annual Report at
www.bat.com/ar2012